Financing innovative small and medium-sized enterprises in times of crisis[1]

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Abstract: *Small and Medium-sized Enterprises (SME) in general and particularly innovative ones are becoming an increasingly important factor on the road to achieving smart, sustainable and comprehensive development. Because of their propensity to innovative undertaking and risk, SMEs contribute significantly to economic growth but are generally less productive and pay the cost of high rates of death and lower rates of profitability. Financing SMEs is risky and uncertain and for innovative SMEs it is even more difficult to access financing. When financing innovative activities, investors perceive high risks and it is even more emphasized in times of crisis when there is an increase in the cost of capital. Institutional support and governmental programmes have an important role in closing financial gap that innovative SMEs are faced with. Because the survival and development of SMEs is to a great extant determined by their ability to access favorable financing, the main objective of this paper is to provide policy recommendations for promoting availability of financing to innovative SMEs in order to foster economic recovery and more dynamic development of Serbia. The recommendations are to emerge from analyzes and evaluation of currently available sources of finance for innovative SMEs.*

Keywords: innovative small and medium-sized enterprises, economic growth and development, financing, risk, crisis

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INTRODUCTION

Small and Medium-sized Enterprises (SME) are becoming an increasingly important factor of economic growth and development not only in developed market-based economies but in transition and developing countries as well. Due to their flexibility, vitality, and tendency for innovative undertaking and risks, they are considered to be the leading initiators of economic growth and a single most important generator of economic activity. The policy makers in developed EU countries have recognized and acknowledged the role and importance of SMEs in generating high employment and promoting innovativeness and competitiveness of their economies, as key preconditions for achieving smart, sustainable and comprehensive development. SMEs are the most efficient parts of economies because they have the ability to adjust to the constantly changing requests imposed by the global and dynamic market in a more superior way than the large enterprises. SMEs are the single most important factor on the road to achieving the objectives set by the Europe 2020 Strategy, and creating environment suitable for their dynamic development and consistent implementation of the European Charter for SMEs is the core of EU economic policy.

Innovation is recognized as a key component of economic growth, sustainable development and wealth of nations. SMEs are dynamic, flexible, innovative and growth-oriented and conduct a significant share of research and development activities. In developed economies, more than half of all SMEs are innovative. However, SMEs in general are facing a number of obstacles to their survival and development, among which difficult access to financing is considered to be the most important one. Because innovative activities are associated with higher risk and uncertainty, it is even harder for innovative SMEs to obtain financing under favorable terms.

The constantly rising share of SMEs in total GDP, employment, export and import, as well as an increasing number of newly opened enterprises year by year, clearly shows that they are becoming a leading factor of economic recovery and development in Serbia, as well. SMEs' share in total number of enterprises in Serbia, as well as their role in economic growth and development, is growing year after year. According to the latest available official data, in 2009 SMEs on average accounted for 99.8% of the total number of economic entities, 42.3% of employment, 33% of GDP, 49.2% of export and 58.0% of the overall import, as well as 66.7% of employment, 67.8% of turnover and 57.4% of GDP of the nonfinancial sector of the Serbian economy.[1] The SMEs dominate in almost every sector of the economy.

THE ROLE AND IMPORTANCE OF INNOVATIVE SMALL AND MEDIUM-SIZED ENTERPRISES

Innovation is the leading engine of economic growth and a key element in making businesses competitive, generating new jobs and achieving smart and sustainable development. It refers to the conversion of knowledge and ideas into benefit in terms of new or improved products, services or processes, which may be for commercial use or for the public good. Only new products and services, or new ways of their production and delivery, create value and provide better living standards. Basically, the future competitiveness of businesses and good health of population, as well as environmental protection, will not be possible without excellence in research and development that should provide the necessary knowledge and technology to European industry and households. Turning smart ideas into jobs and growth is set as an imperative in developed market-based European economies and policy makers have focused their attention on increasing investments in knowledge and improving access to finance for innovation. Thanks to its flexibility and ability to quickly and efficiently adapt to changes in the market, entrepreneurs have the ability to undertake innovative activities and commercialize innovation much faster than the large enterprises.

Innovation, as harvesting the fruits of scientific achievement, requires much more than the ability of converting new ideas into commercial products. It is necessary to provide material resources and availability of appropriate business skills, an adequate system of protection of intellectual property, entrepreneurial incentives and innovative activities. Efforts must be directed towards the development of a culture that is dynamic and that considers innovation as a prerequisite for further economic growth and job creation.

SMEs have a strong ability to adapt to rapidly changing consumer demands and high potential for using new technologies and providing necessary channels for their commercialization. As such, they represent the backbone of innovation in developed economies and there is a rising awareness of their importance for economic growth and development in developing and transitional countries, as well.

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[1] *Report on SMEE 2009, Ministry of Economy and Regional Development, Development Fund of the Republic of Serbia, Republic Agency for the Development of SMEE, Belgrade, p. 11, 2010.*

SMEs contribute to dynamism and innovative performances of an economy by providing mechanisms for dissemination and commercialization of new knowledge and ideas produced in large organizations. Investments in new knowledge don’t necessarily need to be commercialized by the organization in which knowledge is originally created. The concept of the knowledge filter refers to a situation when an organization creates knowledge and ideas, but does not engage in their implementation, transfer and commercialization. There are companies and organizations such as universities and research institutes, which create a potentially valuable knowledge and ideas, but don’t consider their commercialization as a priority. SMEs are the links between the organizations that invest in creating new knowledge and those that implement and commercialize knowledge.

Recognizing the huge potential for innovation and taking into account the long European tradition of producing breakthrough inventions, the European Commission has been engaged on formulating and implementing a set of policies, measures and programs aimed at increasing innovation. The first Action Plan for Innovation in Europe adopted in 1996 was intended to raise the level of innovative performance and remove barriers to rapid commercial exploitation of new technologies. In the 1998-2002 period, the European Commission developed seven programs, which together constitute the Fifth Framework Programme for Research and Technological Development (Fifth Framework Programme for Research and Technological Development), with the main objective of promoting innovation and encouraging greater involvement of SMEEs.

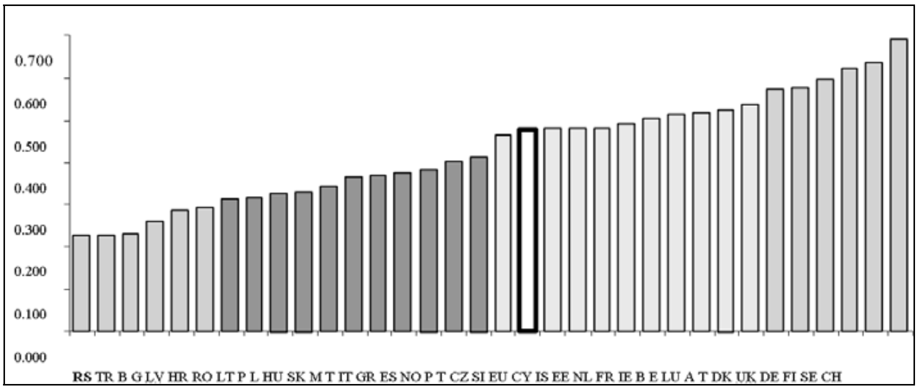
However, despite significant contribution to innovation, SMEs are often faced with numerous difficulties in the wider use of innovation and research, as well as regarding the protection of intellectual property rights. For this reason, the European Union has set a goal of strengthening the innovative and research capacities of SMEEs and increase technology transfer towards them.

In Serbia, unlike the EU, until recently there were no initiatives to support SMEs with high growth rate even though they were known to contribute significantly to dynamism and innovativeness of the economy. Along with rising awareness of the role of innovative SMEs in promoting innovative performances, a number of concrete initiatives to support innovative activities of SMEs (incubators, clusters, innovation centres, competition in the field of technological innovation, financial support for innovative projects) have appeared.

The total level of research and development activities in Serbia, according to international standards, is very low. The largest investment is in higher education, while only about 10% of total investment is realized in the corporate sector (EU-15 60-65%).

According to the European Innovation Scoreboard, an instrument set up by the European Commission to monitor and conduct comparative analysis of the innovative performances in the EU member states and associate members (Croatia, Serbia, Turkey, Switzerland, Norway and Iceland), all countries are divided into following four categories: innovation leaders, innovation followers, moderate innovators and catching-up countries. On the basis of this instrument, the Summary Innovation Index is calculated by using aggregate indexes of national innovative performances. The Summary Innovation Index is calculated as a composite index and contains 29 EIS indicators.

Figure 1. The Summary Innovation Index



Source: European Innovation Scoreboard 2009.

By using average performances, the Composite Innovation Index is calculated for each of the seven dimensions of innovative activity. The analysis represents a collection of related indicators of innovative performances grouped into three categories of weighted composite indexes: indicators of support (high educated and qualified human resources, financial support in terms of available financing and governmental support for innovative activities); indicators of enterprise's activity (investments in innovations, cooperation among innovative enterprises, capacity for intellectual property); indicators of the effects of innovative activities (innovators in terms of their number, economic effects in terms of economic success of innovations).

Serbia was included in the European Innovation Scoreboard for the first time in 2009, which is a positive step forward in attempt to measure the innovative potential of the economy and particularly of the SMEE sector. Serbia belongs to the category of catching-up countries. With the Summary Innovation Index of 22.7 Serbia is significantly below the EU-27 level (47.8).

Greater development of innovative SMEs in Serbia largely depends on the improvements in their access to favorable financing and on strengthening currently very weak cooperation between them and organizations which generate knowledge. Serbia is characterized by a significant potential to generate intellectual property with the possibility of commercialization. On one hand, there are a number of internationally recognized research institutes and organizations, while on the other hand the low level of operations in this sector indicates that there is a significant unused potential for research. The expectations are that the Ministry of Economy and Regional Development and other relevant institutions will provide more effective programmes and measures, including grants for financing innovative projects, to promote the contribution of innovative SMEs to economic growth and development of the Serbian economy.

FINANCING INNOVATIVE SMEs

Access to finance has been identified as the most important factor that determines the survival and development of SMEs. SMEs are often faced with limited access to adequate, in terms of conditions and prices, financial resources from both money and capital markets. Because of their propensity to innovative undertaking and risk, SMEs contribute significantly to economic growth but are generally less productive and pay the cost of high rates of death and lower rates of profitability. Financing SMEs is risky and uncertain and for innovative SMEs it is even more difficult to obtain access to various sources of financing for several reasons. First, the returns to innovative activities are often skewed and highly uncertain. Second, entrepreneurs may possess more information about the nature and characteristics of their products and processes than potential financiers. Third, innovative activities are usually intangible thereby making the assessment of their monetary values difficult before they become commercially successful.[1]

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[1] *2nd OECD Conference of Ministers Responsible for Small and Medium-sized Enterprises (SMEs), Promoting Entrepreneurship and Innovative SMEs in a Global Economy: Towards a more responsible and inclusive globalization, Istanbul, Turkey, 2004, p 5.*

The financing needs of innovative SMEs are different at different phases of development. In the early stage, start-ups rely predominantly on internal funds provided from family, friends and private investors, and the need for external funds arises as they enter the stage of business expansion. At this point, they are still unsuitable for debt financing since their activities are associated with high risk and uncertainty. Innovative SMEs also prefer to keep their financial flexibility by avoiding regular payments and interests. Public equity capital is not a convenient source of financing either, because it is associated with significant fixed costs such as the costs of underwriting, registration and advisory fees, regular yearly expenses related to auditing, certification, and dissemination of accounting information. Consequently, the survival and development of innovative SMEs depends on their ability to attract private equity capital which is interested in investing in these enterprises because of their high potential for growth and profitability. Private equity seems to be the most appropriate source of financing for innovative SMEs in the early stages of their development.

As innovative SMEs grow, debt financing and venture capital become more attractive sources of financing. However, banks usually don't find SME's loan portfolio profitable because of limited and highly risk return, lack of accounting records, lack of appropriate business plans or financial statements, and high administrative and transaction costs. For that reason, debt financing is an expensive source of financing and innovative SMEs rely on it mostly in transition and developing countries where the equity market is insufficiently developed. This is where the governmental support becomes increasingly important. The government can significantly reduce the risk that banks are exposed to by introducing various programmes such as loans guarantees.

Venture capitalists provide innovative SMEs with an access to capital markets. They implement several mechanisms in order to minimize the risk and uncertainty associated with innovative activities, such as the evaluation and examination of potential candidate's business plan, consideration of management flexibility and experience and potential market size. Furthermore, they demand preferred stock with numerous restrictive covenants and participation on the board of directors in return for their investments. Venture capitalists make their investments gradually so that they can monitor the profitability of an innovation over time.

Venture capital and other forms of high risk capital, such as business angels, play an important role in financing innovative SMEs, but the availability and the use of high risk capital differ significantly across the countries depending on cultural attitudes towards entrepreneurship and risk- taking, the supply of risk capital and policies that encourage risk-taking.

One of the alternatives for financing innovative SMEs certainly refers to private-equity funds. Many entrepreneurs in innovative companies, especially in the initial stages of development, are besides financial problems frequently faced with other problems related to business organization, legal affairs, marketing and sales and the like. Under these circumstances, a partnership with private-equity funds may be a reasonable solution. In addition to funding, this type of investors can provide innovative SMSs with other, additional services related to some of the above mentioned activities. In this way, a true partnership and a relationship of trust is achieved until the moment in time when the company becomes strong enough to talk about different exit strategies for private equity funds.

The problem related to SMEs' access to finance has been additionally pronounced with the outbreak of the world financial crisis as these enterprises have suffered a double shock: a drastic drop in demand for goods and services and a tightening in credit terms, which have severely affected their cash flows. The creation, survival and growth of SMEs, especially innovative ones, have been significantly challenged by the crisis which hit them harder than the large ones. SMEs are particularly vulnerable in times of crisis not only because the difficulties of accessing favourable financing continued, but because new supply-side difficulties appeared. SMEs are generally more vulnerable in times of crisis for many reasons among which are: it is more difficult for them to downsize as they are already small; they are individually less diversified in their economic activities; they have a weaker financial structure (i.e. lower capitalization); they have a lower or no credit rating; they are heavily dependent on credit and they have fewer financing options.[1]

In times of crisis it is even more difficult for innovative SMEs to obtain short-term financing as banks are under pressure and are trying to preserve or strength their capital base. Banks are willing to keep only the strongest clients and are seeking fully collateralized transactions. Along with the increased insolvency of SMEs, their inability to access this source of finance is even more emphasized. As a response to the crisis, governments in many countries have strengthened banks' balance sheets, thus allowing them to grant additional credits to SMEs. Governments have also recapitalized the banks and extended the funds and

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[1] *The Impact of the Global Crisis on SME and Entrepreneurship Financing and Policy Responses, Contribution to the OECD Strategic Response to the Financial and Economic Crisis, Centre for Entrepreneurship, SMEs and Local Development, OECD, 2010, pp. 7.*

guarantees available for SMEs. Despite significant efforts put by the governments in many countries to provide incentives for lending to SMEs, these enterprises are still facing serious constrains.

When financing innovative activities in times of crisis, investors perceive higher risks due to an increase in the cost of capital. Because of reduced exit opportunities, shrinking of fundraising activities, and stagnation or decline of investments in new projects it is more difficult to access to venture capital and private equity. Under such circumstances, innovative SMEs are considering alternative sources of finance such as reserves, self-financing and factoring.

In times of crisis, it is of crucial importance that governments adopt anti crisis packages which include measures aimed at easing the SME finance. Many countries have put in place different anti-crisis packages which are mostly consisted of actions aimed as stimulation of demand, credit enhancement measures and labour-market measures. The credit enhancement measures include mechanisms for improving banks' capacities for financing SMEs.

FINANCING INNOVATIVE SMEs IN SERBIA

Innovative SMEs in Serbia are in particularly difficult position regarding their access to finance because they are always associated with higher risk and uncertainty. Debt financing is the most widely used source of external finance by the Serbian SMEs, but is still unreachable for many, especially for innovative enterprises, because of high interest rates, high banking costs and high collateral requirements. Due to an evident shortage of both debt and equity financing, obtaining necessary finance is the major obstacle for the development of Serbian SMEs. The availability of financial instruments coming from the capital market is very limited and there is a lack of financial institutions that could provide SMEs with micro credit lines, local guarantee schemes, local guarantee funds and informal venture capital investments.

The world financial crisis seriously hit the SME sector in Serbia. An increase in the price of capital occurred, thus putting in question the further operation and development of SMEs and in particular of innovative ones. Along with reduced inflow of foreign capital at the beginning of October 2008, the first effects of the crisis imposed new business conditions characterized by a more rigid discipline in debt repayment.[1] The crisis additionally emphasized the importance of the

[1] *Djuricin S., Beraha I.,* Financial Support for SME Sector in Serbia*, Erenet Profile, Vol. 5, No. 4, p. 37, 2010.*

government in helping SMEs in general and particularly innovative SMEs to meet their financial needs.

From the mid 2009 the negative effects of the global economic crises worsened and made general conditions for doing business even more difficult. Maturity dates have been extended, available credit sources decreased and interest rates increased. Under such conditions illiquidity of all participants of the economic and social life has increased (Serbian Government encountered special problems during the talks with the International Monetary Fund on being granted loans for budget liquidity and increase of deficit). Such consequences struck the owners of small and medium-sized businesses the most. To make the situation even worse, financial system in Serbia has not developed mechanisms and systems of micro-financing. There are neither micro credits nor real micro credit institutions which offer fast and favourable loans for the SME sector.[1]

In Serbia, providing financial support for SMEs is in accordance with the 7th Principle of the European Charter for Small Enterprises. The implementation of the European Charter has resulted in facilitating the access to funding sources for SMEs through the introduction of loan guarantees as well as through the establishment of legislation necessary for the operation of investment funds. The institutions that provide financial support to SME sector include institutions established by the Government of the Republic of Serbia as well as domestic and international financial institutions. Financial support for SMEs in form of grants or loan funds under favourable terms is provided by the Serbian government through the following institutions: Ministry of Economy and Regional Development, Development Fund of the RS, Development Fund of AP Vojvodina, Agency for Export Insurance and Financing, Agency for Foreign Investment and Export Promotion, and National Employment Agency.

Despite the large number of banks with a defined program for SME financing and a number of outstanding international financial institutions, such as the European Agency for Reconstruction (EAR) and the European Investment Bank (EIB), the Serbian SMEs and especially innovative ones have a hard time obtaining finance under favourable terms. One of the main obstacles to the use of debt financing certainly refers to a high cost of capital. The additional problem lies in the fact that SME's owners and managers often lack information about the available funds, particularly from the EU. Also, on one hand there is a lack of cohesion and

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[1] *Eric, D.,* The need to enlarge sources of financing of small and medium-sized enterprises under the conditions of global crisis, Case of Serbia*, Erenet Profile, Vol. V, No. 1., 2010, Budapest, p. 18.*

poor coordination between financial and nonfinancial support to SMEs, while on the other hand SMEs seem not to fully understand the importance of business activities, such as planning, creating a business plan and investment project, which are necessary when applying for loans.

Difficulties in obtaining external sources of financing have resulted in a greater share of self-financing in the total capital structure of the Serbian entrepreneurs, while it is certainly not a reflection of their financial strength. For these reasons, the survival of SMEs is in most cases very uncertain. The access to long-term investment loans for the development and innovation has been enabled only to a small number of highly profitable enterprises.

However, the analysis of the types of finance that were used by SMEs over time indicates that the structure of finance has changed towards debt financing, thus indicating a certain progress in the access to external finance. According to the survey "Status, needs and problems of entrepreneurs in Serbia" conducted by the Republic Bureau of Statistics, at the request of the National Agency for Regional Development, the use of external sources of finance increase by 11% in 2011 in comparison to 2010 and by 25% in comparison to 2005. In particular, 44% of respondents financed investments by external sources, while 24% used external sources to finance working capital. The most commonly used source of external financing in Serbia refers to commercial banks' loans (28%), while the share of state funds, lending by friends or partners, guarantees or donations is less represented. Due to the incentive programmes adopted by the Serbian government, the use of commercial loans by SMEs is slowly decreasing in favour of loans from state funds. In 2010 only 10% of respondents used loans from state funds, while in 2011 a 6% increase was recorded. The Serbian SMEs often choose not to relay on commercial banks' loans due to inconvenient credit terms.

Significant investment optimism was recorded among the respondents. Some 62.5% of respondents planned new investment activity over the next three years, which is a 10% increase in comparison to the previous period. This indicator is very encouraging considering that in the past three years 63% of respondents realized their need to improve technical and technological conditions for doing business through investments. Particularly, investment in equipment (63%) was most commonly represented in the investment structure, followed by almost twice lower investment in office space (34%) and very modest investment in acquiring industrial property rights (5%). It is expected that in the following three years, the majority of investments of Serbian SMEs will be in the field of health care, printing services, information technology, transport services and motor vehicles servicing.

The growing need for innovations in Serbia is justified by the fact that, according to the Survey, every second respondent disposes second-generation equipment, almost every third more than ten years old equipment, and only every fifth has modern technology. The old and obsolete equipment is mostly used by medium-sized enterprises which have the greatest potential to generate employment. In most cases, out-dated equipment is used by enterprises in processing industry, transport and printing services, while modern equipment is used in information technology, beauty and recreation salons. According to the survey, every seventh respondent conducts innovative activity, and every fourteenth collaborates with other innovative businesses. The 54% of innovations refer to improvements in raw materials and energy savings, and 46% to labour savings.

Enhancing governmental support for innovative SMEs in Serbia is becoming increasingly important as they are expected to contribute to the creation of modern, knowledge-based economy. Because private equity market is still underdeveloped in Serbia, and debt financing is expensive, the government should put in place measures and programs in order to improve the availability of finance to SMEs.

Having recognized the importance and the role of innovative SMEs for the development of the Serbian economy, the government through the Ministry of Economy and Regional Development and in cooperation with the National Agency for Regional Development, has introduced support programs and measures to help innovative SMEs obtain necessary financing. Within the program named "Support for strengthening the innovativeness of SMEs," an enterprise can apply for a grant in the amount of 1.000-15.000 Euros, and for the purpose of financing innovative activity the coverage of up to 50% of total costs is provided. This program is aimed at financing innovations in the development of new products or services, significant improvements of the existing ones, implementation and testing of new production processes, purchase of domestic patent rights, new product design and marketing plan for a new product or service. Special attention within the program called "Support for the development of innovative clusters" is dedicated to innovative clusters in the initial stage and in developing phase. Enterprises can apply for grants in the amount of 2.000 to 20.000 Euros for innovative clusters in the initial stage, and 20.000-140.000 Euros for innovative clusters in the developing phase.

The operations of the newly established Innovation Fund, along with international financial institutions and donors, have significantly improved the process of financing innovative SMEs in Serbia. The Fund aims to promote innovation in priority fields of science and technology, and to support the implementation of new technologies in the economy through the development of innovative SMEs. In this regard, the Fund has developed two programs: Mini Grants and Partnership Program. The Mini Grants program is intended for private micro and small enterprises in the early stage of development that have developed technological innovation but need financial support to commercialize it. The applicant must be a private, maximum two years old company, founded in Serbia with the majority of domestic capital. On the other hand, the Partnership program is designed for enterprises that are struggling to secure funds for transforming innovations into commercially viable products. The primary objective is to expand the cooperation between innovative SMEs and local strategic partners, investment and venture capital funds to improve private sector's investments in technology development projects. Additionally, the program aims to support enterprises in their efforts to conduct research and development activities and ensure the placement of innovative products on foreign markets. Potential users of the program are SMEs, maximum five years old, founded in Serbia with the majority of domestic capital, that posses technological innovation, the potential for creating new intellectual property and are internationally competitive.

The development of innovative SMEs in Serbia is supported by the EU ″Competitiveness and Innovation Framework Programme″ (CIP). The Programme is aimed at supporting primarily innovative SMEs in the field of eco-innovation and easier access to capital. The program encourages more intensive use of ICT and contributes to the development of sustainable, competitive and inclusive information society and provides incentives for the more advanced use of renewable energy and energy efficiency. Trough ″Improved Competitiveness and Innovation Programme ″(ICIP), the EU provides 3 million Euros to the Ministry of Economy and Regional Development and the National Agency for Regional Development for the promotion of innovative activities and competitiveness of SMEs. The main purpose of the program is to support government agencies in their attempts to promote and coordinate activities that are in line with EU objectives and special needs of the SME sector in Serbia. The program aims to improve the quality of business support for SMEs and strengthen capacity building of institutions encouraging the development of innovation and competitiveness of SMEs and consequently of the entire economy. Financial funds, in the amount of 50 billion Euros, provided by the EU 7^{th} Framework Programme for Research and Technological Development (FP7) are also available for SMEs that are willing to introduce innovation and enhance competitiveness by increasing investment in research activities. The program encourages the cooperation between scientific institutions and SME sector to intensify innovations and economic development.

Innovative SMEs, as enterprises with the highest potential for conducting innovative activities, are considered as one of the main pillars of the development and growth of the Serbian economy. For that reason, further improvements in their access to financing continues to be one of the most significant challenges in years to come. The key policy recommendations to overcome the existing financial gap faced by the Serbian innovative SMEs refer to three fields of activity. First, the government should focus on promoting availability of risk capital to innovative SMEs. Second, the terms under which debt financing is available to innovative SMEs should be improved by creating competitive banking sector. Third, SMEs need to be better informed about available financing options.

Improving the innovative SME's access to risk capital requires the following actions: development of financial market, introduction of new financial instruments and appropriate regulatory framework including flexible investment regulations and viable exit mechanisms, improvement of the transparency of corporate performance to overcome information gap between SMEs and potential investors, enable investors evaluate the nature and quality of innovative activities, and reduce risk associated with innovative activities by introducing guarantee schemes.

Given that debt financing represents the most widely used source of external financing for Serbian SMEs, a proper regulatory framework should be introduced to encourage commercial banks to adjust to the specific needs of SMEs and particularly of innovative ones, to increase the amount of funds available to SMEs and to improve the terms of their credit offers. Creating a competitive banking sector would significantly enhance the SME's access to debt financing.

Innovative SMEs in Serbia are not fully aware of all financing options that are available to them. For that reason, they rely mostly on debt financing which is limited and unfavourable. Managers and owners often lack information about existing government programmes or don't know how to prepare business plans or financial projections necessary for application. There is a low level of managerial skills in Serbia, which is a serious obstacle to attracting risk capital.

Also, improvements are necessary in the field of education of entrepreneurs and owners of innovative SMEs, particularly in the key areas of knowledge related to business success. Innovative activity can hardly be successful unless there is an appropriate organizational support. For that reason, it is of great importance to spread knowledge among the owners of innovative enterprises and to engage on breaking down the resistance to the inclusion of partners. In fact, the owners often believe that they have to be 100% in control of their businesses which creates a number of operational problems and leads to inefficiency. In order to prevent the occurrence of such problems, it is necessary not only to improve the access to finance but to promote education as well.

CONCLUDING REMARKS

Innovation, as a conversion of knowledge and ideas into new or improved projects or processes, is the key prerequisite for achieving sustainable economic growth and development. Due to their flexibility, vitality and propensity to risk, innovative SMEs are the backbone of innovation in developed economies. However, they are facing serious constraints when obtaining financing. Access to financing has been recognized as the major obstacle to the survival and development of innovative SMEs, especially in times of crisis when the risk perceived by investors is higher and the cost of capital is increased. Financing difficulties are even more emphasized in transition economies because of undeveloped financial markets, unfavourable terms of debt financing and insufficient volume and scope of government support programmes. According to international standards, the level of innovative activities in Serbia is very low. Limited access to finance is often a key factor that determines the survival and development of innovative SMEs in Serbia. For that reason, policy actions directed towards promoting equity financing, creating competitive banking sector and raising awareness of available financing options are necessary.

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