# Modest and Fragile Signs of SMEs Recovery in Serbia

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*Abstract: The world economic crisis stopped fast development of SMEs in Serbia and those economic subjects are still suffering. It seems that there are positive signs from 2012, as after few years of downturn business demography of companies is improving and became positive. Considering competitive level very positive signal is fast increasing export, especially high tech products and relatively good position in ICT use. At the same time less optimist position is regarding investments and costs competitiveness, which point importance of governmental support and financial support from banks. Entrepreneurs are aware that the crisis is of long lasting sort. They are ready to fight and ask government to dismantle obstacles and to improve overall business environmen*t.

*The aim of the paper is twofold: firstly, to examine the current situation, problems and limitations to SME development, and, secondly, to propose an adequate support policy mix.*

*Keywords: SMEE, crisis, business climate, support policy*

## 1 Introduction

Serbian economy is relatively low competitive. The main reason for its low competitiveness one can see in slow modernization process and slow restructuring. One of the key factors of competitiveness is investments, mainly investments into knowledge, education and technology. This also influences cost competitiveness and productivity. During the economic crisis overall recession included SMEs and market reforms lost their momentum. SMEE sector is usually seen as important economic agent, as more flexible than large companies,

especially during difficult times. Inventive entrepreneurs even during those years can recognize and use their chances on the market. Small and medium scale companies and shops have higher than average contribution to the national economic development, increase in employment, increase in foreign trade and access to the world market and its competitiveness. It seems that underdeveloped SMEE sector in Serbia did not use this opportunity to generate overall recovery. So, it is important to investigate dynamism of SME sector, its competitive level considering investments, costs, productivity, foreign trade achievements and use of information and communication technologies. It would be useful for tailoring adequate policy measures for support SME development.

# 2 Positive signs in Business demography of companies

Statistical data on business demography are structural indicators and useful tool for assessment of contemporary stage of entrepreneurial development, dynamism of new economic subjects and growth of small and medium scale enterprises and shops. As a consequence of Global economic crisis of prolonged lasting and worsening business conditions a number of new established companies and shops is decreasing and at the same time a number of closing economic subjects is increasing. There are some encouraging signals during recent period. It seems that 2012 was the brake point, as in 2013 a number of newly established companies increased for the first time after the crisis started. At the same time shops, as more vulnerable, still suffering, considering number of both: new established and closed shops, as one can see from table below. All in all, a number of economic subjects in 2013 was lower for 436 entities than the year before (5.847 companies more and 5.411 shops les). Net effect (the ratio between newly established and closed entities) was much better for companies than the year before (3,4 and 1,2 respectively) and not changed for shops (0,9 and 0,9, respectively).

| | **No of enterprises** | | **No of shops** | | **Net effect** | |
|---|---|---|---|---|---|---|
| | **opened** | **closed** | **opened** | **closed** | **companies** | **shops** |
| **2008** | 11.248 | 3.068 | 43.375 | 34.572 | 3,7 | 1,3 |
| **2010** | 9.461 | 9.325 | 35.036 | 37.086 | 1,0 | 0,9 |
| **2011** | 8.470 | 13.581 | 32.236 | 35.288 | 0,6 | 0,9 |
| **2012** | 8.648 | 7.355 | 30.200 | 32.853 | 1,2 | 0,9 |
| **2013** | 8.735 | 2.562 | 30.931 | 36.379 | 3,4 | 0,9 |

Table 1

Serbia - The number of newly established and closed SME
Source: RSO1, processed by MRDLSG2 - research

Better insight into trends of business demography is possible if one look at birth and death rate of enterprises and shops (number of newly established companies or shops compared to total number of companies or shops). It is clear that in the period 2007-2013 regarding companies after increasing trends for both birth rate and death rate during the first three years, there is strong decreasing trend in recent years. Regarding shops birth rate and death rate were rather stable during the period under consideration.

| | **Enterprises** | | **Sole traders** | | **Total** | |
|---|---|---|---|---|---|---|
| | **birth rate** | **death rate** | **birth rate** | **death rate** | **birth rate** | **death rate** |
| **2007** | 16,2 | 5,0 | 22,6 | 14,9 | 20,7 | 12,1 |
| **2009** | 11,3 | 4,1 | 17,4 | 16,1 | 15,7 | 12,7 |
| **2010** | 10,7 | 10,5 | 15,6 | 16,6 | 14,0 | 14,6 |
| **2011** | 9,3 | 15,0 | 14,1 | 15,4 | 12,7 | 15,3 |
| **2012** | 9,4 | 8,0 | 13,4 | 14,5 | 12,2 | 12,6 |
| **2013** | 7,9 | 2,3 | 14,5 | 17,1 | 12,3 | 12,0 |

Table 2
Serbia - Birth and death rate of enterprises and sole traders
Source: RSO, processed by MRDLSG - research

According to density of SMEs (number of SMEs on each 1.000 inhabitants) Serbia is on EU average (44,1 and 41,2 respectively- estimation for 2012), slightly less than Slovenia and Hungary (51,9 and 57,4, respectively) and higher than Bulgaria, Romania and Poland (42,4, 24,8 and 36.1, respectively) [1]. There is slight increase in total number of total SMEs on each 1.000 inhabitants over the period of crisis. However, if one envisages number of newly established SMEs than decreasing trend is clear, as can be seen from figure bellow.

[1] RSO – Republican Statistical Office
[2] MRDLSG – Ministry for Regional Development and Local Self - Government

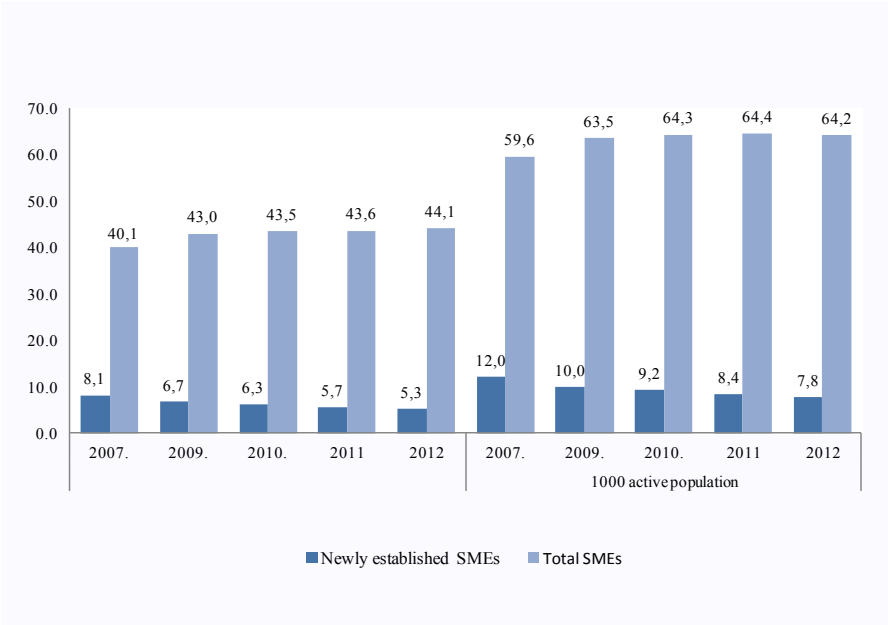


Figure 1
Density of SMEs and newly establsihed SMEs
Source: RSO, processed by MRDLSG - research

On the basis of number of newly esatblsihed SMEs in 2007 and 2012 one can conclude that 58% of new SMEs succed to survive in the first two years of business and continue. It is worth noting and uderstandable that rate of survival of new economic subjects was lower in 2012 than in comparison to 2007 and rate of survival is higher for companies (86,5%) than shops(50,3%).

# 3 Competitivenes of Serbian SMEs is still low

The competitive level of the Serbian SMEE sector is considerably lower than EU average and majority of similar countries, as can be seen from the analysis of business indicators. Qualitative indicators of the SME development level (employment per company, turnover, gross value added – GVA, profit per employee) are lower than EU average and majority of its members. Profitability rate is higher, but it is worth noting that firstly, it is rather result of low statistical basis, but not result of expansion or increasing business activities on the global market and secondly, during recent years it is product of decreasing number of employees and not of business expansion.

## 3.1 Investment competitiveness

Investments into new projects, fixed assets, technology and human resources are the most important factor of economic development. Total investments into fix assets in 2011 were 5,4 billion €, but they were less for 6,7% in real terms in comparison to the year earlier. More importantly, investments into large companies increased for 7%, while investments into SME decreased for 29%, as a consequence of drastic fall in investments into medium scale companies (for 60%) and micro companies, as well (for 29%). Decreasing trend in investments according to the technical structure also pointed problematic financial position of SME sector as a whole [2].

During the period of the crisis SME sector is faced with decreasing trend of investments in real terms, of which the main fall was in 2011. This trend is a consequence of biased approach of financial institutions toward large companies from the past period, low level of development of financial sector and not fully developed network of infrastructure which support SME development. If one compare investments level in 2011 and 2006 than can conclude that investments of entrepreneurs and small companies were lower in 2011than in 2006, for medium scale companies investments were at the same level as before and for micro companies were 76% higher than before the crisis started.

Additional insight into investment competiveness can be seen from data for investments per employee and ratio between investments and GVA. According to value of investments per employee there was a decreasing trend for all sorts of SME companies, but modest increase for entrepreneurs. According to the ratio investments: GVA, small companies invested the least (0,19%), medium scale companies low (0,24%) and entrepreneurs slightly higher (0,36%).

For Serbian SMEE is important to increase investments and investments efficiency, as well. The analysis of marginal coefficient of investments (value of investments compared to percentage increase in GVA) pointed the trend of decreasing efficiency during recent period compared to years prior to the crisis (see figure). Positive fact is that investments efficiency of SMEE is above average of non - financial sector (except small and micro companies). However, more important is trend of decreasing efficiency of investments (as marginal coefficient is higher and higher over years during the crisis).

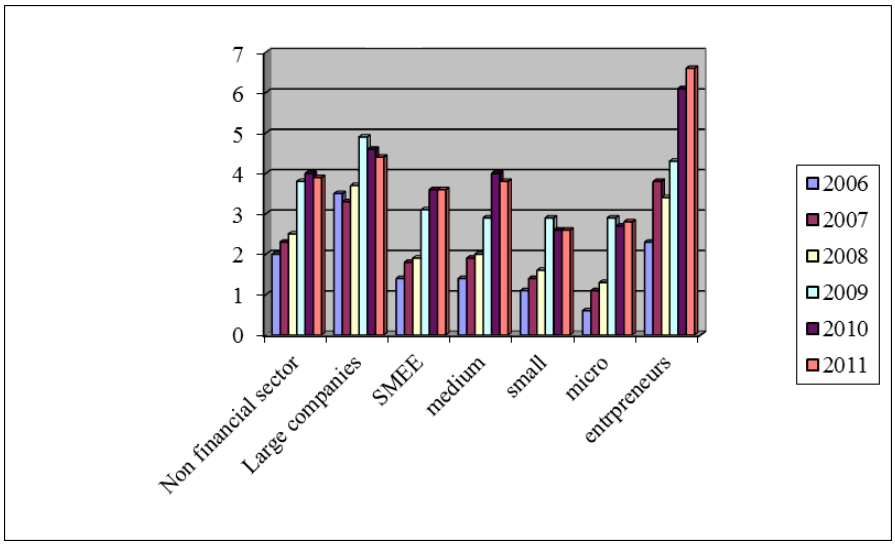


Figure 2
Serbia - Marginal coefficient of investments
Source: RSO, processed by MRDLSG - research

## 3.2 Cost competitiveness

After years of high increase in cost competitiveness Serbian SME faced with deterioration of main indicators of this sort of competitiveness, like labor cost, cost per hour, labor productivity and unit labor cost. During the period 2009-2012 business performances deteriorated more in SME sector than within large companies. Although labor productivity in 2012 was higher than in 2008 it is a result of decrease in employment and not result of higher busines activities. According to labor productivity micro and small companies were the least competitive (decrease -4,3% and -1,3% on average, respectivelly), as a consequence of decreased GVA.

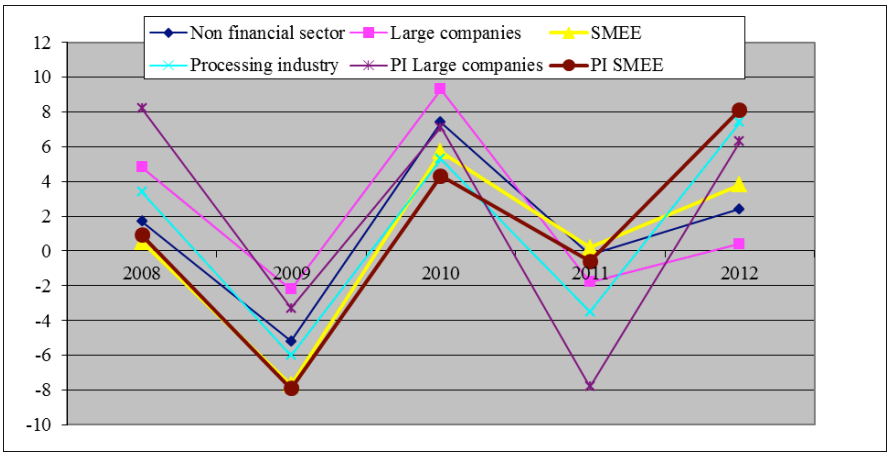


Figure 3
Serbia - Labor productivity growth rate

It is worth noting that contrubution of entreprenurs and micro companies to GVA increase was lower than their contribution to employment.In other words, there was a positive correlation between labor productivity and size of company (with increase in size of company there is an increase in labor productivity).

Unit labor cost (ratio between cost of wages and GVA) is a very important indicator of competitiveness. Unit labor costs were lower in 2012 in comparison to the previous year (62,7% and 63,9%, respectivelly), but still were very high, especially compared to other transitory economies. As can be seen from the table during the period of the crisis among EU countries Romania and Bulgaria only vittnessed increasing unit labor costs.

| | SMEE | | | Large | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2008 | 2011 | 2012 | 2008 | 2011 | 2012 | 2008 | 2011 | 2012 |
| **EU27** | **45,1** | **47,8** | **47,6** | **48,8** | **54,2** | **54,1** | **46,7** | **50,5** | **50,3** |
| Bulgaria | 27,5 | 26,1 | 26,6 | 27,8 | 28,6 | 29,1 | 27,6 | 27,1 | 27,6 |
| Hungary | 52,1 | 55,9 | 55,4 | 42,9 | 46,7 | 47,4 | 47,8 | 51,7 | 51,7 |
| Romania | 57,3 | 66,2 | 66,8 | 53,1 | 43,1 | 43,4 | 55,3 | 53,7 | 54,3 |
| Slovenia | 54,1 | 62,8 | 62,3 | 62,3 | 60,5 | 66,1 | 56,5 | 64 | 63,6 |
| **Serbia** | **61,9** | **63,9** | **62,7** | **61,4** | **57,1** | **56,6** | **61,7** | **60,8** | **60** |

Table 3
Unit Labor Costs (%)
Source: [2]

## 3.3 Export competitiveness

Foreign trade is among bright points of the national economy during the crisis. In 2012 total foreign trade volume was higher 9,5% in comparison to the year earlier, mainly due to the increase in foreign trade of SMEs (increase 17%). After 2009 in which both export and import volume felt, export volume of SMEs was increasing constantly, while import increased modestly (increased considerably in 2012, only) and still is below its volume in 2007. Foreign trade deficit was in meantime narrowed very much (32%), as a result. One has to bear in mind that the national economy faced with problem of lower demand in EU countries when the crisis started and recovery in developed economies induced positive trend in foreign trade.

Better insight into export competitiveness over years can be seen from several indicators like: foreign trade balance, percentage of import covered by export value, the share of exporters (importers) in total number of business entities, the share of export in total turnover and export (import) value per employee. The best export performances in 2012 generated medium scale companies (export growth 18.5%, export per employee growth of 22,8%, the share of export in total turnover increased for 2,2 percentage points and reached 14,3%).

The main problem of Serbian foreign trade came from process of deindustrialization of the economy [3] and low technological level of export products. On the one hand deindustrialization influenced that Serbia has a fewer tradables for exports and on the other that those export products are mainly of the low technological level: agricultural products, raw materials and semi products are prevailed. Processing industry generated foreign trade suficit during the crisis, which in 2012 was 4,1% of total foreign trade value, but this suficit was based on the suficit of low and medium technological level products, mainly. At the same time foreign trade deficit in high tech level products, although decreasing, is still high (26,8% of the total foreign trade value).

Not surprisingly, the SME sector has been better adapted to deteriorating economic conditions from 2009 on compared to large companies, according to the coefficient of structural change of export[3]. Big companies, not being flexible enough, could not adapt easily to worsening economic conditions and their export

[3]The coefficient of restructuring of export is based on the Finger – Kreinin index of structural similarities, which is used for structural comparisons of International trade. The coefficient is calculated as a sum of the minimum pairs of the same type of export products according to SITC in 2010 and 2011. A lower value of the coefficient suggests faster changes, and the maximal value of 1 denotes identical export structures in years of reference.
FC index = ∑min (Xij, Mik), where FC is coefficient of structural similarities, Xij – share of product "i" in total export/import of the country "j", and Mik – share of product "k" in total export/import of the country "k". [4]

dropped by 23% in 2009, while their coefficient of export restructuring was high (0.82). They recovered when overall recovery manifested as an increasing export demand (in the EU) took place, with their coefficient of export restructuring improving in 2011 and 2012(0.71 and 0,75 respectively). It was mainly due to recovery of automobile industry and increase in export volume of those large companies. At the same time, as it has been explained earlier, micro and small companies adapted quickly, but medium-sized companies trailed, producing adverse effects for the whole SME sector. During the new recession tide in 2011 micro companies again managed to adapt quickly at a lower coefficient of export restructuring than other companies in this segment of companies (micro 0.80, small 0.87, and medium-sized companies 0.83).

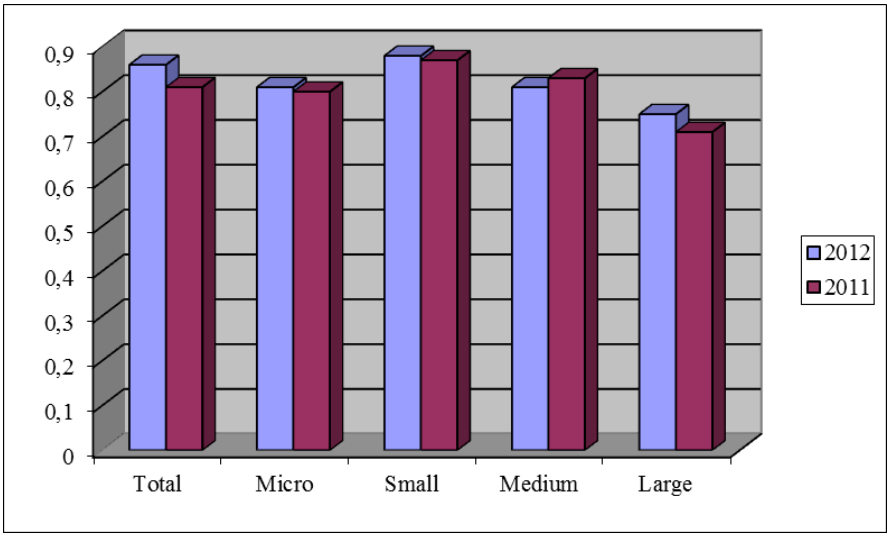


Figure 4
Serbia – Coefficient of restructuring

A more significant economic growth and increase in employment in a long term is possible only with a significant growth of export with parallel decrease in foreign trade deficit. In order to achieve better and sustainable export competitiveness of Serbian products it is necessary to change the structure of export (now widely based on export of metal, steel, raw materials, food) and have more complex products with high level of finalization and high value added per unit. Such a radical change in export structure is only possible with significant local and foreign investments in companies that base theirs business on high technologies, knowledge and innovation.

## 3.4 Use of Information and Communication Technologies (ICT)

Information and communication technologies (ICT) and Internet are the main infrastructure for development of knowledge based society and sustainable development. Development of Internet and ICT produce creation of knowledge based technologies, products and services, development of a new industries, new sort of companies and transformation of traditional industries and development of global competitiveness. Massive use of ICT changed the main factor of competitiveness toward knowledge, innovation and information.

It is encouraging fact that Serbian SMEs use personal computers (PCs) in business more than five EU countries in the Region - on average (Bulgaria, Croatia, Hungary, Romania and Slovenia). Among SMEs medium companies use PCs more than small companies.

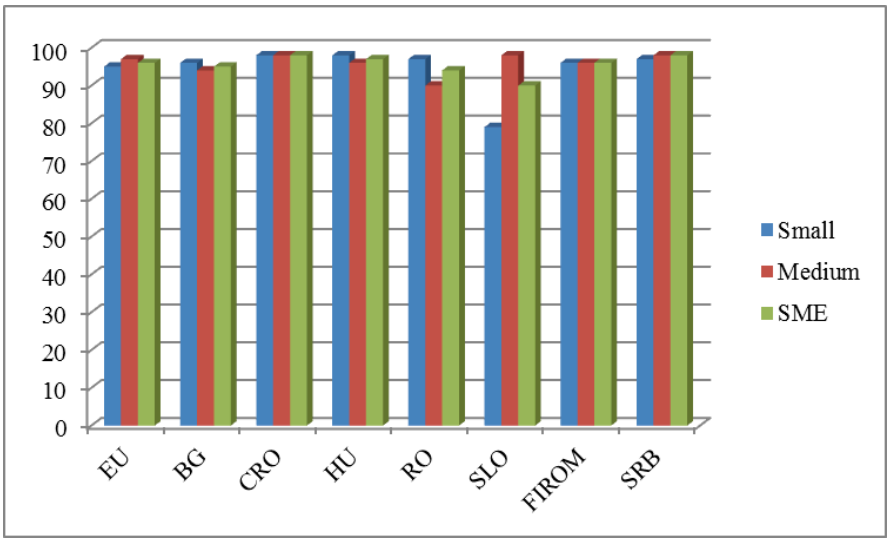


Figure 5
Use of PCs within SME 2012 (%)
Source: RSO, EUROSTAT

According to use of Internet Serbian SMEs are near but below EU average and comparing to other countries within the Region leg behind Slovenia and Croatia, only. Among SMEs medium companies are the best. If one look at sort of Internet access than Serbian companies use DLS mainly (77%), as less sophisticated and slower sort of connection. According to this indicator Serbia is better than Romania, Bulgaria and Hungary, but worse than Slovenia, Croatia and FIROM. Cable Internet connection use 25% of Serbia SMEs (46% medium scale companies and 26% small companies), which is at the EU level, but worse than other countries within the Region. The highest technological connection, like

broadband 3G network use only 19% of Serbian SMEs (27% of medium scale companies and 12% of small companies) and according to this indicator Serbia is well behind economies considered [2].

| | % of companies received WEB orders | | | % of companies received SMS orders | | |
|---|---|---|---|---|---|---|
| | Small | Medium | SME | Small | Medium | SME |
| EU | 12 | 17 | 15 | 5 | 12 | 9 |
| BG | 6 | 6 | 6 | 1 | 4 | 3 |
| CRO | 25 | 26 | 26 | 7 | 11 | 9 |
| HU | 9 | 10 | 10 | 2 | 7 | 5 |
| RO | 4 | 6 | 5 | 2 | 3 | 3 |
| SLO | 12 | 14 | 13 | 3 | 8 | 6 |
| FIROM | 5 | 5 | 5 | 1 | 2 | 2 |
| SRB | 18 | 28 | 23 | 2 | 6 | 4 |

Table 4
E - trade development
Source: RSO, EUROSTAT

Low level of use high quality internet connection, general low ICT knowledge of inhabitants and not finished legal framework for its use have negative influence to companies for wide use of Internet business services, like e - business, e - trade, e-payment, b2b connection, e – government, e – marketing, use of web cite etc. It is important negative factor for competitiveness and innovation capabilities of SMEs.

E - Trade is among the most important and popular internet services and valuable indicator of overall ICT development of the national economy. According to the share of orders received by use of internet – web sites in comparison to total number of orders Serbia is well positioned, as 23% of total orders Serbian SMEs get throw web sites, which is higher than EU average (15%) and economies in the Region (except Croatia). According to this indicator medium scale companies are more advanced than small companies (28% of orders and 18% of total orders, respectively), unlike situation in EU where small companies are more advanced in ICT use. It is important to note that the main obstacle for development of e – trade

in Serbia until recently (until 2013) was the lack of e – payment[4]. So, e – trade is realized through traditional methods of payments until recently. Orders can be obtained by Internet and SMS messages as well. However, according to this sort of orders Serbia leg behind EU average and advanced transitory economies from the Region (Croatia, Slovenia and Hungary).

# 4 The Investigation on development level, needs and problems of SMEES

The media Gallup conducted a regular investigation on development level, needs and problems of Serbian SMEEs for the National Agency for Regional Development. Interesting, useful and above all not optimistic results has been obtained [6].

As can be seen from the Figure 5 the most entrepreneurs and companies plan not to expand their business (53%) and one third plan to expand activities. From dynamic point of view one has to recognise pessimism within entrepreneurs, as more and more over the period under investigation plan not to expand business and less and less plan expansion. The closer insight pointed that the most optimistic were medium scale companies and the least were entrepreneurs.

[4] Practicing of tax evasion, generally and among SMEs, is possible additional factor and explanation. Namely, so - called shadow economy is assessed as 21-30% of the legal one, during the last three years [5].

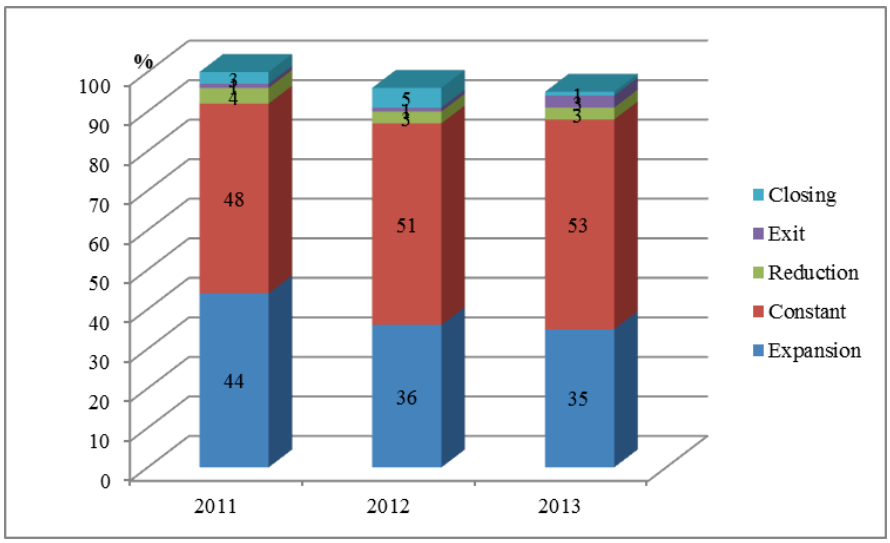


Figure 6
Business plans of SMEEs
Source: [6]

Considering business problems SMEs saw bad payment collection is the most serious problem (40% of SMEs pointed), than financial problems, precisely access to financial sources and financial stability and competitiveness on the global market and demand for their products and services. In order to make business successful entrepreneurs saw that it is primarily necessary to improve the financial aspects of business (57%), and then payment collection (53%). According to those problems the most affected seem are micro and small companies as the most fragile.

Factors affecting business success were estimated, as well. Entrepreneurs saw the state support, from all level: from government to municipal, as the most important (53%). There is a common feeling that the main reason is weakening of state support over the years of economic crisis, instead stronger support to SMEs in order to offset increasing business problems. The second important factor is support from financial institutions (36%), and from local environment (29%).

The biggest dissatisfaction in SMEE sector is related to tax regulation and procedures (52%), than with work and inspection bodies and problems regarding business registration is seen as the third (26%). Unfortunately, before the global crisis has started Serbia was labelled as one of the leader in market reforms, but after few years it considerably has worsened its place on the world list of places with business friendly environment.

World economic crisis still has negative impact on the scope of business of the majority of SMEs, but it still does not require layoff (43%). It has no effect on one

of four enterprises, whereas it has a negative impact on 30% of enterprises. So, they are forced to decrease their number of employees or their survival is under question mark.

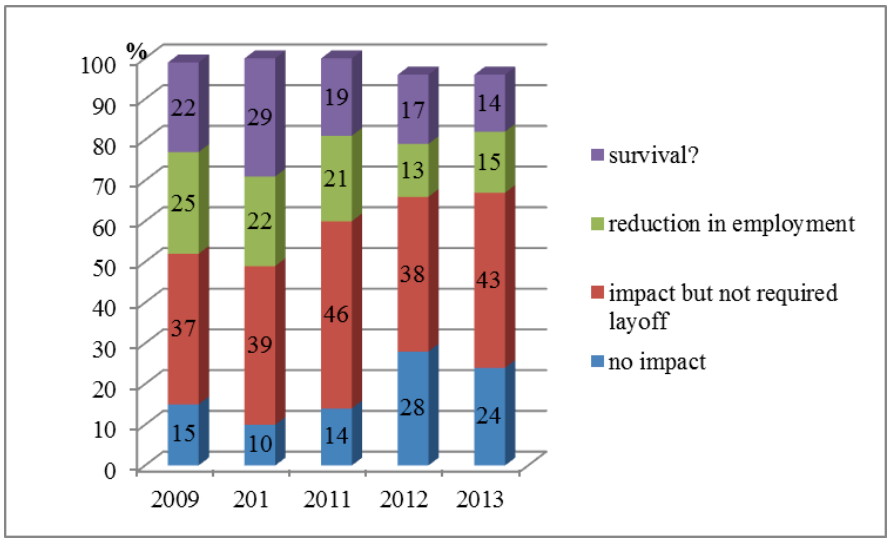


Figure 7
Impact of the world economic crisis
Source: [6]

# Conclusion

In Serbia the SMEs sector still represent great potential for overall development. It means that it is neither high developed, nor self - sustainable, but rather need governmental and support from financial institutions and municipalities. During the years of the crisis overall economic dynamism witnessed oscillations and SMEs, as well.

New recovery within EU countries positively influenced Serbian SMEs. It seems that the brake point was in 2012 and from this year on business demography became more optimistic, covering companies only and not shops, as more fragile.

In order to investigate level of competitiveness of SMEs on the world market several aspects were took into consideration. Investments were considerably hampered during the recent years, especially into medium scale companies. Investments were affected by weak financial situation of companies and shops, adverse position of banks toward SMEs and weaker governmental support than before. Cost competitiveness is on the low level comparing to other transitory countries. Growth in productivity during the crisis period was unfortunately the

result of lower employment and not of business expansion. There is more optimism in foreign trade, as export is increasing fast and faster than import volume and, what is more important, export of high tech products, like automobile. Considering ICT use Serbia is well positioned and some legal and infrastructure improvement can help considerably to overall development.

The regular investigation of entrepreneurial needs and problems pointed several interesting results. There is common feeling that long lasting crisis produced result that entrepreneurs are more realistic than before, but still ready to fight. They are expecting help from the state and financial institutions, considering them as vital for improvement of overall business climate.

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