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EVALUATION OF SME DEVELOPMENT IN SERBIA

The purpose of this paper is to explore the private sector and SMEs development in Serbia, as well as to identify their obstacles and opportunities. The paper includes the analysis of various aspects of private sector development: the obstacles to the development and the role of private sector in revitalizing Serbia's economy during the last decade. The author also explains some factors which must be taken into account when considering policies for the development of private sector in Serbia and possible routes forward.

Keywords: SME, private sector, business environment, obstacles, opportunities, Serbia.

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ОЦІНКА РОЗВИТКУ МСП У СЕРБІЇ

У статті вивчено розвиток приватних малих і середніх підприємств в Сербії, визначено перешкоди для їх розвитку і можливості зростання. Проаналізовано різні аспекти розвитку приватного сектору: перешкоди для розвитку і роль приватного сектору в поживленні економіки Сербії протягом останнього десятиліття. Пояснено деякі з факторів, які мають бути взяті до уваги при розгляді політики розвитку приватного сектору в Сербії.

Ключові слова: МСП, приватний сектор, бізнес-середовище, перешкоди, можливості, Сербія.

Таб. 2. Літ. 31.

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ОЦЕНКА РАЗВИТИЯ МСП В СЕРБИИ

В статье изучено развитие частных малых и средних предприятий в Сербии, определены препятствия для их развития и возможности роста. Проанализированы различные аспекты развития частного сектора: препятствия на пути развития и роль частного сектора в оживлении экономики Сербии в течение последнего десятилетия. Объяснены некоторые из факторов, которые должны быть приняты во внимание при рассмотрении политики развития частного сектора в Сербии.

Ключевые слова: МСП, частный сектор, бизнес-среда, препятствия, возможности, Сербия.

1. Introduction. In any market economy SME is the primary driver of economic development and employment. Researchers agree that SMEs are crucial contributors to job creation and economic growth in both high and low-income countries. Consequently, this statement can apply to Serbia where the appearance of the SME sector has been largely linked to privatization and the break-up of large state-owned enterprises. Namely, during the last decade Serbia has recognised that the SME sector is of key importance for economic development. In line with this, Serbia has followed the EU trend in developing this sector.

Since 2001, the transition period in Serbia has been accompanied by a series of policy adjustments and an increased urgency to realign its economic policies to adapt to new economic order. The reforms have been carried out by the government to sup-

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port their development as well as many other measures to improve the business environment in Serbia. Due to the implemented government reform program to support SMEs, a lot of indicators characterizing this sector improved during the period. Despite certain improvements, however, the SME development has not had such a favourable trend, nor has it resulted in improving entrepreneurship activities in a desired manner, due to a negative macroeconomic environment in the country and the recession that hit the national economy (beginning in 2008). Namely, the private sector failed to perform its role as regards absorbing the unemployed workforce that was left redundant as a result of privatization of state-owned companies. Furthermore, no satisfactory results have been achieved as regards new employment, nor is there any increased interest among the unemployed in trying their chances in the private sector. In order that a more complete and detailed assessment of the trends in the development of the private sector in Serbia be made, this work will primarily focus on the analysis of the macroeconomic environment, the changes in business demography in the period under consideration, the restraints in SME development and the characteristics of business environment.

2. Literature overview. The academic literature contains a number of approaches to private sector development, each revealing important aspects of it. Namely, the scientific literature has varied in its scope, methods of analysis and interpretation. In line with this, two basic sources of economic growth through entrepreneurship can be distinguished in literature, e.g. major established firms, and an entrepreneurial process taking place in new and growing enterprises (early-stage entrepreneurship), (Reynolds et al., 2002). Ayyagari et al. (2006) analysed the firm-level survey data for 80 countries to test which elements of business environment are the most constraining for enterprise growth. They found that the lack of financing, street crime, and political instability directly affect the growth rate of firms, whereas taxes and regulations have no significant effect. The World Bank study states that rather than directly subsidising SMEs and aiming at a large number of small enterprises, policy-makers should focus on creating a business environment that allows easy entry and exit for firms and assures entrepreneurs and financiers that property rights and contracts will be enforced (Beck and Demirguc-Kunt, 2004). In addition, The World Bank's "Doing Business Report" (2005) has made an important contribution to breaking down regulatory burdens into more operational categories. In fact, empirical evidence suggests that a less bureaucratic business environment fosters economic growth (Altenburg and Drachenfels, 2006).

According to Cooper (1981), the decision to start an enterprise in the private sector seems to be influenced by 3 major factors: (a) entrepreneurs' background, including different aspects that impact their motivations and perceptions, such as in their knowledge and skills; (b) the nature of the organization they have previously worked in, which influences the location, nature and the paths of new enterprises; and (c) the factors that generate a climate more or less favourable for founding a new enterprise. Radovic-Markovic and Avolio (2012c) stressed that the entrepreneurs' background includes psychological characteristics (the need for achievement and the conviction that they can control their own destinies), several family aspects (father or some close relative is owner of his/her own enterprise, the type of education received, and professional experience). They also pointed out in their research that the factors

that generate a climate more or less favourable for formation of new enterprises include the availability of risk capital, economic conditions and business environment, another entrepreneur who acts as a model or advisor, the availability of personnel and support services and access to customers. Survival analysis is commonly used in the economics literature to analyse the determinants of firms failure (Helmets and Rogers, 2008). Audretsch (1991), who analyzed firm survival at the industry level, did include a variable on innovation. He found that survival rates could be higher in more innovative industries. Furthermore, many researchers used patents as an indicator of innovation. As such, patents have been found to be positively correlated with firms' productivity and market value (Bloom and Van Reenen, 2002, Klette and Kortum, 2004). Thus, firms with a larger number of patents should be expected to be more innovative and, therefore, have a competitive advantage (Helmets and Rogers, 2008). The number of authors who analysed firms survival found them to be in close connection with universities. According to their research, all firms connected with universities have a lower hazard rate than other firms (Helmets and Rogers, 2008). Hence, a better relationship between an education institution and an entrepreneurial activity can contribute to fast information exchange, better access to the most recent knowledge and experiences in this domain and save time and money (Radovic-Markovic, 2010 a). In addition, Radovic-Markovic (2012a) pointed out that the amount of entrepreneurial activity and willingness to take risks are closely related to a host of possibilities for making profit.

3. Privatization process. A set of privatisation laws has been implemented in two phases and enacted in 2001 to ensure the completion of the privatisation of all companies in social ownership by 2010.

In the privatization of companies Serbia implemented the joint venture model, the so-called "flexible model". This model promotes privatisation through strategic partnership and aims to provide new investments, modernization, employment and exports growth. In that context, the completion of the privatisation of large systems in all economic spheres and a more intensive inclusion of SMEs are expected to contribute to the advances in the private sector with all the positive effects in the improvement of competitiveness, innovation and export performance of Serbian economy (Radovic-Markovic and Char, 2010).

However, due to the impact of various factors, the privatisation of the remaining public companies and the public sector is constantly delayed. Despite certain delays, however, the privatization process in Serbia planned to be completed by 2012 has already been so. From 2002 till 2009, 2333 companies were sold (Table 1). In 2010, only 32 companies were sold, whereas in 2009 3 times as many companies were sold (97). The privatized companies increased their incomes by 69% in the period under consideration, whereas the income of unprivatized companies remained on the same level. Characteristic of the observed period was a gradual decrease in the number of cancelled privatizations. Also, the income per capita increased 4.3 times in privatized companies.

Table 1. Privatization Process Results in Serbia, 2002-2009

	2002	2003	2004	2005	2006	2007	2008	2009	Total
No. of sold companies	212	637	236	305	269	309	268	97	2 333
No. of employees in sold companies, in thousands	37.5	76.8	39.3	58.7	45.3	45.9	23.2	8.7	335.5
Sales price (in EUR mil)	319.3	839.8	154.7	375.4	266.8	403.8	264.8	80.9	2 705.5
Total investments (in EUR mil)	320.2	319.8	100.0	101.1	294.1	124.9	65.7	43.0	1 368.8
Social programme (in EUR mil)	145.8	128.3	2.6	0.1	0.0	0.0	0.0	0.0	276.7

Source: Bulletin of Public Finances of the Republic of Serbia.

According to the data obtained from the Autonomous Trade Union of Subotica, the sales in 2010 brought 17.4 mln euros and 714 mln dinars. The income earned from the sales of the Equity fund shares in 58 companies amounted to EUR 5.6 mln. In 2010, the entire property of 32 companies in bankruptcy was sold, as well as sections of 77 companies. It was in this way that the sum of 1.76 bln dinars was collected (Autonomous Trade Union of Subotica, 2010).

The privatization process was accompanied by numerous reforms conducted by the state. Namely, since 2001, the transition period in Serbia has been accompanied by a number of policy adjustments and an increased urgency to realign their economic policies to adapt to the new economic order. Serbian reform program referred to, among others, reviving economic growth through re-orientation of the country from a public sector-led economy towards an increased private sector participation. In line with this, Serbia has followed the EU trend by developing the SME sector in order to reduce the lag in the development of the private sector in comparison to the EU member states. Many claim that it is only in privatized firms that the number of employees has fallen in the last decade or so, however, the data disclosed by the Privatization Agency show the opposite. Namely, the number of employees has fallen simultaneously in both privatized and not privatized firms in the period under consideration. In 2002, privatized firms employed 28% of the entire employed population; this percentage was considerably lower in 2010, and amounted to merely 11%. At the end of 2011 there were 537 privatized firms in Serbia (Privatization Agency, 2011). The privatization of national economy has not resulted in significant changes in its structure, primarily due to negative effects of the global crisis that largely devaluated the effects of ownership transformation. The analysis of the privatization in Serbia leads to a conclusion that it has not resulted into the expected economic growth on the basis of business efficiency improvement, but rather in a specific redistribution of income and economic power (AKTER, 2011).

Structural reforms have been more successful, as privatisation and enterprise restructuring have led to a significant increase in the share of employment in private enterprises.

4. Major obstacles to entrepreneurship development in Serbia. It is very difficult to carry out entrepreneurial activities in Serbia. The reason lies in numerous obstacles and limitations, whose effects are extremely discouraging when it comes to meeting these expectations of SMEs. Here we will analyse only a number of obstacles to

the development of the private sector and of entrepreneurship, the most important ones in our opinion, regardless how they are ranked by the World Economic Forum.

A. Corruption: The first line of obstacles to doing business refers to corruption. Namely, corruption continues to be a worrisome obstacle for private sector development in Serbia. Namely, the citizens of Serbia perceive corruption to be a major problem: the results presented in UNODC report (2011) show that they rank corruption as the most important problem their country faces after unemployment and poverty/low standard of living. According to the research conducted by the USAID in 2011, firms ranked corruption mainly as an issue of personal relationships rather than direct offer of bribe. Almost 90% of the respondents reported they had never been in a situation to be set an inappropriate financial requirement by a state servant, whereas 70% reported they had never given a state servant anything of value, not even a tiny present. More than 50% of the respondents, however, claim they did pull personal connections to accomplish one business or another (USAID, 2011).

Despite the fact that Serbia introduced important anti-corruption legislation by adopting the Law on Prevention of Conflict of Interests in performing Public Functions (2004), the Law on Corporate Liability for Criminal Acts (2008) and the most recent Law on the Agency for the Fight against Corruption (2010), Serbia's corruption rank continued to rise in 2011 (Table 2).

The fight against corruption remains one of the key challenges in the coming period while the performance of Serbian government will be measured against the progress it has made in achieving good governance objectives (Radovic-Markovic and Char 2010).

The second line refers to a discouraging fiscal and administrative framework for the development of entrepreneurial activities. Although in its Strategy of Development of Small and Medium Enterprises (SMEs) by 2013 Serbian government predicted a reduction in administrative costs by at least 25% by 2011, just the opposite happened. Serbian entrepreneurs pay 3 times more taxes than most European countries and those in the region.

Table 2. Corruption Perceptions Index (2008- 2011)²

Country	Rank				Score			
	2008	2009	2010	2011	2008	2009	2010	2011
Serbia	85	83	78	86	3.4	3.4	3.5	3.3

Source: Transparency International, Corruption Perceptions Index (2008, 2009, 2010 and 2011).

B. Inadequately educated workforce. Any country pretending to have a dynamic economy has to permanently work on improving the competences of its workforce. Serbian work force is slow to adjust to the changing economic situation. As a result, the demand for skilled employees is increasing faster than the supply (Radovic Markovic, 2010a). The skill gap can easily explain this statement due to inflexible labour market and missing programmes for specific knowledge and skills. To solve this problem, career counselling and identification of competences and qualifications for

² The Corruption Perceptions Index ranks countries/territories based on how corrupt their public sector is perceived to be. A country/territory's score indicates the perceived level of public sector corruption on a scale of 0 - 10, where 0 means that a country is perceived as highly corrupt and 10 means that a country is perceived as very clean (Transparency International)

an active employment policy should be targeted (Radovic Markovic, 2010b). Besides, there is no synergy between scientific and educational institutions and the environment. Therefore, the modern business environment should be accompanied by a change in educational environment. Consequently, permanent adjustments between these two environments should be made that will be beneficial for both individuals and the society (Radovic Markovic, 2012b). This is corroborated by the experts of the Center for Development of Entrepreneurial Society (2010), "weak connection of universities and research and development institutions with the businesses has resulted in insufficient and limited flow of knowledge and know-how, lack of application of scientific and technological research to increase the level of innovation (in the areas of products, production, design, marketing) and modernising technical and technological process of production. It has not been in the function of enhancing the competitiveness of the economy".

Our research shows that the existing education system in Serbia (Radovic-Markovic, M. 2012d) should be redefined and so should educational programs for entrepreneurship. They have to obtain multidimensional relationships between course concepts and community based on entrepreneurship experiences. Hence, creative and interactive education should provide a completely new dimension of gaining knowledge. This active mode of learning allows for the development of innovative personality who creates something unique and turns it into entrepreneurial activity.

C. Access to finance. SME financing has become an important banking market segment in Serbia. In the times of economic crisis, transition economies are facing numerous challenges at financial markets, thus searching for the most appropriate model to regulate financial sectors. There are only two indicators available to Serbia in this area, neither of which actually measures access to finance and private capital for SMEs. According to the European Commission (2011), it seems that the creditors in Serbia enjoy a higher degree of protection through collateral and bankruptcy laws than in the EU on average, which should generally facilitate lending. At the same time, the indicator measuring the reliability and coverage of public and private credit bureaus which is an important element of a stable financial market is also slightly above the EU average.

According to a large number of experts, private sector in Serbia and the method of its financing reveal numerous specificities. Primarily, the sources of financing in this sector are limited to a significant degree. Possible financial sources in the Republic of Serbia are loans granted by commercial banks, leasing companies, factoring, microcredit organizations and capital market - corporate bonds, share issuing. The type of financing per life cycle phases is determined by the existing conditions in the region. Consequently, in the conditions of expansion and growth, investors become interested in investing their money into small and medium-sized enterprises. In the conditions of recession and crisis, however, when aggregate demand declines, small and medium-sized enterprises lose working capital at a fast pace and their solvency is endangered sooner than that of the solvency of large companies. In such circumstances, banks lose their interest in investing into SMEs, unless the state grants some kind of subsidized loans. Hence, it is in the conditions of crisis that specific models of financial support to small and medium-sized enterprises emerge, such as business angels or their network. The notion of business angels is absolutely unknown

to as many as 39% of the respondents, 24% of them is generally not familiar with it, partly familiar are 20%, whereas only 2% are completely familiar with the notion in Serbia (Eric et al., 2012). It should be particularly stressed here that today's business angels are no philanthropists, they are mainly profit-oriented when investing into SMEs. All the above-mentioned sources of SME financing call for entrepreneurs to rethink their choices and make their optimum mix. This mix means combining own and external financial sources to ensure the achievement of optimum outputs as regards solvency, economy and profitability of firm financing.

D. Informal economy. The entrepreneurial sector of the economy of the Republic of Serbia is facing a real problem called informal economy. Serbia has a large informal sector estimated at 20.6% of GDP in 2010, while in the same year its share in the EU is on average 15% of GDP (Radovic-Markovic, 2010 c). It is fuelled in Serbia by a weak regulatory framework, inappropriate tax and expenditure policies, and weaknesses of law enforcement, including the fight against corruption. It remains an important challenge as it reduces the efficiency of economic policies.

Women are most represented in the structure of informal employment - specifically, those women who have remained outside the process of work. They worked mainly in those industries which are least profitable, or have worked in the informal (residual sector). Often a modest family budget does not give the ability to start their own business with its own funds or savings, which most women use to start new businesses. Also, there was no help from society, nor any special purpose loans provided, reflecting the inability of women to reach their undoubtedly entrepreneurial and managerial potential. Therefore, most of them are engaged in marginal jobs in the informal economy or working in some places in the state or socially-owned companies and they aren't in leadership positions (Radovic Markovic, 2009c).

E. Inadequate activities of institutions. Institutions in Serbia failed to adequately prepare a favourable environment so that they pass the Act on small business in the future period. According to the research conducted by the members of the Forum of the SMEs of the Chamber of Commerce of Serbia, the attitudes on the conditions for a successful management of small and medium enterprises correlate with the necessity to pass the Act on small business as well as with conceptual and technical skills of management. This is of specific importance in today's circumstances when management is faced with a new formula by which the competitive success is based on doing more jobs with less resources. Managers of small and medium enterprises and entrepreneurs will have to go through a period of vigorous activity to preserve their businesses in current conditions and to institutionally and unanimously lobby changes of legislation.

5. Opportunities of entrepreneurship development in Serbia. The macroeconomic framework for the 2012-2016 period is focused upon a radical improvement of the business milieu in Serbia that primarily strives to reduce the public expenditure to the level known in the countries on a similar level of development, i.e., with a 35% share in the GDP (Chamber of Commerce of the Republic of Serbia, 2012). Similarly, it is very important to determine the size of administration and its financing that is acceptable if a desired level of development is to be achieved. A large and too expensive administration hinders many and contributes to their failure, hence this issue must by no means be neglected by our political and economic elites. Given that the

climate for setting up and development of SMEs is not really favourable yet, it is necessary that all the indicators that contribute to this end should be improved (the lowest ranked among which are the issuance of construction permits and enforcement of court orders). Namely, reducing these obstacles is an essential step towards the development of private sector in general, which represents the main objective for all policymakers and practitioners intent on enhancing the business climate in Serbia. This is by no means an easy job, especially not in the conditions of recession that hits Serbia too. Consequently, it is hard to expect that the SME sector will be the driver of economic growth and increase in employment unless the state starts resolving their crucial problems in a more determined manner. The action is needed now and the results can be seen only in the long run. There is a number of incentive programs and policies for the development of SMEs and entrepreneurship as well as national and foreign programs of support for the development of SMEs and entrepreneurship. There is a number of government-sponsored programs aiming to stimulate and finance SME development; some have been institutionalized, such as the Development Fund and the Guarantee Fund. Still, a more systematic assessment of the impact of government-sponsored programs would be useful. The point is that such programs have to be better focused (Radovic-Markovic and Char, 2010).

At the beginning of March 2012, Italy granted the second tranche of loans for small and medium enterprises and utility companies in Serbia, the amount of EUR 30 mln in total, under rather favourable conditions. Namely, the loan was approved for the period of 8 years, with an effective interest rate (EKS) of 4.85%. These are the so-called "tied loans", since as much as 70% of the total sum is "tied for the purchase of equipment and goods of Italian origin", whereas the remaining 30% is to be spent on paying local costs such as procurement of equipment, raw materials, services (Radovic-Markovic, 2012a).

The European Bank for Reconstruction and Development (EBRD) has acted as the biggest investor in Serbian economy since 2001, with an investment of EUR 3.3 bln in total. The EBRD also deals with the private sector, hence 65% of the assets are placed into loans for the small and medium enterprise development. The Bank is engaged in 3 ways: it grants loans to a private entity, it becomes a shareholder with 5-10% shares for 3 to 5 years in a firm that is being set up or developed, and then it abandons ownership, while the third aspect of activities is the issuing of collaterals for loans from private banks. The EBRD perceives the economic potential of Serbia as the basis for the development of the entire region, with 3 strategic priorities — investments into the corporate sector, into infrastructure and into the finance sector (International Radio Serbia, 2012).

Conclusion. We are witnessing great expectations of economic, political and scientific community as regards small and medium enterprises (SMEs) in terms of their impact on the economic development and their capability to generate new jobs, which would significantly reduce the high unemployment rate in Serbia (25.6% in 2012). Also, expectations are expressed in terms of their contribution to innovation, fostering competition, helping large enterprises increase production efficiency as well as the quality of services in accordance with the requirements of local, national and global markets. However, on the other hand, the aforementioned expectations are not adequately monitored and an enabling environment for their development has not

been created. Namely, given that the rating of business environment for 2012 is lower in comparison with the year before, this may have a negative impact upon a further development of the private sector in Serbia. Firstly, as long as this sector is characterised by low competitiveness, an impeded access to finance sources and an undeveloped financial market, a chronic insolvency, an inadequate labour market structure, an uneven regional distribution, an inefficient legislature and a burden of administrative procedures and a high rate of corruption in the administration, it is not realistic to expect that all the potentials of this sector will be well employed in the near future. Serbia's private sector, already heavily taxed and legally restrained, is currently not in a position to absorb newly redundant public-sector workers. It is obvious now that the state's tendency to cover the budgetary deficit by raising taxes will not result in desired outputs in the economy of Serbia and will restrain the development of SME. A reform of tax system should be conducted, that would mean the change in the structure of taxation through reducing taxes and dues paid on work but raising taxes on consumption. Thus, work costs would be reduced and the price competitiveness of all companies will be improved, whereas the raising of taxes on consumption would additionally burden the imports sector in particular, however the export-oriented manufacture would not be exposed to such additional burden. Also, it should be remembered that the tax system reform would be of great importance for the reduction of the non-formal sector in Serbia.

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