

*Preliminary communication*

## **DEVELOPMENT OF SMALL AND MEDIUM-SIZED ENTERPRISES IN THE REPUBLIC OF SERBIA AND THE REPUBLIC OF CROATIA**

Mr. Zdenka Dudić, Faculty of technical science  
Dositej Obradović Square 6, 21000 Novi Sad, Republic of Serbia  
E-mail: zdenkadudic@yahoo.com

Msc. Mirjana Cvijić, Faculty of technical science  
Dositej Obradović Square 6, 21000 Novi Sad, Republic of Serbia  
E-mail: cvijic.mirjana@gmail.com

### **ABSTRACT**

*Micro, small and medium-sized enterprises (SMEs) are an important generator of new jobs and additional value of every national economy. The European Union constantly points to the key role that SMEs play in ensuring competitiveness in the market, and uses various policies to create a more favorable business environment, as set out by the Lisbon strategy. Creating adequate conditions to encourage innovation and other factors that may improve the business of SMEs is very important in a dynamic market, but also because of increasingly sophisticated demands coming from clients. Various world studies show the following problems: inadequate level of activity in launching new business ventures, a small percentage of newly established enterprises, administrative barriers to the implementation of entrepreneurial activities, underdevelopment of financial markets and lack of entrepreneurship education which provides knowledge and skills in business. The aim of this paper is to review the current situation of small and medium-sized enterprises in the Republic of Serbia and in the Republic of Croatia through several aspects: dynamism, innovation, importance of the sector for the economy and regional development, access to finance, access to educational programs and professional services, as well as the possibilities of financing development through the European structural and investment (ESI) funds.*

**Keywords:** *small and medium-sized enterprises; innovation; innovative activities; competitiveness; entrepreneurship*

## 1. INTRODUCTION

Since the period when the Republic of Serbia and the Republic of Croatia were one country until today, the situation has changed dramatically in terms of enterprises and entrepreneurship in the region. The Republic of Croatia is now a respected member of the European Union, while the Republic of Serbia has yet to become a member state. Since the late nineties to the present day, the process of restructuring large SOEs and changes in the ownership structure have been more effective in the Republic of Croatia. There are more Croatian brands in the European market than Serbian ones, so the enterprises in the Republic of Croatia have expand their operations beyond their country borders.

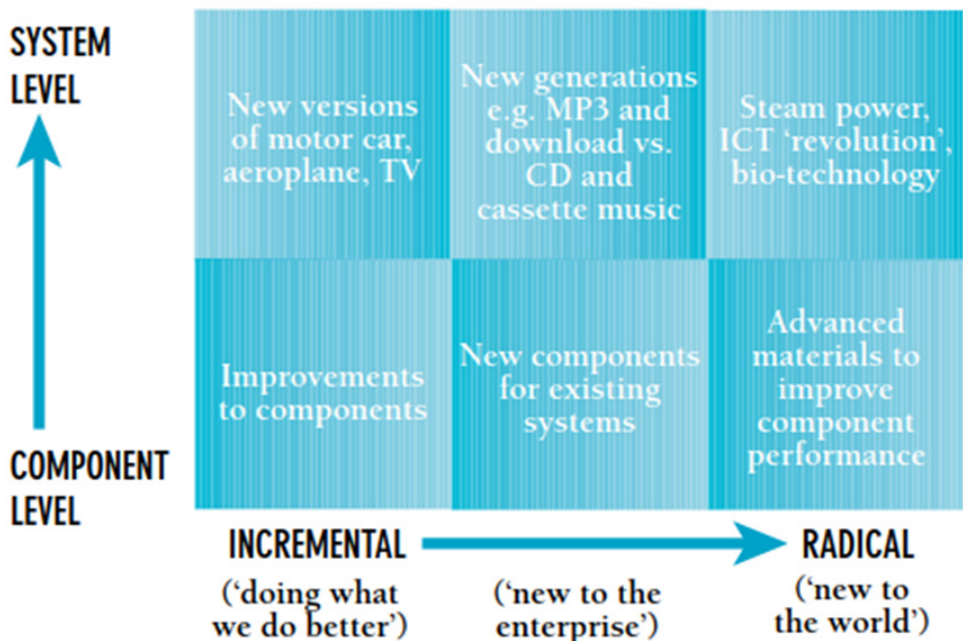
Micro, small and medium-sized enterprises are a significant generator of new jobs and economic value added. By giving importance to SMEs, it is possible to achieve the competitive advantage, development and survival in the market, and therefore have a positive impact on the economic development of a country. The promotion of entrepreneurship and encouragement of innovative activities are key factors in achieving profit. There is a big difference between the companies; some companies cannot overcome the obstacles and problems, while other companies turn these obstacles into new opportunities; they change their business, innovate and generate higher profits.

The word *entrepreneur* was first used in 1755 by Richard Cantillon in his work "Essai sur la Commerce". The term comes from the French verb *entreprendre* which means "to undertake", while *entrepreneur* (an English word) means an industrialist, an employer or a businessman. The English word *enterpreneurship* is *preduzetništvo* in Serbian or *poduzetništvo* in Croatian. There is no universally accepted definition of entrepreneurship. According to some authors, entrepreneurship primarily means innovation, whereas other authors see it as risk-taking or starting, owning and managing a private company. The primary aim of entrepreneurship is to create new value, to raise funds for realization of an entrepreneur's business ideas. Various authors describe entrepreneurs differently in their works. For Adam Smith, for example, an entrepreneur is a person who provides capital. He classifies business people depending on how they gain their capital; the first group of businessmen work diligently and save money, the second group speculate, while the third group deal with business innovations. In his work *Capital*, Karl Marx sees entrepreneurs as the owners of capital and the entrepreneurial profit is surplus value taken from workers and this is the main cause of all the crises that arise. Joseph Schumpeter defines an entrepreneur as a person who continuously innovates, improves, creates new products, introduces new modes of production, conquers new markets... William Baumol states in his paper that the entrepreneur is important for an increase in productivity, which can be achieved not only by innovation but also through aggressive imitation. Like Adam Smith, author Friedrich Hayek argues that the market influences the problems which arise in economic development and their elimination. The author who advocates the theory that the entrepreneur is an innovator is the famous Peter Drucker, who extends Schumpeter's theory and gives

great importance to innovations. He argues that one should always be the first and the best, and do things no one expects, because their sources of innovation are: unexpectedness, incompatibility, process needs, industrial and market structure changes, demographic trends, changes in moods and new knowledge. Michael Potter agrees and advocates the theory that innovations foster competitiveness of enterprises. He believes that the most successful countries are the ones in which the process of interaction of all factors of national competitive advantages is the most dynamic. Innovation is not only about generating new ideas, but the process of converting these ideas into practical use.

Authors Tidd, Bessant and Pavitt (2005) came to the conclusion that continuous innovation is common to all successful companies. New products maintain or even increase market share and profit of the enterprises. Depending on the degree of new knowledge there are incremental and radical innovations on the market (Figure 1). Radical innovations are revolutionary and essential innovations, and they imply a completely new product, service or business processes that did not exist on the market until now. Incremental innovations represent small improvements in existing products, services or business processes, but some authors claim that incremental innovations include continuous improvement of existing processes (Pullen, 2009).

**Figure 1.: Dimensions of innovation**



Source: Adapted from: Tidd, Bessant, Pavitt: Managing Innovation, 2005, page 12

The transition period is characterized by downsizing, layoffs, the closure of certain jobs and of large companies, with the aim of reducing costs. Consequently, a lot of people who lose their jobs start their own businesses and establish small companies, which can be successful, because these people are qualified. As a result, unemployment can be reduced. Therefore, good ideas and innovations are gaining in importance because it is a necessity, not just a trend, to be different and do something new and place it on the market. Incremental innovations are more common in both the Republic of Serbia and the Republic of Croatia as radical innovations are few. There is great competition in the world market and even though companies have good innovations, it is difficult to commercialize them due to the lack of external funding (Beck, 2007), or bad marketing (Hannan, Freeman, 1983, Stinchcomb, 1965). Small and medium-sized enterprises have very large social and economic importance (Abor, Quartey, 2010). For many years it was believed that the size of a company is what matters for the growth and performance of the company (Audretsch, Thurik, 2001; Bain, 1968; Bracker, Keats, Pearson, 1988; Chen, Hambrick, 1995; Coad, 2007; Ketchen, Ireland, Snow, 2007; Nooteboom, 1993, 1994; Verdú-Jover, Ilorens-Montes Garcia-Morales, 2006). Large enterprises have their own research centers, greater monopoly on the market, lower costs, higher revenue, but also more complicated bureaucracy and slower processing. Consequently, the SMEs can have a more flexible organizational structure, faster decision-making, motivation, direct contact with clients, flexible technology and can respond more quickly to customer requirements. A lot of worldwide authors have explored the influence of SMEs on the economy in their works (Davidsson, Kirchhoff, Hatemi-J, Gustavsson 2002; Fotopoulos, Giotopoulos, 2010; Gilbert, McDougall, Audretsch, 2006; Macpherson, Holt, 2007; Payne et al., 2009; Stam, 2010).

## **2. BUSINESSES IN THE REPUBLIC OF SERBIA AND THE REPUBLIC OF CROATIA**

When we look at the companies in the European Union and also in the countries wishing to become its new members, the situation is similar. When it comes to the classification of enterprises by size, the criteria that apply are the same in the Republic of Croatia and the Republic of Serbia, because they were created according to the recommendations of the European Commission. Thus, Table 1 shows the classification by number of employees and the type of business entity.

**Table 1: Classification of SMEs**

Criteria	Number of employees RS/RC	Annual revenue and value in EUR in EU*
<i>Micro</i>	0-9	up to 2 million to EUR
<i>Small</i>	10-49	up to 10 million to EUR
<i>Medium-sized</i>	49-249	up to 50 million to EUR
<i>Large</i>	More than 250	

Source: [http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition/index\\_en.htm](http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition/index_en.htm) (03.08.2016)

According to data from the European Commission for 2014, in the Member States of the European Union (EU28) there were 22.3 million active small and medium-sized enterprises, which represents 99.8% of all enterprises in the European Union. Small and medium-sized enterprises (SMEs) made 3,700 billion euros of value added, which represents 58% of total value added, and employs approximately 90 million people which is 67% of total employment. Compared to 2013, in 2014 value added increased by 3.3% and employment by 1.2%. These data may lead to the conclusion that the conditions in the macroeconomic and business environment for SMEs improved, that the end of the global economic crisis was near and everything was going forward. But the business of small and medium enterprises in 2014 cannot be generalized for every country because it differs significantly between the Member States. Value added of SMEs in the Czech Republic, Cyprus, Greece, Italy, Sweden declined, whereas it increased in the Netherlands, Ireland, Germany, Slovenia, Poland, Malta, Romania and the UK, even above the EU average of 3.3%. In the European Union 93% of all European SMEs are micro enterprises, 6% are small enterprises, while medium-sized enterprises account for only 1% of the total number of small and medium-sized enterprises. The sectors in which SMEs create most value added and employ most people are the wholesale and retail trade, then manufacturing, construction, business services, and provision of accommodation and food. According to data provided on SORS and [www.dzs.hr](http://www.dzs.hr), in 2014, the Republic of Serbia had the population of 7,131,787 and the Republic of Croatia 4,238,000. When we look at the table we can conclude that there is an insufficient number of employees, or high unemployment rate in the Republic of Serbia.

**Table 2: The number of companies, employees and value added in the territory of the Republic of Serbia and Republic of Croatia**

Year 2014.	Number of enterprises		Number of employees		value added	
	Republic of Serbia	Republic of Croatia	Republic of Serbia	Republic of Croatia	Republic of Serbia	Republic of Croatia
	Number	Number	Number	Number	The number in the billions RSD	The number in the billions KN
<b>Micro</b>	81327	102895	147641	422238	179422	215807
<b>Small</b>	9198		185206		279323	
<b>Medium-sized</b>	2131	1221	220944	145246	334737	112320
<b>SME</b>	92656	104116	553791	567484	793481	328127
<b>Large</b>	494	354	413408	262632	808058	290663
<b>Total</b>	93150	104470	967199	830116	1601539	618790

*Note: Data for the Republic of Serbia came from the site RZS for 2014 (1.8.2016), while the data presented for the Republic of Croatia were taken from Economic trends - 06/2014, "Croatian Chamber of Economy, 2014, p. 49. Analysis of financial results of the entrepreneurs in Croatia in 2014, " FINA, 2015, p. 21 and 22, which are micro-enterprises and small enterprises merged and shown as a number of small businesses (Gospodarska kretanja - 06/2014", Hrvatska gospodarska komora, 2014., p. 49.; Analiza financijskih rezultata poduzetnika RH u 2014. godini", FINA, 2015., p. 21, 22)*

Source: Author

Table 2 shows that in 2014 there were 93,150 registered companies in Serbia, 81,327 of which were micro-enterprises (which represents 87.3%), 9,198 small businesses (9.9%), 2,131 medium-sized (2.3%) and 494 large companies (0.5% of the total number of companies operating in the territory of the Republic of Serbia). If we look at the situation by sectors, in the Republic of Serbia most companies are involved with motor vehicles trade or repair (35%), 17.9% is in the processing industry, 11.2 % of companies are engaged in professional, scientific and innovation activities, 8% construction and 5.6% transport and warehousing. The gross value added in RS for 2014 amounts to 11.2% for micro, 17.4% small, 20.9% medium-sized and 50.5% large enterprises. As for the data for the Republic of Croatia (RC) when looking at the period of 2010, the data show that there were 99.5% SMEs and 0.5% of large companies operating in that territory, which was also the case in RS in 2014. But in the following years the number of large enterprises in the Republic of Croatia decreased and in 2014 there were 0.3% of large enterprises and 99.7% of SMEs. The contribution of small and medium-sized enterprises in 2014 in the Republic of

Croatia was 53% in total revenues, which is 0.9% more than in 2013. In 2014 the contribution of small enterprises in total exports of RC grew 2.9% (see table 3).

**Table 3: Data on exports by size of an enterprise - R. Serbia and R. Croatia**

Exports (2014)	Republic of Serbia	Republic of Croatia
	<i>The number of companies is represented in percentages</i>	
<i>Small</i>	22,7	25,2
<i>Medium-sized</i>	20,6	23,3
<i>SME</i>	43,2	48,5
<i>Large</i>	56,8	51,5
<i>Total</i>	100	100

Source: The author with the data RZS and Hrvatski izvoznici, 2015

As Table 3 shows, there is a higher percentage of small businesses in the Republic of Croatia which participate in the export of their products to other markets than it is the case with small companies from RS. The position of SMEs in the market should be strengthened because the Republic of Croatia is much better positioned in terms of exports compared to RS. Therefore, a good innovation strategy of SMEs should include the adoption of strategic decisions concerning the development of new products, services, processes which adjust the abilities of companies and opportunities provided by the environment, in order to fulfill the realization of long-term goals set by a company (Davila and al., 2006). The European Union sees innovation as the most important factor that enables competitive position of companies in the market and thus creates new jobs and achieves economic growth. In 2010 EU launched the Innovation Union, an initiative consisting of more than 25 action points aimed at improving conditions and access to finance research and innovation in Europe. Innovation Union is the focal point of Europe 2020 strategy in order to ensure that innovative ideas are turned into products and services that will bring economy growth and jobs. In 2014 a project called Horizon 2020 was launched, which is the largest EU Framework Programme for Research and Innovation. In order to monitor innovation in the European Union, Eurostat and the statistical offices of the Member States and those who wish to become Member States collect data on innovation. In this way the innovative activities of enterprises can be observed and analyzed. The definition of innovation was given by the OECD (2005): product / service innovation, process innovation, innovation in organization and innovation in marketing.

Global Entrepreneurship Monitor (GEM) is the world's foremost study of entrepreneurship. GEM was established in 1999 by the ten most developed countries. Since then, the number of participating countries increased to 60 in 2015, which covered approximately 4/5 of the world's gross domestic product. The Republic of Croatia was involved in the research in 2002, while Republic of Serbia is still not

included. Global Entrepreneurship Monitor (GEM) study gives the opportunity to each country to monitor the entrepreneurial capacity in their communities, but also to compare itself to those who do better. According to the results of the GEM research in the Republic of Croatia, in 2014, when compared to 2013, there is a slight increase in the number of small and medium-sized enterprises whose products were new to everybody by 0.1%, a decline in the number of companies whose products were new to some by 2, 8%, and an increase in the number of companies whose products were not new to anyone by 2, 6% (source: GEM Croatia 2012 - 2015, CEPOR - Centre for small and medium-sized enterprises and entrepreneurship). However, international research on the Global Innovation Index (data available on the website: <https://www.globalinnovationindex.org/gii-2015-report#>, accessed on 08/10/2016) which is conducted every year shows information about the level of innovation of 141 countries in the world, and in 2015 this research ranked Croatia 40th, an improvement of two places compared to 2014, while the Republic of Serbia was ranked 67th (see table 4).

**Table 4: The values of the Global Innovation Index 2014 and 2015**

Country	Rank 2015	Rank 2014	Changes in the list
Switzerland	1	1	<i>There was no change</i>
Finland	6	4	<i>Falling 2 places in the rankings</i>
the Netherlands	4	5	<i>Rise for one place</i>
Germany	12	13	<i>Rise for one place</i>
Slovenia	28	28	<i>There was no change</i>
Hungary	35	35	<i>There was no change</i>
Slovakia	36	37	<i>Rise for one place</i>
<b>the Republic of Croatia</b>	<b>40</b>	<b>42</b>	<b><i>Rise for 2 places</i></b>
Montenegro	41	59	<i>Rise for 18 places</i>
Macedonia	56	60	<i>Rise for 4 places</i>
<b>Republic of Serbia</b>	<b>63</b>	<b>67</b>	<b><i>Rise for 4 places</i></b>

Source: Global Innovation Index, 2015

As Table 4 shows, RC is far better ranked than RS. From neighbouring countries Montenegro recorded the greatest progress in terms of innovation, by rising 18 places in the rankings and is now behind RC. In order to increase the competitiveness of companies and thus to strengthen the economy, it is very important to continuously invest in research and development, as well as develop good communication among the scientific research centers and SMEs. Large companies have their own centers for research and development, and so the improvement of these connections would not only bring science and practice together, but would also help SMEs to cope with more sophisticated requirements coming from their clients. Table 5 shows the situation in terms of competitiveness.



**Table 5: The Global Competitiveness Index from 2006 to 2014.**

<b>Year/CountryGCI/ Rank (number of countries on WEF list)</b>	<b>Serbia</b>	<b>Croatia</b>	<b>The difference in the rankings (number of positions on the list)</b>
<b>2006 (125)</b>	3,69/87	4,26/51	36
<b>2007 (131)</b>	3,78/91	4,20/57	34
<b>2008 (134)</b>	3,90/85	4,22/61	24
<b>2009 (133)</b>	3,77/93	4,03/72	21
<b>2010 (139)</b>	3,84/96	4,04/77	19
<b>2011 (142)</b>	3,88/95	4,08/76	19
<b>2012 (144)</b>	3,87/95	4,04/81	14
<b>2013 (148)</b>	3,77/101	4,13/75	26
<b>2014 (144)</b>	3,90/94	4,13/77	17

Source: WEF(15.8.2015), Z. Dudić, KOR 2015

The Global Competitiveness Index (GCI) is a composite index based on twelve major pillars of competitiveness, which are organized into three groups, namely:

- BASIC REQUIREMENTS such as:
  1. Institutions,
  2. Infrastructure,
  3. Macroeconomic stability,
  4. Health and primary education,
- EFFICIENCY ENHANCERS such as:
  5. Higher education and training,
  6. goods market efficiency,
  7. Labour market efficiency,
  8. financial market sophistication,
  9. technological readiness,
  10. market size
- INNOVATION AND SOPHISTICATION FACTORS:
  11. Innovation
  12. sophisticated business processes.

According to these data (Table 5), RC excels in the field of competitiveness compared to RS. Every year RC has a better ranking in the list published by the World Economic Forum. The smallest difference between RC and RS was recorded in 2012 when RS was 14 places behind Croatia. The following year the difference amounted to 26 places in this list of competitiveness WEF.

### 3. CONCLUSION

SMEs in both EU countries and non-EU countries face various problems such as finding new customers, inadequate skilled labor, and insufficient training of the employees. New equipment and a new way of production require new knowledge. The biggest obstacle is finance and access to it. Access to finance is a bigger obstacle for micro enterprises than it is for small and medium-sized enterprises. The biggest problem for small and medium-sized enterprises in the EU is finding skilled labor and experienced managers. Another problem for medium-sized enterprises is competition or business conditions. Improved access to finance, as well as improved legal framework and incentives for SMEs would greatly contribute to a better performance and results on the market. Businesses in Croatia are in a better position than businesses in RS, because they have easier access to various EU funds since Croatia is one of the Member States. The government of Croatia has increased the promotion of entrepreneurship and so the forecasts of the future are more optimistic. According to data from GEM there will be a greater value added and more new jobs in SMEs. Unfortunately, this is not the case with the companies in the RS, because they are facing a very difficult period, a period of reforms. However, with a good strategy and adequate steps taken by the government of RS, this period of transition might come to an end.

## RAZVOJ MALIH I SREDNJIH PODUZEĆA I PODUZETNIŠTVA U REPUBLICI SRBIJI I REPUBLICI HRVATSKOJ

Mr. Zdenka Dudić, Fakultet tehničkih nauka  
Trg Dositeja Obradovića 6, 21000 Novi Sad, Republika Srbija  
E-mail: zdenkadudic@yahoo.com

Msc. Mirjana Cvijić, Fakultet tehničkih nauka  
Trg Dositeja Obradovića 6, 21000 Novi Sad, Republika Srbija  
E-mail: cvijic.mirjana@gmail.com

### SAŽETAK

*Mikro, mala i srednja poduzeća (MSP) važan su generator stvaranja novih radnih mjesta i kreiranja dodatne vrijednosti svake nacionalne privrede. Europska unija kontinuirano ukazuje na ključnu ulogu koju mala i srednja poduzeća imaju u osiguravanju konkurentnosti na tržištu te različitim politikama usmjerenim na ovaj sektor kreira za njih povoljnije poslovno okruženje, kako se i navodi u Lisabonskoj strategiji. Kreiranje adekvatnih uvjeta za poticanje inovativnosti i drugih činitelja koje mogu utjecati na bolje poslovanje MSP-a vrlo je važno na dinamičnom tržištu, ali i zbog sve sofisticiranijih zahtjeva klijenata. Razna svjetska istraživanja u svojim izvještajima kao prepreku prikazuju nedovoljan nivo aktivnosti u pokretanju novih poslovnih pothvata, mali postotak novootvorenih poduzeća, administrativne prepreke za provođenje poduzetničkih aktivnosti, nedovoljnu razvijenost financijskog tržišta te nedostatak edukacije usmjerene na razvoj poduzetničkih znanja i vještina. Cilj je ovoga rada prikazati pregled trenutnog stanja sektora malih i srednjih poduzeća u Republici Srbiji, kao i u Republici Hrvatskoj preko nekoliko aspekata: dinamičnost, inovativnost, značaj sektora za privredu i regionalni razvoj, pristup izvorima financiranja, dostupnost obrazovnih programa i profesionalnih usluga, kao i mogućnosti financiranja razvoja Europskim strukturnim i investicijskim (ESI) fondovima.*

**Ključne riječi:** mala i srednja poduzeća; inovacije; inovativne aktivnosti; konkurentnost; poduzetništvo

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