

# Improvement in Competitiveness of Serbian Small and medium enterprises

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### Abstract

*During last decade SME became important factor of Serbian economy. Although encouraging achievements were made in their development, due to late transition process, comparing to other transitory economies and to EU, SME in Serbia are well bellow, especially in efficiency. During the World economic crisis small and medium enterprises suffered like other companies, but most severe problems are related to shops. In spite of Government increasing help shops in 2010 had a negative net demographical effect. SME are vital and very important in the phase of economic recovery, which already started, and have to be supported. In the future SME supportive policy ought to be oriented toward a) competitive improvement and b) innovation development. With more efficient small and medium scale companies only Serbian economy has better prospects on the Global market.*

## Introduction

During transition period in Serbia (2000-2010) small and medium scale enterprises became important economic factor. Their share in total GDP and total employment increased considerably, as result of better economic environment, changed legal and institutional framework for business, and especially as result of measures oriented to support SME development.

Although those achievements look impressive comparing to the 1990s, comparing to other transitory economies and especially comparing to EU member countries, Serbian small and medium scale companies are well bellow. Namely, share of SME in total GDP, employment, export and import is similar to other neighboring

countries. However, if we compare different ratios per employee then clear conclusion appear, that Serbian SME are not efficient and consequently, not competitive on the Global market.

During prevailing period of last decade SME supportive measures were oriented to so - called quantitative support, when it was most important to achieve increasing number of newly opened companies each year and finally, their critical number. The goal of increasing number of companies was to increase employment and absorb number of workers, who had to leave companies in restructuring. As result from 2005 on total employment start to increase.

World economic crisis negatively influenced Serbian economy from the last quart of 2008, and all companies suffered including small and medium one. Number of newly opened companies is decreasing during the crisis, while number of those closed, in meantime, is increasing. Among SME shops are facing the most difficult problems and net demographical effect for them was, unfortunately, negative in 2010.

From mid 2010 there are signs of modest economic recovery. For secure and self - sustained development SME are of critical importance. Considering their weaknesses in competition abroad, in the future SME supportive policy ought to be oriented toward a) competitive strengthening and b) innovation development. Some pioneering steps in this respect were made, but this orientation is matter of long - term approach, and great deal of human and financial sources have to be engaged.

The aim of the paper is threefold: a) to illuminate problems which SME are face with during the contemporary crisis; b) to envisage competitive level of Serbian SME and c) innovative strength and potentials, with possible policy advice.

## **1 SME suffer during the crisis, shops mostly**

In the period 2000-2010 Serbia has realized a number of market oriented reforms. One can say that the first phase of transition is over. Legal framework for business is mainly in line with EU, as a huge task of harmonization is under way. Institutional infrastructure was developed on the basis of EU White book, as well. Economy is well restructured (transformed) and GDP formation also. On the company level majority of socially - owned companies was privatized and restructured. However, public (state owned) companies are at the beginning of restructuring process, as only few of them were privatized recently and started restructuring.

Fast GDP growth in the period under consideration, more stable and favorable business environment than before, made room for small and medium scale companies and entrepreneurship development. Proactive policy aimed for SME to grow more than average helped in creating favorable business conditions. Policy supportive to SME and entrepreneurship development had several lines of activity, as follows. 1) *Institutions* responsible for SME and entrepreneurship support were created on republican, regional and local level, as well; 2) *Legal environment* – laws and other regulations – became, during harmonization with EU legal framework, more business friendly than before; 3) Government introduced a number of *tax, custom and investment incentives* for SME specially; 4) Governmental and non - state institutions introduced *financial incentives* for SME and entrepreneurs, with serious support from international financial institutions. As result, increasing number of small and medium scale companies and shops were established from year to year. Total employment started to increase from 2005 on and SME absorbed number of unemployed people, who had to leave companies in restructuring, more successfully than before. One can argue that the first phase of SME development is over in Serbia. It means that during this period the aim was of quantitative sort - to establish critical number of SME within economy – and was achieved successfully.

Impressive results were achieved as result of changed and more favorable business environment and supportive policy measures oriented toward fast SME growth. SME became important economic agent. The SME share in total GDP was 59.1% and in total employment 67.2% in 2008, as the last year before Global economic crisis appear. The SME share in total turnover was 66.6%, 59.1% in total value added of non – financial sector and 58.7% in total profit realized<sup>1</sup>.

The first sign of World economic crisis appeared during the mid 2007 firstly as a crash of US real estate market. The pick was in September 2008, when the oldest investment bank, Leman Brothers, bankrupted. Banks have stopped to borrow money to each other and huge liquidity problem appeared. The crisis has become global, as banks from whole world were involved in speculations with US securities based on (dubious) mortgage credit lines. The first negative effect of the crisis on Serbian economy was produced by the leave of international players from Belgrade stock exchange in May 2007, when the prices of different securities dropped by 30% on average, like in other financial markets within the region.

The world economic crisis caused severe problems on financial sector of Serbian economy and non - financial companies also from the last quart of 2008. Foreign direct investments have shrunk and capital outflow has started, foreign demand decreased considerably, saving deposits of citizens within banks (FX deposits

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<sup>1</sup> Ministry of Economy and Regional Development, Republican Development Bureau, Republican Agency for SME Development, Report on SME Development in 2008, Belgrade, 2009

mainly) decreased for 1 billion € in few months<sup>2</sup>, credit conditions worsened very much<sup>3</sup>, liquidity problems sharpened, as collecting claims became extremely difficult, especially from Government and public companies.

One has to bear in mind that the World economic crisis did not caused economic problems in Serbia solely, but rather sharpened them. Precisely, during the last decade a neo – liberal attitude was prevailing with negative consequence to overall development. Fast economic growth (5.4% GDP increase on average in the period 2001-2008)<sup>4</sup> was based on expansive public and personal consumption<sup>5</sup> mainly. High share of public consumption in GDP<sup>6</sup> was signal that public services were not restructured, from governmental to pension. Also public companies did not start restructuring at all. Macro economic policies were not coordinated well: fiscal policy was expansive and monetary policy had to be very restrictive, in an aim to safe macro economic stability. So, GDP increase was sub – optimal – less than potentially possible. All in all, development before crisis was in fact non – sustainable in medium – term and the crisis from abroad was sharpened economic problems only.

When World economic crisis started to influence Serbian economy Government and Central bank were reluctant, were late in reaction and measures introduced were week to prevent recession. Generally speaking, Serbian banks were in better shape than banks in neighboring countries when crisis came<sup>7</sup>. National Bank of Serbia firstly introduced measures to improve liquidity (decrease in compulsory reserves obligation). In order to prevent outflow of FX deposits from banks amount guaranteed by the state (insured) was increased from 3 thousand € up to 50 thousand € per single deposit. An agreement between NBS and foreign banks present on Serbian market <sup>8</sup>was achieved (so - called Wiener agreement) not to dismantle exposure of clients: companies and citizens. Unlike other central banks, which put down interest rate near to zero in order to prevent recession, NBS instead increased referent interest rate aiming to prevent inflation expectation (up to 17.5% p.a.).

Government introduced weak encouraging measures with an aim to prevent recession. Tax duties on saving deposits from capital gain were annulled in order

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<sup>2</sup> Data from National Bank of Serbia (NBS)

<sup>3</sup> It was due to increase in country risk (to 2% p.a.) and increase in referent interest rate of National bank of Serbia (interest rate on governmental bonds up to 17.5% p.a.).

<sup>4</sup> Statistical Office of RS

<sup>5</sup> Free formation of wages resulted in their high increase over 10% per year in real terms. Source: Ministry of Finance RS.

<sup>6</sup> During the period 2001-2008 the share of public consumption in GDP was 45-50% and increase in indirect tax duties was 9.8%p.a. Source: Ministry of Finance RS

<sup>7</sup> They were overcapitalized (28% was capital adequacy), partially due to higher capital adequacy ratio requirement in Serbia (12%). Source: NBS

<sup>8</sup> Approximately 75% of total bank assets belong to foreign banks. Source: NBS

to recover domestic savings. Tax duties related to securities transfer were annulled, as well, in order to recover volume of transfers within stock exchange. In order to curb recession Government supplied support to different credit lines subsidized interest for: 1) *Companies in liquidity problems* (0.8 billion €); 2) *Companies investing* (0.17 billion €) and 3) *Citizens* for consumption and mortgage credits (0.2 billion €)<sup>9</sup>.

Government and NBS measures were mainly in right direction, but late and weak. It was clear that influence of Global economic crisis was stronger than they expected. An overcome of the crisis was inevitably seen with IMF support only. The stand – by arrangement with IMF was made for the period until April 2011, based on financial support of 4 billion USD aiming to strengthen FX reserves and to prevent deterioration in FX rate of domestic currency. At the same time arrangement emphasized need for continuation of market reforms, public services reform, decrease in public spending and macro economic stability.

National economy suffered in 2009 a lot. GDP dropped by 2.8%, industrial production 13%, trade 12% and traffic by 15%. Export volume decreased for 26%, due to weaker foreign demand and import volume even more, dropped for 35%<sup>4</sup>. SME and entrepreneurs could not be an exemption and their development slow down considerably. There were a lot of unfavorable factors, but the most influential seem to be: 1) *Fewer chances* for entrepreneurs than before on domestic and foreign market, like it is the case during the downturn of economic cycle; 2) *More fears* for entrepreneurs who wants to start business or wants to develop it, because of unstable conditions and weak domestic and foreign demand; 3) *Unfavorable financial conditions*, lower credit volume available and under more difficult conditions; 4) *Decreasing demand* on domestic and external market, from both companies and citizens; 5) *Increasing competition* among entrepreneurs and between SME and big companies, as all economic subjects try to survive; 6) *Lower liquidity* and more difficult collecting claims.

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<sup>9</sup> Source: NBS

	Number of companies		Number of shops		Net effect	
	Established	Closed	Established	Closed	Companies	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.	9.391	9.340	35.036	37.168	1,0	0,9
1-2 2010	1.523	439	5.219	6.462	3.5	0.8
1-2 2011	1.270	2.243	4.579	5.831	0.6	0.8

Table 1

Number of newly established and closed companies and shops

Source: Republican Business Registry, processing Republican Development Bureau

Development of Serbian SMEE slow down considerably after the period 2004-2008 when the sector became important factor of the economy in market reform and revitalization<sup>10</sup>. Since 2008, as a consequence of the economic crisis and deteriorated business environment, the number of opened companies and shops has been in decline and the number of economic entities that terminate their operations has been on the rise. During whole 2009 10.014 new enterprises were established and 39.365 shops (for 11% and 9.2% less then year before), while 3.597 companies and 36.441 shops were closed (for 17.2% and 5.4% more than year earlier). During 2010 net effect in so – called business demography was worsening further. The tendency of decreasing number of new established firms, on the one hand, and increasing number of closed, on the other hand, got momentum. As result of further deterioration of business conditions during whole year 9.649 companies were established (5.4% less then year before) and 9.340 were closed ((even 169.7% more than year before). At the same time new 35.036 shops were established (11% less then year before) and 37.168 were closed at the same time (2% more then year earlier). Net effect for companies (number of established to number of closed) was worsening from year to year and in 2010 was 1:1 (1:2.8 in 2009). *Net effect for shops was even worse 1:0.9, which means that for the first time in Serbia there were more closed than established shops.*

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<sup>10</sup> Ministry of Economy and Regional Development, Republican Development Bureau, Republican Agency for SME Development, Report on SME Development in 2008, Belgrade, 2009

In the period January - February of 2011 new 1.270 SME were established (by 16.6% less than in the same period year before) and 2.243 enterprises were closed (by 410.9% more). At the same time 4.579 new shops were set up (by 12.3% less than in the first two months of year before) and 5.831 were closed (by 9.8% less). The ratio between the number opened and the number of closed companies (net effect) equaled 0.6:1 and it was much less favorable than in the same period of 2010. (3.5:1). Net effect of the opening of new shops was at the level of last year and it stood at 0.8:1 approximately. It seems that data point still difficult conditions for business, especially for start up, and are matter of certain time lag in reaction of entrepreneurs on deterioration in business climate.

Economic crisis caused slowdown in development and drop in the competitiveness of SME sector. Basic business indicators are less favorable than before – drop in turnover, GDP and profit. The problem is more dominant in qualitative business indicators, in spite of decrease in number of employees. Recession effects limited entrepreneurial activities and chances entrepreneurs and small economic subjects to transform decrease of the economic activities into recovery and growth. Drop in domestic and foreign demand and investments, increase in risk and investments costs, as well as the fear from failure influenced the decrease in the number of new entrepreneurs and thus the job creation, as well. GEM research<sup>11</sup> on different aspects of entrepreneurial activities in 2009 indicated negative effects of the crisis on the entrepreneurial climate in Serbia. The number of start ups and new enterprises has been decreased posing significant limitations on job creation opportunities. Comparing tendencies in selected countries in the period prior to crisis with period 2008-2009, one can conclude that more than a half of entrepreneurs within the region believe that it is more difficult to start doing business now. *They also believe that it is easier to achieve the growth in existed business than to start up a new one.* Their expectations regarding employment increase are very modest and penetration of foreign market, as well.

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<sup>11</sup> Global Entrepreneurship Monitor, 2009 Global Report, Babson College, Universidad del Desarrollo, Reykjavik University, LBS, 2010

	<b>Entrepreneurs</b>	<b>Micro</b>	<b>Small</b>	<b>Medium</b>	<b>SME</b>	<b>large</b>	<b>Total</b>
No of enterprises	5.3	0.9	-5.2	-7.7	3.7	-6.9	3.7
No of employees	-10.7	-0.3	-6.2	-8.1	-7.2	-5.0	-6.5
Turnover	-12.2	-15.2	-19.9	-10.6	-14.7	-19.4	-16.2
GDP	-9.0	-14.7	-12.5	-9.8	-11.2	-4.8	-8.6
Export	-13.3	-6.0	-17.8	-4.9	-8.9	-24.2	-17.2
Import	-18.4	-25.4	-32.6	-14.1	-24.2	-25.5	-24.7
Foreign trade deficit	-56.4	-34.1	-37.8	-23.8	-33.1	-28.1	-31.8
Profit	-10.1	-25.3	-16.5	-10.8	-15.6	1.8	-8.4
Profitability rate	-1.1	-12.3	-4.6	-1.0	-5.0	6.8	0.1

Table 2

Growth/fall of business indicators 2008-2009

Source: Statistical Office of RS processing by Republican Development Bureau

There are first signs of economic recovery worldwide from mid 2009, but economic experts are afraid of possible so – called W effect.<sup>12</sup> The increase in foreign demand is related to the first sign of domestic economic recovery. Industrial production in 2010 was higher 3% in comparison to year earlier. Retail trade is increasing from July 2010. GDP increased 1.5% in whole 2010 and an increase of 3% is expected for 2011<sup>13</sup>. However, as it was noted, it is too early for positive reaction of entrepreneurs and it can be expected in the future with certain time lag.

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<sup>12</sup> So – called W effect means that economic situation is still fragile, that after increase a repetition of recession is possible.

<sup>13</sup> Statistical Office of Republic of Serbia



## 2 SMEE are neither competitive...

*There are clear signs of economic recovery in Serbia, considering GDP growth, increasing industrial production and trade. In order to secure recovery SMEE have important role. During the last decade supportive measures toward SMEE development were realized in order to create critical number of new small and medium scale enterprises and shops, which in the future will be the basis for self sustained economic growth and development. This aim was successfully achieved. If we compare SMEE with EU average they are on average by their share in GDP formation, employment and value added. However, if we look at efficiency of those newly established companies and shops, and compare them to EU average they are far bellow regarding efficiency and regarding different ratios per employee. Consequently, Serbian economy can not be competitive abroad and increasing trade deficit during last decade prove this fact. In order to improve efficiency of SMEE a supportive set of measures has to be changed into qualitative one. The aim is to make companies more competitive abroad and to close, as much as possible, trade deficit in the future.*

Through dynamic transitional development the entrepreneurial sector significantly contributed to national economic growth during the previous decade. It is estimated that in 2009 SME sector had share of 33% in GDP formation and 42.3% in the total employment<sup>14</sup>. *Serbian SME, like other economic entities, are not competitive on foreign market if we look at investment activity, cost of production and export characteristics.*

*Investment activities of SMEE deteriorated in Serbia in crisis circumstances and comparative analysis pointed lower level of investments in Serbia. The recession during the crisis caused lower values in companies' production, but not in their liabilities, which result in fewer tendencies to invest. In changed and worsened business conditions, which are primarily related to limited and expensive sources of financing, insufficiently developed SME sector in Serbia has not managed to raise the level of mobility and development of internal potentials and thus prevent a fall in the level of competitiveness. SME share in total investment of non financial sector was 50.4% in 2008 and the share of investment in GVA dropped from 40% to 27% (2007 and 2008 respectively). Investment of non financial sector in 2008 with value of 449.7 billion RSD or on average of 1.5 billion RSD per company account 65.9% of total investments and they are 8.6% lower then year before. SME sector accounts for 33.2% of total investments within economy and 50.4% of non financial sector (58.7% in 2007). Almost 43% of the value was*

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<sup>14</sup> Ministry of Economy and Regional Development, Republican Development Bureau, Republican Agency for SME Development, Report on SME Development in 2009, Belgrade, 2010

implemented in medium sized companies. According to GVA/investments ratio SME sector is well below the non financial sector average (27% to 32%). The crisis affected micro business the most, and their investments in 2008 are only 9% of GVA (29% in 2007) and only medium sized enterprises are above average (36%). Comparative analysis of investments per employee and per company in the neighboring and EU – 27 countries pointed out a significantly lower level of these indicators in Serbia, both for SME and national economy<sup>15</sup>.

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

Table 3

Investments of non - financial sector in European countries

Source: Euro stat, Republican Development Bureau

Business activities of SME in the period prior to crisis (2004-2008) were marked by positive tendencies of *cost competitiveness*. High growth rates were achieved in GVA (10.9%), as well in average value of labor costs expenses (10.4%) and productivity (4.9%). Growth dynamics stopped in 2009 and the strongest effect was on micro and small companies. A drop in production at the end of 2008 was not followed by appropriate decrease in the number of employees and wages,

<sup>15</sup> Ibid

which is why unit labor cost went up. Wages in SME accounts for almost 2/3 of GVA and there is not much room for the companies to improve and modernize the operational process.

Serbian companies are neither *export competitive* on average nor SME are. The crisis mostly affecting companies active in international trade, and that is the reason why the number of exporters and importers was reduced in 2009. Lower domestic demand had a much bigger influence on the reduced import than export, which caused the increase of coverage ratio to 52.8% in total and 43.4% in the SME sector. Negative effect of the economic crisis is stronger in medium sized and large companies with relatively large share of export in trade (10.9% and 13% respectively), than in small and micro enterprises, which are mainly oriented toward domestic market. Value of export and import per employee in 2009 in relation to 2008 is dropping by the rate 12.5% and 20.5% respectively. Real drop within SME sector was significantly lower than in large enterprises (-3.4% and -20.2% respectively). Higher figures of the revealed comparative advantage index in 2009 are also a result of faster decrease in import than in export. Even though foreign trade of high tech product shows the fastest growth, Serbian economy still depends on export in low technology intensive industries<sup>16</sup>.

Regarding *implementation of ICT* Serbian SME are slightly behind EU-27 average, and in the use of internet they are significantly below average. Equipment and use of equipment in business operation shows that Serbian SME are near to EU average and better of in comparison to some EU members. In the use of Internet and in types of connections in access to Internet they are well behind the EU average and most countries within the region. Lagging behind the types of access to the Internet is especially emphasized in case of mobile connections. Serbian SME most often used Internet for banking and financial services while E-business (online buying and selling) is used less.

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<sup>16</sup> Ibid

	% of companies using computers		Types of devices and communication systems							
			Extranet		Intranet		Wire LAN		Wireless LAN	
	SME	Total	SME	Total	SME	Total	SME	Total	SME	Total
EU	96	96	18	19	30	32	76	77	32	33
Bulgaria	88	88	16	17	45	45	60	61	24	25
Hungary	89	89	11	11	19	20	58	59	25	26
Romania	80	80	10	10	25	26	54	55	16	17
Slovenia	98	98	13	14	28	30	81	82	30	31
Croatia	98	98	13	14	29	30	69	70	35	35
<i>Serbia</i>	<i>98</i>	<i>98</i>	<i>11</i>	<i>12</i>	<i>43</i>	<i>44</i>	<i>69</i>	<i>69</i>	<i>37</i>	<i>37</i>

Table 4

Use of computers, devices and communication system in business, 2009

Source: Euro stat, Republican Statistical Office of RS

From data above it is clear that *priority of policy which support SMEE development in the future is competitiveness strengthening*. Measures would be introduced for improvement in companies' abilities in an aim to operate more successful on the global market. This aim should be realized through several targets, as follows: 1) On macro economic level - *economic structure development in line with EU and compatible to EU structure* – it means fast growth of activities with value added above average; 2) On micro economic level - improvement in competitive abilities of companies by *closing discrepancy to EU average in gross value added per employee*; 3) *More balanced regional development* – considering high regional discrepancies in Serbia it is necessary to support fast socio economic growth of underdeveloped regions.

It is also important to enforce and develop linkages between on the one side, educational and research institutions and companies and companies, on the other side. Programs for improvement competitiveness would be oriented to: 1) *Support investment in R&D and innovation*; 2) *Support companies' internationalization*; 3) *Introduce strategy for productivity increase in companies*; 4) *Support cooperation and enforce linkages between companies and developing clusters*.

### 3 SMEE (are) nor innovative

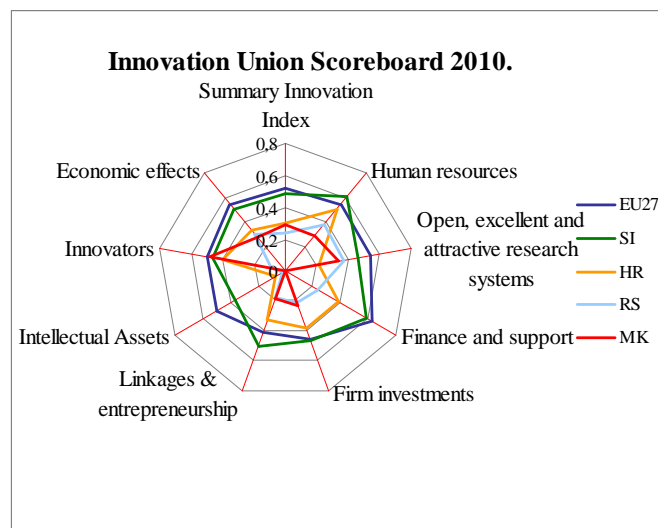
*Another side of coin of Serbian low efficiency on the international market is low innovative level of companies, which point low level of development and implementation of new technologies. It was partially seen from data on ICT implementation within Serbian SMEE, as it is prevailing part of the economy. Additionally it was clear from the structure of import and export regarding type of product according to level of technological implementation. If one wants to explain this low technological level then several reasons are important, as follows: 1) socio - economic environment was for decades not affirmative and encouraging for innovations, as Serbia, as part of the former Yugoslavia, has developed a specific market – plan mix, where companies were not oriented toward profit maximization; 2) a neo – liberal development concept was prevailing during transition, and consequently short term goals and market forces are seen as keys for all economic problems; 3) During the crisis SMEE are faced with more limitations than big companies generally, and in the process of development and application of new technology, especially.*

European Innovation Scoreboard is an instrument of EU Commission for monitoring and comparative analyses of innovation performance of member and joined countries. According to achievement the countries are categorized into four categories, as follows: Innovation Leader, Followers, Moderate Innovators and Catching up countries. For the first time Republic of Serbia was included in investigation for 2009<sup>17</sup>, which is the first important step toward screening of innovation potentials of the country and sector of SMEE. This is more important for formulation of the policy and measures for stimulating innovative activities. According to the findings companies in Serbia belong to modest innovators and as a country in pre accession procedure Serbia belong to Catching – up countries.

Data pointed that Serbia is well bellow EU 27 average. If EU 27 innovation index is 47.8 then Serbia Index is 22.7 only. However it can be said that the potential of the economy is quite solid, in relation to the average performance - human resources and financial support, and also economic effects are matured as product of innovations introduced. The high potential can be seen as a consequence of weak activity on the company level regarding capacity of intellectual property and the share of companies - innovators in total number.

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<sup>17</sup> [http://ec.europa/research/innovation-union/pdf/innovation-union-communication\\_enpdf](http://ec.europa/research/innovation-union/pdf/innovation-union-communication_enpdf)

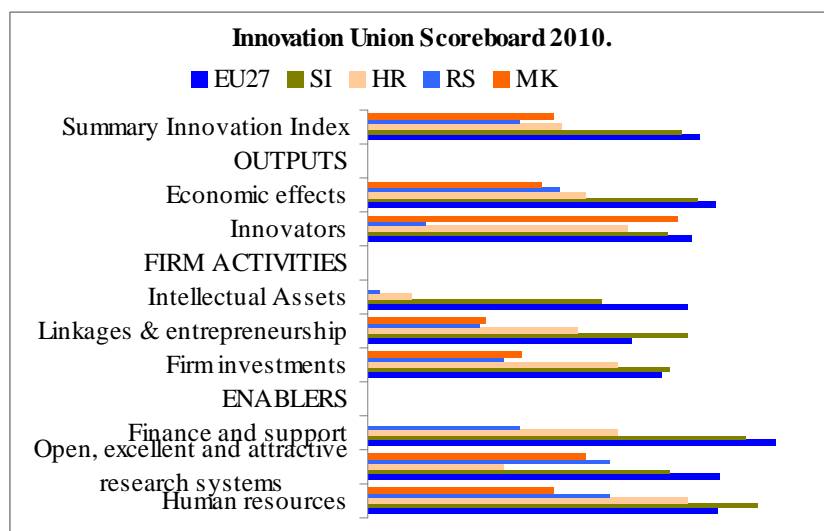


Source: European Innovation Scoreboard 2010

*First dimension - enablers:* Serbian research system has modest potential comparing to EU average and neighboring countries (Slovenia and Croatia). Human source is also limiting factor (with 19.2% highly educated and 85% with secondary school in total young population). *Second dimension – firm activities:* Serbia is investing 0.5% of GDP (public and private sources) in research (EU 2%). On the company level 28% of all Serbian SME and shops can be labeled as innovative<sup>18</sup>. There are 3.5% innovative SME with linkages and cooperation in research in total number of SME. *Third dimension – outputs:* The share of SME introducing processing/product innovations is 18.3% and 18.1% organizational/marketing innovations in total. Comparing to EU and matured transitory economies Serbia is less efficient in utilization of innovations. The share of employment in knowledge based activities is 3.9% of total. The share of medium and high tech product export is 27% in total and knowledge service export 34% in total. The share of sales of new to market and new to firm innovation is 10% in total turnover and lastly, the share of revenues from licenses and patents from abroad is 0.1% in GDP.

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<sup>18</sup> Ministry of Economy and Regional Development, Republican Development Bureau, Republican Agency for SME Development, Report on SME Development in 2009, Belgrade, 2010



Source: European Innovation Scoreboard 2010

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

Results of the survey show that regarding legal form of business SME most often choose liability company (Ltd 88% of total), because of its flexibility in organizational transformation and formal conditions. Two third of enterprises are in business more than 6 years, and 43% of them more then 11 years. There is an evident intention of most entrepreneurs that their companies continue to work, with increased (37%) or same level of activities (50%). Only 5% of them plan to close and 2% to transfer business to somebody else. Half of medium sized companies have plans for further expansion; while strongest reserve to expansion small entities have (30% of sole traders and 38% of micro and small companies plan to develop business). The survey results confirm dependency of improvement of business operation upon external factors (67% of total), like support from the state and local government. Companies investigated ranked business problems very high; and the largest obstacles are related to lack of financial sources under favorable conditions and legal environment (graded 1.9 and 2.2 on 1-7 scale). Surveyed SME are mostly equipped with medium generation equipment, 5-10 years old, and only ¼ of them owns equipment up to five years old. The need to invest in technical and technological business conditions was emphasized by 60% of companies, as they invested in past three years, but further intention is to postpone investment to future. The use of PC is not and obstacle for business

improvement, as 83% of companies use computers, with 6.5 computers per surveyed company. Results show that every fifth company performs innovative activities, and one out of eleven has innovation cooperation with other business entities or institutions. Innovative activities resulted in introduction of new products or services in 1/5 of total. Effects of implemented innovation are in 54% of cases in the saving of raw materials and energy, and in 46% in the reduction of labor costs. Only 16% of companies protected some of intellectual property types, although there is increasing trend (5 percentage points more than year before).

Serbian Statistical Office conducted a *research on innovative activities of SMEE* for the period 2006-2008<sup>19</sup>, with the aim to grasp a true between the business policy of companies and innovative activities. Regarding to all SME from the sample 18% of total are technology innovators, 18% are other innovators that introduced organizational or marketing innovation and 6% did not finish and implement innovation. When looking at the share of certain type of innovation that was introduced according to size of SME innovators, it is visible that the biggest share is in the organizational innovation (28% of total) in small (28%) and medium sized (29%). In total 19% refer that they were a part of a group of connected companies, and 93% of SME innovators responded that their company is a base company. Regarding market orientation 98% of total responded that they were selling on Serbian market. According to new product or service introduced 23% is related to product and 28% to new services. In total 6% of SME innovators registered trademark, and 16 named time advantage in relation to competitors as significant innovation protected method.

Serbia is realizing „*Strategy for development of competitive and innovative small and medium scale companies 2008-2013*“ from 2008. Implementation of the Strategy should concentrate measures and activities to those specific companies with potential for fast growth and export expansion. Priorities for dynamic companies and gazelles support are: 1) *Legal framework reform*, with an aim to harmonize laws in line with EU, to minimize administrative procedures and requirements; 2) *Innovation support*, with an aim to define system of stimulations for research and development and innovative activities and their implementation within companies; 3) *Functional education*, with goal to increase overall level of knowledge of managers and employees improving bought formal and especially informal education system; 4) *Financing improvement*, with aim to disperse institutional framework for micro financing, investment funds and venture capital funds; 5) *Closing institutional infrastructure*, in order to develop further institutional network covering whole territory; 6) *Opening to World market*, with

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<sup>19</sup> Serbian Statistical Office – The Research on innovative activities of SMEE for the period 2006-2008, Statistical office of Republic of Serbia, Belgrade, 2009



goal to improve competitive strength of dynamic and innovative companies on the global market.

### **Conclusion**

During transition period SMEE in Serbia became important economic factor. It was result of market reforms introduced, business climate improved, and mainly due to supportive policy implemented. The main aim of the policy was to establish more and more SMEE each year in order to increase employment and absorb surpluses of workforce from companies in restructuring. This important goal was achieved and share of sector of SME in total GDP and employment is considerably higher then before. Facing the Global economic crisis SMEE are suffering, smaller companies are suffering more then bigger one. Recently, economic recovery in Serbia got momentum. In order to make it secure and self sustained the role of SMEE is seen as important. Although Serbian achievements in SMEE development are encouraging, comparing those companies to companies from mature transition countries and EU members, they are less efficient and less competitive. This finding led to inevitable shift in policy stimulations for SMEE development toward more efficiency and innovation oriented. Some important steps are realized, like data collection and measurement, and especially strategy definition.

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