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## ENTREPRENEURSHIP DEVELOPMENT AND FINANCIAL PERFORMANCES IN SMEs SECTOR IN SERBIA

### Abstract

*Small and medium sized enterprises are one of the key factors in the dynamic economic development and the reduction of the high unemployment rate, especially among the young and hard-to-employ categories in the society. These enterprises contribute to the more efficient resource allocation because they apply work intensive production methods which provides balance establishment between higher workforce availability and lack of capital. There is a special importance of the production oriented SMEs in Serbia because the economic policy of the transition period favoured service sector development. That is the reason for the results in SMEs and entrepreneurship sector to be far lower than expected, followed by insolvency, high indebtedness and unfavourable sources of funding dominated by too expensive bank loans. The economic policy in the future should provide a favourable business environment for SMEs and entrepreneurship sector growth and development, as well as raising their competitiveness in relation to companies from the developed economies.*

**Key words:** SMEs sector, entrepreneurship, financial performances, competition

**JEL Classification:** M 21, F 63

## РАЗВОЈ ПРЕДУЗЕТНИШТВА И ФИНАНСИЈСКЕ ПЕРФОРМАНСЕ СЕКТОРА МСП У СРБИЈИ

### Апстракт

*Мала и средња предузећа су један од кључних фактора динамичног привредног развоја и смањења високе стопе незапослености, посебно младих и теже запошљивих категорија друштва. Ова предузећа доприносе ефикаснијој алокацији ресурса јер примењују радно интензивне производне методе чиме обезбеђују успостављање равнотеже између веће расположивости радне снаге и недостатка капитала. У Србији су од посебног значаја МСП која се баве производном делатношћу јер је економска политика у транзиционом периоду фаворизовала развој услужног сектора. Због тога су и резултати пословања сектора МСП и предузетништва знатно испод очекиваних, праћени великом задуженошћу и неповољним изворима*

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*финансирања у којима доминирају прескупи банкарски кредити. Економска политика у будућем периоду мора обезбедити повољан пословни амбијент за раст и развој сектора МСП и предузетништва и подизање њихове конкурентности у односу на предузећа из развијене привреде.*

*Кључне речи: сектор МСП, предузетништво, финансијске перформансе, конкурентност*

## Introduction

Entrepreneurship is a modern form of business behaviour used to find economically more efficient and more attractive business activities in the market. That is a creative activity of competition and comparative advantage of product, service, business or individual formation, and that provides an increase in market and economic results for entrepreneurship oriented businesses. Entrepreneurship foundation and development represents an important economic, technological and social phenomenon. Nowadays, when the challenges of the environment are greater and more complex, entrepreneurship is becoming the key factor responsible for the development of individuals, business systems and nations.

Entrepreneurship in Serbia has not reached the necessary level of development, nor the one proclaimed by the economic policy after the year 2000. That is why all the negative results of the transitional processes are still present, from high unemployment and low competition to high level of foreign debt. Entrepreneurship can be the key factor of the desirable changes in Serbia, such as : worker productivity increase, product and service quality increase, competition strengthening, better use of the available capacities, export growth, higher employment, public and foreign debt decrease, etc.

Bearing in mind the following: foreign debt level, GDP structure (where almost two thirds are realised through nontradable sectors), high foreign trade deficit and negative results of the environment in 2016, it is easy to understand that the economic policy creators in Serbia have a difficult task of negative economic trends prevention in front of them, as well as entrepreneurship development and unemployment reduction. In these conditions, there arises a question of economic policy change which will lead to a sustainable economic growth and development, remove regional disparities, provide the necessary investment level and favourable environment for SMEs sector development. The affirmation of entrepreneurship as a whole, primarily productive entrepreneurship, can be a good start of progressive and undoubtedly pragmatic transformation and transition of our society towards the economically developed world.

## SMEs and entrepreneurship importance for economic development

Entrepreneurship can be defined as a group of activities with the practical application of heterogenous knowledge and skills at its basis, with the aim of conducting a certain activity including further growth and development of the business. Thus, entrepreneurship represents a combination of various knowledge, abilities, readiness to accept appropriate possibilities, innovations and risks. An important entry of entrepreneurship is a readiness to accept innovation. Knowledge and information gradually come to the fore, and can be

considered as strategic factors of entrepreneurship. Timely and good quality information to reduce risk, uncertainty, enable better quality decision making and creative possibility development.

Entrepreneurship represents a model of business behaviour, which means that the owners/managers are actively pursuing new business opportunities. Entrepreneurs are the stakeholders, and their behaviour most often implies activities such as innovation, proactivity and risk propensity at business chances usage. Entrepreneurship also represents the way of thinking, and the essence of entrepreneurship is action.

Entrepreneurship opens new workplaces and it is a driving force of the economy, and its development strongly supports social development. Entrepreneurship is a dynamic process where entrepreneurs take initiative in production and new ways of doing business. We can observe entrepreneurship as a market function (with the aim of explaining differences in the market when an entrepreneur reacts), as a process (recognition of chances and organisation for their usage), and as a person, who has got initiative, authority, prediction ability, who takes risks and leadership (entrepreneur) (Herbert & Link, 1989; Bygrave & Hofer, 1991; Stevenson & Jarillo, 1991).

A holder of entrepreneurial activity has to integrate: knowledge, tendency towards new ideas, innovation application, creative thinking ability, a willingness to work hard, constant improvement, ability for quick decision making and risk taking, as well as orientation towards future. Potential entrepreneurs are people from the existing private sector, with shorter or longer working life as private business owners; people from the grey economy area; unemployed or people made redundant; intellectuals with a worsened financial position; farmers in positions of entrepreneurs for a number of years, etc.

According to the EU definition, entrepreneurial companies are organised as micro ( up to ten employees), small ( from ten to fifty employees) and medium ( up to 250 employees). Law on Accounting ( the Official Gazette of the Republic of Serbia n 62/2013) classifies legal entities in Serbia according to the number of employees in the identical way, taking into account the criteria of realised business income and average value of operating assets. The European chart of SMEs points out the importance of small and medium-sized enterprises for competition and employment increase, and it also defines the basic principles for their support, cheaper and faster start-up, better laws and regulations, access to funds and fair tax policy. The EU has identified the most important objectives – high level of European competition achievement, better SMEs relations with universities and research centers, socially responsible approach to the society, etc.

The basic characteristics of SMEE (small and medium-sized enterprises and entrepreneurship) are size, flexibility, innovation and risk prone ventures, more possibilities for specialisation, etc, enable these enterprises to adapt more easily to the continuous changes in consumer demands and conditions of doing business in global markets than the big business systems. Thus, SMEE encourage competition strengthening which results in product and service quality improvement, price lowering, innovation and new technology development, economic growth of national economies in general. It is expected from the government to diminish the negative impact of external factors on the businesses in Serbia (Jankovic, et al, 2016). In the era of constant changes in all the spheres of business, important factors of the survival of the enterprise are keeping track of the events in the region, swift reactions to actual trends and predicting the future market events. By this means the enterprises become more successful and achieve a proactive control over their future (Gavrić, et al, 2016).

SMEE sector often shows a characteristic of below average productivity because they are too small to accomplish the economies of scale effects. Besides, they are less

capital, and more work intensive. Unlike large companies which naturally tend to achieve monopolistic or duopolistic position in the market, SMEs contribute to the creation of the competitive economic structure as a prerequisite of economic efficiency increase (Berry, A. 2007). SMEs contribution to the economic growth is realised through their tendency towards innovative ventures and risk, although they pay the price of high extinguishing rates and lower rentability rates because of that. SMEs sector is a place where successful entrepreneurial ideas are created and realised. Most of the small enterprises started their life cycle as micro companies, while many large companies grew out of SMEs sector. These companies are the ones with a larger tendency of including SMEs in their supply chains, and they contribute significantly to the economic efficiency (Eric, D. et al, 2012).

The following dimensions are often pointed out in the context of the SMEs contribution to the economic growth and national economic development (Hobohm, S. 2001):

- Compared to large enterprises, SMEs are more work intensive and influence the lowering of inequality in income distribution. These enterprises play an important part in employment generation and poverty reduction, especially in the creation of workplaces for people from the poorer society groups and women with less alternative sources of income.
- In the developing countries, SMEs contribute to the more efficient resource allocation through work intensive production method application, which provides the establishing of balance between larger work force availability and the lack of capital.
- SMEs support the creation of the production capacity system by the absorption of production resources at all levels of the economy, the contribution to the creation of dynamic and elastic production systems where small and large enterprises are mutually connected. Compared to large enterprises, SMEs are geographically more evenly allocated, and that fact contributes to entrepreneurial ideas and skills development and diffusion, as well as economic differences reduction between urban and rural areas.

## **Entrepreneurship development in the transitional period in Serbia**

Entrepreneurship and self-employment in Serbia represent the areas that gain importance along with the changes of the economic context – privatization, change in the economy and ownership structure, increased possibility of losing a job, work force market instability. The changes in economic structure also cause a completely new approach to human resource development (demands for new knowledge, skills and high competencies, mobility, adaptability, etc).

One of the directions of sustainable economic development is entrepreneurship, which has positive results in the economically developed countries. However, the business environment for entrepreneurship development in Serbia is still unfavourable, with almost the same obstacles as at the beginning of the transition, despite the declared support of the economic policy creators. Solving the problem of unemployment, young personnel migration prevention, worker productivity increase, innovation adoption – these are only some of the positive effects of entrepreneurship development. In the process of creating a favourable environment for entrepreneurship development there

are others with an important part, except the institutions of the state: entrepreneur association, SMEE association, state and private universities, international and local organizations and associations.

According to the global aspirations, both among the Serbian scientists and economic policy creators, entrepreneurship is observed as one of the key factors of the economic growth and employment generator. The government of the Republic of Serbia has adopted the Strategy for poverty reduction (2003) where entrepreneurship development is marked as an important element of the economic development and poverty reduction in Serbia, while self-employment and “start-up” are defined as the key segments of entrepreneurship development. In the National sustainable development strategy (2008) one of the key priorities is competitive market economy development and balanced economic growth, with innovation encouragement, entrepreneurship promotion and SMEs development as the main activities for achieving those aims.

The main task of the Strategy for SMEs and entrepreneurship development in Serbia is to create a framework for making sustainable, internationally competitive and export oriented SMEs sector which will provide a social well-being in the Republic of Serbia. Unfavourable economic trends slowed down the dynamics of solving basic problems of SMEs and entrepreneurship development, so that nowadays in Serbia we have an incomplete institutional environment and regulations, inadequate knowledge and skills of entrepreneurs and SMEs staff, insufficient skills promotion in the companies, insufficient encouragement for the improvement of intellectual property management development, property rights included.

There are very unfavourable economic conditions and inappropriate forms and extent of financial support in the course of the transitional period: dominating banks with the expensive credit offer and short terms of loan repayment, lack of microcredit institutions at regional and national levels, but also the lack of other financial instruments suited to the real needs of SMEs and their economic strength. Also, programmed approach to finances is still undeveloped – cooperation with private investors, credits and loan guarantee programmes, no collateral loans for capital provision in innovative SMEs, risk fund capital capitalization, tax incentives, etc.

One of the characteristics is an insufficient connection with large companies, which also means underutilised opportunities for dynamic development of the SMEs sector as cooperatives (suppliers, subcontractors) of large business systems; it also means an underutilised opportunity of SMEs sector advantages over large companies in certain segments of production which demand flexibility and fast adaptation of scientific-technology and market sectors. Relevant institutions have not fully recognised the possibilities and needs of the SMEs sector, which caused the lack of necessary incentives for the modern technology introduction, as well as innovation, standards, quality control, etc; therefore, there was no necessary internalisation and this sector did not enter highly-developed markets.

Besides all the above mentioned, SMEs sector made a significant contribution to the economic growth in the period of transition. This sector is also an important factor in the process of the Serbian economy approach to the developed market economies, as well as on the road to the EU integrations. The encouragement of this sector's development is defined as one of the priorities in the economic policy in Serbia, and 2016 was declared the year of entrepreneurship. It is especially important to encourage productive entrepreneurship because it can contribute not only to the financial stability, but social and political as well, since it opens new work places, releases creative energy of innovators, regains faith in one's own abilities and prevents “brain drain”. Therefore, the focus of attention should be transferred from the area of financial economy to the



world of the real economy as soon as possible, material production before anything else (Pokrajac et al, 2011).

It is necessary to introduce entrepreneurship into the school system, which will recruit a larger number of successful entrepreneurs and make it easier for them to manage the development of their own business ventures. Entrepreneurship education has both short-term and long-term effects in the society (Arasti et al, 2011), and higher education significantly increases the prospects of entering entrepreneurship for business chances and ideas, not out of the economic need (grbovic et al, 2013), which is a very common case in Serbia, especially in the recent years of crisis.

According to the study on youth employment and migrations in Serbia (Vladislavljevic et al, 2010), entrepreneurship is more a result of the “push effect”, that is, the need for work and survival, and less a result of the “pull effect” – the recognition of business possibilities and the situation in the market. The characteristics of the market in Serbia are: work force offer and demand nonconformity, high share of long-term unemployed people, large inflow of redundancies (laid off from the public sector, large companies bankruptcy and liquidation), unfavourable age and qualification structure among the unemployed, high share of the young and women in the total number of the unemployed, large differences between labour markets in the region, large number of the people involved in the grey economy area, low mobility of the work force, large number of the hard-to-employ categories of people, etc. According to the Work force Poll, the rate of unemployment was 17.9% at the end of 2015, and it increased in comparison to the end of 2014, when it was 17.3%.

Adult education can be used in the function of improving the complete skills of entrepreneurs: improved comprehension of the need of further adult education development in the SMEs sector; devising the appropriate models and programmes in adult education with the aim of greater entrepreneurship internalisation and deficit decrease in trade exchange in the region; SMEs interest connection to the legislative structures of the state, local governments and institutions of education and science with the aim of the competition increase, coordination and good practice application, and similar measures continuously conducted in order to achieve long-term effects which influence development and increase in entrepreneurial culture.

Entrepreneurship can be the key factor for the desirable changes in Serbia, such as: work productivity growth, product and service quality increase, competition strengthening, better use of the capacities available, export increase, higher employment, public and foreign debt decrease, etc. In fact, only entrepreneurship can bring the desired dynamics into our economic life, regain the confidence for the population, prevent migration abroad, increase life quality for all people, and generally, set the new standards of social stratification based upon knowledge and productivity. Learning and knowledge can be best recognized in entrepreneurship as the true capital which can be quickly and legally reproduced.

Negative business results of the companies in the recent years also point to the need of the stronger and more comprehensive support for entrepreneurship and SMEs sector development. The problems of insolvency and high debts of the companies in all sectors of the economy are especially evident. Thus, according to the Business Registers Agency, we can see in table 1 that the large business companies have a share of ca  $\frac{1}{2}$  in the complete capacities of the economy (6,262,714 million dinars), and that the share of the fixed assets in the total business assets is as much as 70.45%, which is much more than the share of the fixed assets in the total assets of the small, medium and micro businesses (55.63%, 49.17% and 45.91% respectively). Of course, the situation is reversed in the case of the working assets share (supplies, claims, cash, short-term financial placement).

It all points out the fact that the SMEs sector has not, to the extent necessary, taken the position that the large companies had held earlier – the ones doing business with great difficulties (many undergoing the process of rehabilitation, bankruptcy or liquidation). The absence of the SMEs cluster or collaborative association and connection processes based on the SMEs examples from the developed countries is evident. On the other hand, the economic policy has favoured foreign investments through subsidizing, and that at the expense of the domestic investors.

Table 1: Business property structure according to the business entity size  
Millions of dinars

DESCRIPTION	Business entities according to size			
	Large	Medium	Small	Micro
A. Subscribed unpaid capital	836	2.031	4.559	15.394
B. Fixed assets	4.412.537	1.086.018	1.134.796	898.628
C. Deferred tax assets	26.036	7.286	7.974	2.249
D. Working assets	1.823.304	857.034	1.159.140	1.040.505
E. Total business assets	6.262.714	1.952.369	2.306.469	1.956.777

The source: Business Register Agency (2015), the statement on business economy in the Republic of Serbia in 2014.

## Financial performances of the SMEs sector

Survival, growth and development of the SMEE is mainly determined by the favourable source financing possibilities. The most important feature and the biggest problem of these companies is restricted access to financing sources in money and capital market, especially concerning the cost and terms of usage. In an effort to provide the necessary funds from the most favourable sources, the companies face the following dilemmas in the course of their life span: whether to finance investments and business development from their own or borrowed sources, how much capital to secure from the borrowed sources, whether to obtain the capital from the banks and other financial institutions in the securities market or by attracting formal or informal investors, what is the desirable structure of the company's capital. The number of the financing sources available for the SMEE is low, and they satisfy their need for capital much harder than the large business systems. Therefore, the management of SMEE financing is specific in many ways.

Also, that is why high rates of putting out of companies are one of the important features of SMEE. The uncertainty of survival is the price these companies pay due to their innovation and risky ventures orientation, as well as fast and dynamic growth. Under the conditions of high specialisation and insufficient business activity diversification, the lack of entrepreneurial skills, knowledge and experience, the strategy of wrong market niche focus or inaccessibility of adequate sources of finances all lead to the extinguishing of a business. The high rate of SMEs extinguishing has negative implications on the average resource usage and the employee work place security efficiency (Eric, D. et al, 2012).

SMEs vulnerability in crisis conditions is explained by the following characteristics (Centre for Entrepreneurship, 2009):



- SMEs have more difficulties in conducting the activities of restructuring or downsizing than the large companies because they are already small businesses;
- Low level of business activities diversification;
- Poor financial structure;
- Low or no credit rating;
- Dependence on credit as the basic external source of finances;
- Accessibility to lower number of alternative sources of finances;

Restricted access to favourable sources of financing is one of the most important limiting factors of SMEE growth and development. The possibility of capital acquisition is the key determinant of survival, growth and development of these companies. Relying on their own funds is a problem due to their limitations and impossibilities to satisfy the growing needs of the companies for capital, especially at the later stages of their life spans. Borrowed funds from various sources are far less available to the SMEs than the large business systems. The most common obstacles to bank credit usage are the lack of appropriate collaterals, non-existent paperwork on business ventures and enterprise, impossibility of presenting the project to the potential creditors in an adequate way, the unadjusted methodology for small project evaluation which makes the success evaluation process too expensive (Paunovic, B., Novkovic, N. , 2003).

Securing the necessary funds through private investment funds, risk capital funds and Business Angels are mainly reserved for innovative and high potential growth SMEs. Raising capital in the stock market through initial public offer of the stocks is also negligible because most of these companies are insufficiently attractive for investors.

Due to the lack of adequate personnel solutions in the area of financial management, in managing the economic policies, the small enterprise sector makes a series of mistakes. There is no understanding of the basic income parameters, especially which leverage points manage income, and the income themselves are set in too optimistic way. The time to create income at all is also underestimated. Many important expenditure items are underestimated in the projections, other expenses are overlooked, and that necessarily leads to liquidity problems. The necessary cash assets are not obtained very fast so there is a cash flow as a result, and the positive cash flow is the most important in the starting phases of the development, the profitability will come later. (Lucic, Lj., 2006)

The unfavourable business environment and the inert weaknesses of the SMEs sector have influenced the negative results of the business the sector accomplished in the previous period. Small enterprises are not able to improve the unfavourable financial structure so that the expenses are too much of a burden, and they prevent them from achieving better business results. The analysis of the basic indicators of the business shown in the table 2, point to the most favourable structure of capital and borrowed sources in the SMEs sector compared to the large business entities. Thus, for example, the share of the capital in the total liabilities (sources of funds) of the large companies is 51.86%, while it is much lower in the SMEs sector- 40.83%, medium-sized 41.18%, and only 35.72% in micro businesses. Also, there is an extremely high share of the short-term liabilities in the total sources of funding, so that it is 47.63% in medium-sized companies, 48.80% in the small ones, while it is entire 72.10% in micro businesses. All business entities, except the small ones, have done business with the negative net reversible capital, which implies a financial imbalance and problems in liabilities payments, that is, insolvency of the complete economy.

Table 2: Structure of the sources of financing, according to the business entity size  
Millions of dinars

DESCRIPTION	Business entities according to size			
	Large	Medium-sized	Small	Micro
A. Capital	3.248.413	797.174	949.830	698.993
B. Long-term reserve and liabilities	1.128.099	371.042	430.043	408.733
C. Deferred tax liabilities	139.863	13.988	6.921	2.718
D. Short-term liabilities	2.254.935	930.017	1.125.668	1.410.855
E. Loss in excess of capital	508.596	159.852	205.993	564.522
F. Total assets	6.262.714	1.952.369	2.306.469	1.956.777

The source: Business Registers Agency (2015), the statement on business economy in the Republic of Serbia in 2014.

From the data in table 3, we can see that the large business entities achieved 45.2% in the total share of income, and 45.5% of the total expenses of all business entities in 2014. Their business was mainly done in tradable sectors, and there is the highest individual part in sector C – manufacturing industry. Unlike large companies, small business entities mainly operated in nontradable sectors in 2014, and most of them in sector G – wholesale and retail trade. Among all the business entities, only the small enterprises achieved positive net financial result (18,845 in millions of dinars), while the other groups had a negative net financial result mostly due to the negative result in financing (high interest rates and negative foreign exchange rate differences).

Table 3: Income, expenditure and results structure, according to business entity size  
Millions of dinars

DESCRIPTION	Business entities according to size			
	Large	Medium-sized	Small	Micro
A. Total income	4.042.166	1.724.155	2.112.621	1.063.867
B. Total expenditure	4.103.225	1.733.613	2.079.584	1.109.441
I. Business result	183.129	61.938	107.549	17.337
II. Financing results	-121.476	-56.592	-62.245	-33.568
III Other activity results	-119.951	-14.088	-10.447	-29.083
IV. Net profit for discontinuing the business	562	540	482	1.157
V. Net loss from discontinuing the business	3.322	1.255	2.302	1.418
VI. Net financial result	-79.023	-18.966	18.845	-52.639

The source: Business Registers Agency (2015), the statement on business economy in the Republic of Serbia in 2014.

## Conclusion

SMEs represent the most efficient segment of the economy in almost all the countries in the world. Considered individually, these enterprises achieve the greatest contribution to employment increase, gross added value and turnover, so they are regarded as the backbone of growth and development in the national economies. Their

role is especially important for the countries in transition faced with the problem of high unemployment, low level of business activities, insufficient competition, lack of investments, and still with the presence of large, inefficient state companies. As a stable source of new work places creation, SMEE also achieve an important social function through the absorption of work force surplus resulting from the transition process as well as ownership transformation of state and public enterprises.

Business results of the SMEs sector and entrepreneurs in Serbia in the recent years are not very encouraging, partly because of the economic policy which gave primacy to the foreign investors, while the domestic investors were in the background. As the year 2016 was declared the year of entrepreneurship in Serbia, it can be expected that the SMEs sector development will finally get the place it deserves with the creators of the economic policy. The additional reason is the announced reduction of the number of employees in the public sector, on the request by the MMF and the World Bank, as a condition for further reform support in Serbia on behalf of these institutions. Besides business environment improvements in the state, it is necessary to introduce numerous measures of the internal character by the SMEs sector and entrepreneurship, beginning with the adoption of the quality standards, innovation application, new technologies, employees' competences, etc.

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