

CHAPTER

8

EFFECTS OF GLOBAL ECONOMIC CRISIS ON
SMALL AND MEDIUM-SIZED ENTERPRISES
IN SERBIA*

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Abstract

The aim of this paper is to show the effects of the global economic crisis on the small and medium-sized enterprise sector in Serbia. Contrary to expectations, in some aspects, the negative impact of the global economic crisis in South-East Europe, and consequently in Serbia, was much bigger than in many developed countries. Though vital and dynamic, the sector of small and medium-sized enterprises (SMEs) in Serbia suffered huge downfall, so that in this paper different ways in which crisis was manifested in this sector in Serbia would be analysed. This paper consists of the three main parts. In the introduction the importance of SMEs sector for Serbian economy is pointed out. In the second part, consequences of the crisis on Serbian economy would be analysed, and finally in the third part the impact of the global crisis on SMEs businesses would be analysed.

Key words global crisis, small and medium sized enterprises, small business, financial crisis, management, finance of SMEs

INTRODUCTION - THE IMPORTANCE OF SMALL AND MEDIUM-SIZED ENTERPRISE SECTOR IN SERBIAN ECONOMY

The end of the first decade of the 21st century would certainly be remembered for the global economic crisis which has not been found for many years ago. Created through credit crunch and collapse of mortgage market, first of all in the developed countries, it has spread itself as an infectious disease through financial systems of all countries world over, and transferred from the financial to the real sector of economy causing recession in many countries. Global crisis showed in practice how contemporary world is global and interconnected (F. Mishkin, 2007, p. 259).

In this paper we would try to analyse how global crisis affected SMEs sector in Serbia. In order to achieve this goal, we would try to answer some questions, first of all the following:

- What is the role and the importance of the SMEs sector for Serbian economy?

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- In which form the world economic crisis appeared in Serbia?
- To what extent the crisis affected the sector of SMEs and how it manifested?
- How is the state trying to help?

The importance of small and medium-sized enterprises (SMEs) for the Serbian economy has grown year in year out. What is more important is the raised level of awareness in the very country, as well as abroad. According to the most recent EU Serbia progress report (for 2009), a good institutional framework for SMEs had been put in place, and its performance has improved in recent years. Overall, preparations in the area of industry and SMEs are advanced and fulfil the relevant SAA requirements. Serbia continues to be fully committed to the process of the *European Charter for Small and Medium-sized Enterprises*. Internal coordination is working well and there is active participation by all relevant bodies in the process. In particular, there has been a substantial improvement in cooperation and coordination between the various actors – the Ministry of Economy and Regional Development, the Republican Agency for SME and Entrepreneurs, and lot of other stakeholders. The SME Council, as a main coordinating body in respect to SME policy, which comprises representatives of various ministries and entrepreneurs, meets regularly and is functioning well. Unfortunately, still not all ministries understand the great importance of the SEMs sector, so there is a series of unsolved problems which have been pointed out by entrepreneurs and small and medium-sized business owners. The current level and importance of the SME sector in Serbian economy we can summarize by some numbers:

- Number of commercial entities – with 99.8% - The total of 304,017 enterprises were operating in Serbia in 2008, out of which 303,449 or 99.8% from SMEs sector. According to data of the Agency for Business Registration of the end of September 2009, the total number of registered companies was 109,142 and 223,733 entrepreneurs;
- Total number of employees with 67.2% - or the absolute value of 940,159;
- Total turnover with 66.6%;
- GDP of the Republic of Serbia with around 59.2%;
- Export with 45.9% and import with 60.5%, and
- Achieved profit with 58.7%.

*Table 8.1. SMEs sector development indicators in Serbia
- 2007 and 2008 -*

	SMEs		Share SMEs	
	2007	2008	2007	2008
Number of enterprises	296.086	303.449	99,8	99,8
Number of employees	906.669	940.159	65,5	67,2
Turnover (mill. RSD)	4.106.838	4.662.624	67,6	66,6
GDP (mill. RSD)	719.659	837.990	58.3	59,1
Export (mill. RSD)	226.786	274.506	44,5	45,9
Import (mill. RSD)	652.587	751.817	61,7	60,5
Commodity balance (mill. RSD)	-425.802	-477.311	77,8	74,2
Investments (mill. RSD)	288.960	...	58,7	...

Source: Report on small and medium sized enterprises and entrepreneurship for the year 2008, page 16

The most important economic sectors dominated by SMEs in Serbia are the following:

- Trade, retail in particular – with 35.7% in 2008, which is by 1.8% less than a year before.
- Processing industry with 17% of the total number of SMEs in Serbia. Unlike trading, number of enterprises in this field grew by 0.2%.
- Real estate business with 12.8% (increase by 1.1% in comparison with 2007).
- Civil-engineering with 8.3%.

The fact that speaks in favour of the increasing importance of the SMEs sector for Serbian economy is that the state authorities make huge efforts to assist and promote this sector. Therefore, there are many instruments and institutions which facilitate the development of this sector, such as:

- *The Strategy for Development of Competitive and Innovative SMEs 2008-2013*, and its *Action Plan*, drawn up after wide consultations with representatives of the SME sector, was adopted in 2008 and is in the process of implementation. Based on relevant EU policy documents supporting entrepreneurship, Strategy is structured around 5 pillars, with the vision of development of entrepreneurial economy, based on knowledge and innovativeness, which creates a strong, competitive and export oriented SME sector and substantially contributes to an increase in living standard in the Republic of Serbia.
- *The Serbian Law on Innovation Activity* was adopted in 2005, and provides a basis for the establishment of a legal framework for support of innovation activities. It is currently being redrafted.
- *The Inter-Ministerial Council for SME Development* has overall responsibility for coordination and monitoring of SME support. The Ministry of Economy and Regional Development (MoERD) is the policy making body responsible for defining and implementing the overall economic development policy, including the SME development strategy, foreign direct investment strategy, employment policy etc. The Ministry mandate covers 6 other bodies dealing with sector specific policy implementation, namely: Privatization Agency, Agency for Business Registration, Export Insurance and Financing Agency, Republican Agency for the Development of Small and Medium-Sized Enterprises and Entrepreneurship (RADSMEE), Serbia Investment and Export Promotion Agency (SIEPA), Bankruptcy Supervision Agency and the Tourist Organization of Serbia.
- *The Republican Agency for the Development of Small and Medium-sized Enterprises and Entrepreneurship* (RADSMEE) was established with the basic aim to support (help, advise and protect) the development and interests of SME sector, contributing to evening out of structural imbalances in the economy, and promoting economic development. It currently has a primary role in implementing the activities and measures in the Strategy for Development of Competitive and Innovative SMEs 2008-2013. In accordance with the new Law on Regional Development, adopted in July 2009, *the National Agency for Regional Development* (NARD) will be established. NARD will take over all competencies of RADSMEE (which will be one part of NARD), and, consequently, relevant department for SMEs in NARD will be considered as one of the beneficiaries/project partners.
- *The Enterprise Europe Network* in Serbia was established on June 2009 throughout RADSMEE. This incorporates the innovation support provided through the Euro Info and Innovation Relay Centres, and will be integrated into the institutional infrastructure for business support.
- *The Serbian Investment and Export Promotion Agency* (SIEPA) has institutional responsibility for improving the international competitiveness of SMEs. SIEPA activities include provision of financial grants for SMEs for market research; participation in international fairs; product and packaging design; product testing and certification; implementation and certification of new standards; preparation of promotion materials; and international legal protection.
- *The National Programme for Business Incubators and Cluster Development in Serbia 2007-2010* provides policy support for cluster development in Serbia, and is an integral component of the institutional infrastructure for encouragement of innovation. The Programme supported 14 clusters in 2008. Since 2006, 18 business incubators have been established all across Serbia.

There are more authorities and institutions in Serbia which support growth and development of SMEs sector, but the scope and the nature of this paper do not allow us to give deeper analysis of them. Furthermore, we would try to explain how global economic crisis affected Serbian economy.

EFFECTS OF GLOBAL ECONOMIC CRISIS ON SERBIAN ECONOMY

Prior to explanation of the effects of the global economic crisis on Serbian economy, we would point out several basic characteristics in relation to economic growth in Serbia after political changes in 2000. From 2001 to 2009 Serbia had positive GDP growth rates, which fluctuated from 2.4% to 8.3%. During the whole period there was a trend of the increasing buying power of the citizens and such trend could have continued. On the other hand, Serbia experienced some problems, first of all a relatively high inflation rate, unemployment and huge deficit of payment balance. Inflation rate in Serbia is much higher if compared with the EU average and the countries in the region. During the last decade, only in 3-4 years it was below 10%. The unemployment rate is also much higher than the EU average, and it ranged from 15 to 20%. Finally, during the whole period Serbia experienced the problem of deficit in current account balance which as the per cent of the GDP varies from one year to another and ranged from 2.5% GDP in 2001 to 17.3% in 2008 (*World Economic Outlook Database, International Monetary Fund, April 2009.*).

The first negative effects of the global crisis in Serbia were identified in the middle of the year 2008 and manifested themselves in several forms. We would try to identify a couple of the most important ones:

- All economic activities slowed down significantly. – During the course of the year 2009 GDP stopped growing. It even fell by 3.5%. Economic growth set back was evident at the end of the year 2008 when such growth was only 2.8% compared to 4.9% in the third and 6% in the second and 8.5% in the first quarter of the year 2008. (*Report on small and medium-sized enterprises and entrepreneurship for the year 2008, p.73*)
- Negative effects in business of the non-financial sector of Serbian economy – after two positive years, Serbian economy suffered net loss in 2008 which was by 12.3% bigger than the presented income. The loss was most prominent in the big enterprise sector, where it surpassed the amount of profit by 89.4%. Contrary to the big enterprise sector, the SMEs sector turned out to be much more flexible. Although the loss in this sector increased significantly compared to the year 2007 (by 69.5%), profit was by 18.3% (RSD 34.1 bill) bigger than the loss, which is one more evidence that this sector represents the most profitable part of the Serbian economy. During the year 2009 the situation worsened significantly in all parameters mentioned above.
- In the period October – December 2008, citizens deposits were withdrawn to a great deal – it has been estimated that around EUR 1 bill was withdrawn. Unfortunately, the Government of the Republic of Serbia was late to respond to the panic of the savings accounts owners and yet in the late December adopted the Appendix to the *Law on insuring deposits* raising minimal amount required for the insurance of deposits from 3 000 to 50 000 EUR.
- Due to psychological factor, which was very significant in the whole region, and as a consequence of insufficient degree of trust in financial institutions and instruments, significant local and regional companies withdrew from the Serbian market. That further deepened crisis which was initially caused from abroad. As a consequence, share price index fell greatly on the Belgrade Stock Exchange. While indexes of the world leading stock exchanges fell approximately by 27-28% in the period 1 Jan. 2007 – 20 Aug. 2009, and the regional West Balkans countries by approx. 45%, in Serbia, the Belex index 15 fell by even 60.66% (*D. Erić, A. Zdravković, D. Nikolić, 2009, p. 25*). Judging by this parameter, it can be concluded that the crisis affected the region of South-East Europe and Serbia more severely than developed countries.
- Simultaneously with the withdrawal of both citizens' deposits and the regional big companies from the Belgrade Stock Exchange, and slower inflow of foreign direct investments, the structure of bank assets worsened, which greatly influenced restrictions in loan granting to all economic sectors, especially the SMEs sector.
- Simultaneously with the fall in economic activities, the buying power of citizens reduced and debts could hardly be recovered.

- Problems have grown in public finances in the Republic budget. This problem was particularly evident in 2009 when Serbia had negotiations with the International Monetary Fund on being granted special loans with the increase of the level of budgetary deficit to 4-4.5% of GDP.
- Finally, as one more consequence related to the effects of the crisis was the increase of the unemployment rate, which was exceptionally high in Serbia before the crisis (more than 15%).

The Government of the Republic of Serbia tried to respond to the negative effects in different ways. Yet, during November 2008, a set of measures was adopted, and those measures were directed towards banks and financial system. The aim was to stabilise first of all the banking system, and prevent ever increasing withdrawal of the deposits, particularly in foreign currency, which was one of the most evident problems. Concrete measures entailed the following: (*D. Erić, A. Zdravković, D. Nikolić, 2009, p. 28*):

- State guarantees for insuring savings deposits – where the limit was raised from
- 3 000 to 50 000 Euro. This measure turned out to be effective, since it calmed down the savings accounts owners and prevented further withdrawal of deposits.
- The tax on capital gain has been abolished in order to prevent further fall in share prices on the Belgrade Stock Exchange. The measures turned out to be very problematic, since there were no capital gains (due to decreasing – “bear” market).
- The 0.3% tax on the negotiation of absolute rights in share trading, which is not a measure to fight global crisis, but the correction of a deviation in financial operations in Serbia, originating from the 1990s.
- Since illiquidity was one of the biggest problems Serbia has faced with, several measures were taken so as to solve this problem, such as: extension of the deadline for the repayment of previously taken loans, facilities enabling loan taking abroad through abolition of the mandatory reserve on newly taken loans, measures towards removal of negative exchange rate differences, etc. These measures were short-term ones, since during the time, illiquidity have grown and particularly affected the SMEs sector, which would be discussed in part three of this paper.

Another group of measures taken by the Serbian Government was directed towards real sector, i.e. towards prevention of growth of the unemployment rate and fall of the economic activity. Within this group of measures the following can be pointed out:

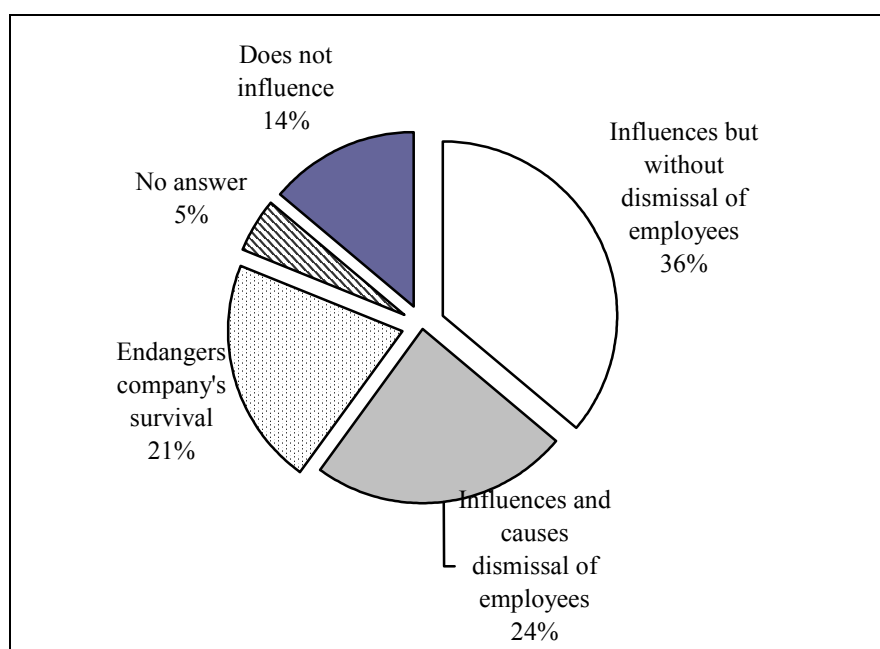
- State savings measures, which represented recommendations given by the Internationally Monetary Fund (IMF) and which should have meant the reduction of the salaries in public enterprises, agencies and civil service – which was done at the beginning of the year 2009.
- Restrictions in employment with the state authorities, reductions in the number of employees through downsizing and rationalisation – which was of a more declarative character.
- Favourable loans – for liquidity, for investments, for standing operating capital, developmental, investment, etc. It has to be admitted that it was a very effective measure, but a huge problem has arisen – very limited real sources of financing and a small number of economic entities which were entailed.
- Regulation on conditions for subsidizing interest rates on loans for keeping up liquidity and financing standing operating capital in 2009
- Regulation on conditions of using co-financed loans for investments with the guarantee issued by the Guarantee Fund in 2009.
- Regulation on conditions and criteria for subsidizing interest rate for consumer loans for provision of certain consumer goods in 2009, under favourable conditions, so as to prevent fall in demand and further spreading of crisis in the real sector.
- Measures providing incentives to employment – favourable tax facilities for all employers who employed trainees.

Time to come will show how effective these measures are. For now, it can be said that the crisis in Serbia during the course of the year 2009 was fierce and caused deep consequences, especially in the sector of small and medium- sized businesses.

HOW THE CRISIS AFFECTED THE SMES SECTOR IN SERBIA?

A mid 2009, the Republic Agency for the Development of Small and Medium-sized Enterprises and Entrepreneurs (RADSMEE) conducted very detailed survey on conditions, problems and prospects of small and medium-sized business in Serbia. The research, which was made in cooperation with the Republic Institute for Statistics, entailed 3000 small and medium sized enterprises and was organised in accordance with the highest standards of scientific and research practice. The special section of the research was dedicated to the analysis of the influence of the global economic crisis on business operations of the SMEs sector. At that moment almost 80% of the surveyed ones stated that they felt consequences of the crisis, and only 14% stated that the crisis did not influence their business. The results of the survey can be seen in Figure 8.1.

Figure 8.1. Influence of economic crisis

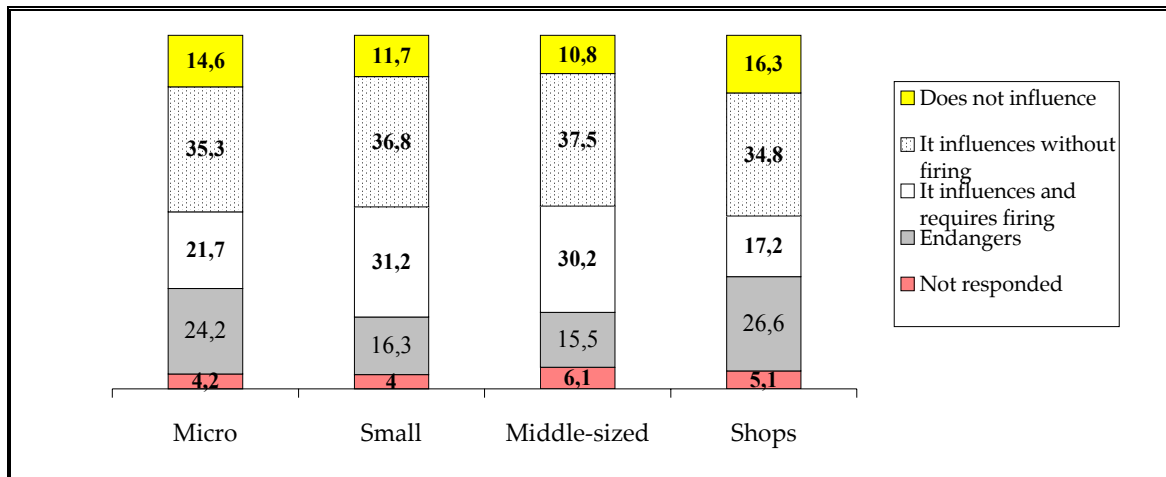


Source: RADSMEE, p. 27

Almost every fifth surveyed entity (about 21%) stated that economic crisis endangers the survival of the company. Apart from that, the survey showed that the survival was endangered to small companies, especially shops where even 27% of the surveyed claimed that they face the problem of further existence. Research showed one fact – the bigger the enterprise, the least endangered its existence is. The results showed that only 16% of the medium-sized enterprises claimed that they are threatened to face bankruptcy.

About one quarter of the surveyed (24%) is forced to take decisions on downsizing, while 36% of the surveyed claimed that even though they are affected with the crisis, they do not intend to dismiss the workforce. The results in this segment depend on the size of the enterprise as well, but in a reverse proportion in relation to the size. However, in around 30% of the medium-sized enterprises the owners have planned to dismiss employees, which is a lot more in comparison with shops (17%) or micro and small-sized enterprises, where it totalled 16%, which can be seen in the Figure 8.2.

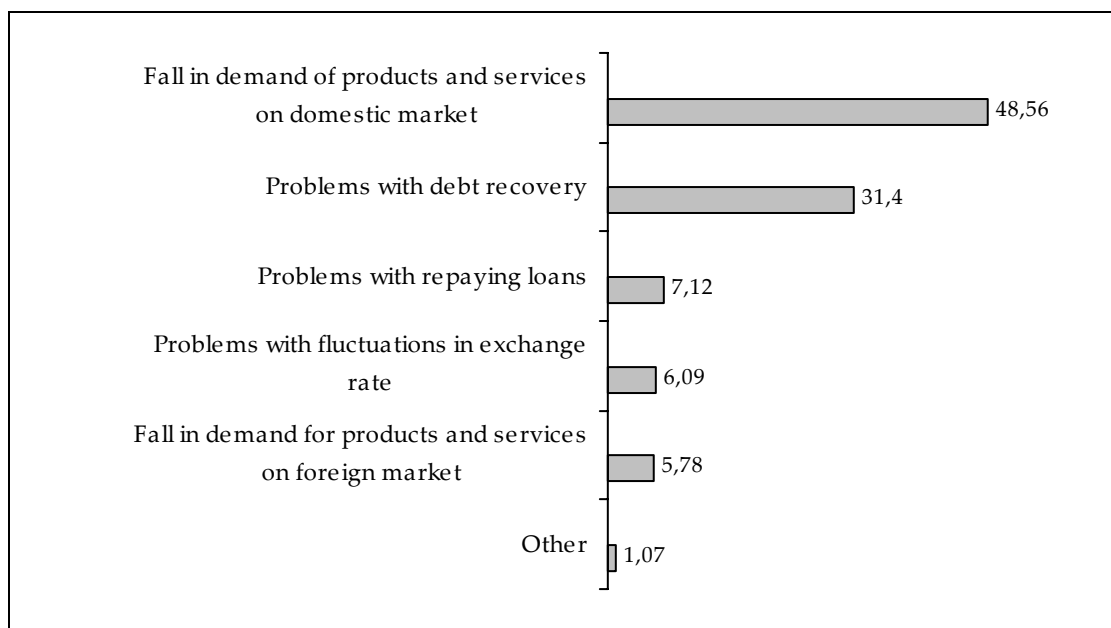
Chart 2. Influence of economic crisis on survival of companies and redundancies



Source: RADSMEE, 2009, p. 28

As it can be seen, the biggest number of the SMEs in Serbia was affected by the crisis. The question that follows is how the crisis manifested itself or what the consequences were. The results are very heterogeneous. One of the biggest consequences mutual to all surveyed companies referred to the decrease in demand, first of all on the domestic market. Almost 50% (more precisely 48.56% of the surveyed) stated that that represented the biggest problem. Another burning issue is recovery of debts, which was a problem for the SMEs sector in Serbia even before the crisis. Around 31% of the surveyed claimed that it was one of the biggest consequences of the crisis. With worsening of the crisis, the conditions for debt recovery became even more difficult and prolonged, and extended to even more than 120 days. In that way the problem of illiquidity transferred to the whole economy of Serbia, thus contributing to further deepening of the crisis which was externally caused by the events on international level. Among other consequences, the following have been mentioned: loan servicing, negative fluctuations of the exchange rate, decrease in the demand on the international market, etc. How Serbian small and medium-sized business owners perceived negative effects of the crisis can be seen in Figure 8.3.

Figure 8.3. Manifestations of the negative effects of the global economic crisis



Source: RADSMEE, p. 29

We are certain to claim that global economic crisis struck deeply Serbian economy. The Republic of Serbia encountered huge problems in balancing budget. Huge budget deficit (which has been estimated to achieve 4.5% by the end of 2009) has been substituted by loans on behalf of the International Monetary Fund and The Russian Federation. Negative consequences affected small and medium-sized enterprises. Almost 80% of the SMEs suffered from the negative effects of the economic crisis. Apart from negative effects of the world economic crisis in 2008 the number of enterprises increased in the SMEs sector for 7,363 economic subjects (or by 2.5%) in relation to 2007. As the most important factors that influenced the increase in the number of enterprises in the SMEs sector the following can be stated: new legal registration procedures (establishment of the Agency for Business Registration significantly shortens and simplifies new enterprise founding procedure), bankruptcy and executive procedures.

Company foundation rate has been falling in Serbia during the last few years (it fell from 22% in 2006 to 18% in 2008) contrary to the termination rate which has been increasing (it increased from 10.6% to 13.2% in the observed period). In 2008, 11,386 economic subjects were founded in Serbia, which is by 16.3% fewer than in the previous year. (*Report on small and medium-sized enterprises for the year 2008, p.35*). On the one hand, the number of new enterprises has decreased, and on the other, the number of closed commercial entities increased. In 2008, 5,682 enterprises were erased (which is more by around 1,500 or 35% in comparison with 2007) and even 34,572 shops (more by almost 3,000). For the first time after so many years, two new enterprises were founded instead of one being closed. This ratio was many times higher in previous years. Please see the Table 8.2. presenting data on number of newly founded and closed small and medium-sized enterprises and entrepreneurs (small shops).

Table 8.2. Number of newly founded and closed small and medium sized enterprises

	Number of companies		Number of shops		Net effect	
	Founded	Closed	Founded	Closed	Companies	Shops
2006	14.423	1.449	45.693	27.010	10,0	1,7
2007	13.602	4.184	47.951	31.619	3,3	1,5
2008	11.386	5.682	43.375	34.572	2,0	1,3

Source: *Report on small and medium enterprises and entrepreneurship for the year 2008, page 36*

Having understood negative effects of the global economic crisis on the SMEs sector, the Serbian Government tried to help SMEs sector in different ways, through institutional and financial support. By the end of 2008, the Government adopted several key documents which would contribute to further development of the SMEs, among which the following should be pointed out:

- Operational plan for implementation of the Strategy for development of competitive and innovative small and medium-sized enterprises for the period 2008-2013.
- Strategy of regulatory reforms in the Republic of Serbia for the period 2008-2011, which envisages the increase of competitiveness of the SMEs and ‘reduction of regulatory burdens for SMEs’ (*Report on small and medium-sized enterprises and entrepreneurship for the year 2008, summary*). It has been estimated that by the year 2011 administrative costs of SMEs business will have reduced by 25%.
- Memorandum of understanding for participation in the EIP/CIP programme (signed by the end of the year 2008) which offers legal framework for ‘establishment of cooperation in strengthening of competitiveness and innovativeness of the enterprise, especially small and medium-sized enterprises).

As a support to the SMEs sector, the Serbian Government provided finances in the amount of RSD 19.5 bill (around 210 mil Euro, from which 11 bill or 125 mil from the budget of the Republic of Serbia and RSD 8.3 bill from the Fund for the development of the Republic of Serbia) in 2008, so as to help development and advance of the SMEs sector. Finances were directed towards the following:

- Long-term loans under extremely favourable conditions for business start up (start-up loans – 2,158 loans in the amount of RSD 3.3 bill. The number of approved applications in 2008 in comparison to 2007 has increased by 51.2% (*Report on small and medium-sized enterprises and entrepreneurship for the year 2008, p 70*);
- Credits support for entities, as well as small and medium-sized enterprises in the field of tourism;
- Support to the development of small and medium-sized enterprises and entrepreneurship in the least developed municipalities in the Republic of Serbia;
- Reducing the number of the unemployed (RSD 2.5 bill has been paid from the budget of the Republic of Serbia, providing employment for 22 277 people, (*Report on small and medium-sized enterprises and entrepreneurship for the year 2008, p. 69*);
- Development of cluster (RSD 56.8 mil from which 48.5 mil has been spent);
- Establishment of business incubators (10 incubators have been active, 5 have been registered, while 3 incubators are being registered now);
- Encouraging exporters promotion;
- Loans granted to the SMEs sector exports;
- Insuring exports and issuing guarantees for SMEs loan granting.

Apart from great efforts made to facilitate the business activities and provide help in financing, one of the persisting problems in Serbia is financing of the SMEs sector. Besides mechanisms of state support, bank loans dominate as the second most common source of external character (with about 40% related to 17% from the state source, *RADSMEE, p. 40*). In Serbia, due to relatively undeveloped financial system bank margins are still very high, and bank loans are very expensive source, because the annual interest rate can amount more than 12% on loans denominated in Euro and over 20% on loans in the national currency – dinar. High interest rate on debts makes high costs of capital, which narrows possibilities of small business owners to find projects with positive net current value or higher internal rate of return. That, however, has negative influence on further development of this sector. Negative consequences of the difficult conditions of financing do not influence SMEs sector only, but the whole Serbian economy.

CONCLUSION

In the introduction to this paper we emphasised how participation of the SMEs sector in Serbia has grown from one year to another according to all parameters – the number of economic entities, participation of GDP, total profit, employment, etc. On the other hand, we had an opportunity to see how global crisis left a very deep trace on the Serbian economy and how negative effects in some aspects surpassed those that struck developed countries. Under such conditions, the whole range of negative manifestations of the crisis transferred to the SMEs sector, first of all in terms of fall in the demand, difficult debt recovery and worsening of conditions of financing, which resulted in setting back the whole economic growth of the country.

If it is supposed that the development of the SMEs sector represents the main axes of the future development of the Serbian economy, than it is necessary to put a lot of effort so as to help the SMEs sector. Each crisis brings about great dangers, as well as certain opportunities. The dangers have been discussed a lot in this paper. They are evident in the fall in demand, high illiquidity and great difficulties in financing the SMEs sector. Yet, opportunities can be found in the efforts of the very entrepreneurs and SMEs owners to make considerable improvements, innovations, reduce irrationalities and raise efficiency and effectiveness of their business operations. On the other hand, state authorities, agencies and institutions can facilitate SMEs business operations, and particularly their financing. The SMEs sector shows considerable vitality and that is something which guarantees success after the completion of the global crisis.

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