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EFFECTS OF THE GLOBAL ECONOMIC CRISIS ON SMALL AND MEDIUM ENTERPRISES IN SERBIA

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Abstract

The current international economic turbulences represent one of the most destructive economic crises in the last one century, perhaps with more devastating effects than ever before. The overall international economic system, almost all individual national economies and especially the vulnerable transition economies of South East Europe are affected. It is understandable that small and medium enterprises are particularly affected by market turbulences and that their position is clearly unfavorable in the newly created world economic circumstances. Problems are reflected in reduced demand, difficult access to export markets and particularly capital markets which are reserved for the recovery of those economies which caused the current economic crisis.

Keywords: Global economic crisis, small and medium enterprises, protectionism, competitiveness

1. INTRODUCTION

Small and Medium Business Enterprises (SMEs) are considered to represent the driving forces of sustainable local economic development throughout the world. They form the base of economies, stimulate private property and entrepreneurial capabilities which, due to their flexibility, can quickly adjust to market changes, generate employment, create diversified

economic activity, and contribute to exports and trade. This is also how SMEs have become the pillars of development in transition economies.

Until the outbreak of the global economic and financial crisis achieved results of SMEs in the Serbian economy gave hope that this economy, after years of economic stagnation, will eventually succeed to reach development levels of less developed EU countries. Those efforts and results have now

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been brought into question, not only in Serbia but also in other transition economies where the GDP is expected to decrease during 2009.

The main assumption of the authors is that management, particularly specific financial management skills of SMEs, can make the sector more efficient and allow continued growth on this basis, thus contributing to social-economic development. The condition is that the owners of enterprises responsibly manage their survival, growth and development, instead exclusively planning for personal wealth and profitability. Economic policy should not introduce, but eliminate restrictions for SMEs, particularly in times of the world economic crisis. Current characteristics and problems of the SME sector, observed by the authors can be described in the following way:

- Scientific research about financing mechanisms, credit loans, and business practice of SME are not sufficiently financed which would improve the understanding of specific ways of how SMEs do business, what are their life cycles and how to approach development interventions during the world economic crisis;
- Commercial banks do resist fair and healthy competition of micro credit organizations which can improve the financing of SMEs and even bring new clients to the banks.
- Commercial banks do not recognize some of the characteristics of the SME sector, which could facilitate the proposition and adoption of laws on micro credit organizations in Serbia and other countries of transition which don't recognize the significance of microcredit.
- There is no awareness among SME owners that their existing management skills and knowledge are relatively weak and

inappropriate for the demands of the world economic crisis.

- Resistance to change and life-long learning, particularly among Serbian SMEs represents one of the major obstacles in facing the consequences of the world economic crisis.
- Availability of credit for the SME sector is still insufficient, and banking sources of finance along at favorable interest rates would certainly resolving the lack of sources of finance as one of the key problems for growth and development of SMEs.
- A wide range of other specific stimulating measures and resources are not provided for SME growth (for example measures to stimulate creativity, inventions and innovations), especially in the conditions where it is not realistic to expect any significant profitability of SMEs in the first years of doing business and during the world economic crisis.
- Tools of modern financial management specific for SMEs used inappropriately and in uncreative ways.

2. *SMEs* AND THEIR CREATION IN TRANSITION ECONOMIES

When trying to precisely define SMEs it is important to emphasize that quite often, particularly in poor and developing countries, these entities also include micro enterprises and newly founded businesses that are registered or awaiting registration (start-ups).

A typical SME can be defined as: *An enterprise in market economies founded on the basis of innovation and with the help of entrepreneurial spirit, usually governed by owners or partial owners in a personalized*

way. SMEs are usually founded in one of the following ways:

- start-up;
- buying of an existing SME;
- franchising of SME;
- decomposition of a large enterprise.

In transitional economies, SMEs are a company also created through formalization of the businesses from grey and black economy. However, the future of such companies is uncertain in comparison to entities developed in the legal sphere through innovation processes and entrepreneurial spirit. Hence, it is recommendable for transition economies to fine-tune the level of taxes in order not to endanger the survival of SMEs, particularly during the world economic crisis.

Micro-economic theory consents that the category of size of an enterprise is defined on the basis of the number of employees and/or annual turnover of a company.

These criteria vary significantly depending on the country, institution or goals considered. Current theory has not at all accepted a precise definition. We will briefly present the three definitions.

2.1. Definition of micro, small and medium enterprises according EU legislation

Micro, small and medium-sized enterprises are defined according to their staff headcount and turnover or annual balance-sheet total (European Commission, 2005):

- A medium-sized enterprises are defined as enterprises which employ fewer than 250 persons, and whose annual turnover does not exceed 50 million euro or whose annual balance-sheet total does not exceed 43 million euro.

- Small enterprises are defined as enterprises which employ fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed 10 million euro.

- Micro enterprises are defined as enterprises which employ fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed 2 million euro.

2.2. American's definitions small business

American Small Business Administration published Table of Small Business Size Standards matched to North American Industry Classification System Codes (2007) where the main criteria are: size standards in millions of dollars and size standards in number of employees. In most industries size standard is to a maximum of 500 employees, but some industries have differences (Small Business Administration web site).

The SBA (Small Business Administration web site) defines a small business as one that is:

- is organized for profit;
- has a place of business in the U.S.;
- operates primarily within the U.S.;
- independently owned and operated;
- and is not dominant in its field.

2.3. Serbian official definition

According to article 6 of the Serbian Accounting and Audit Law Business (Republic of Serbia, Ministry of finance, 2006) entities are classified as small, medium and large enterprises depending on headcount and annual turnover. Medium enterprises have to fulfill at least two of the following

criteria:

1. Average number of employees for the business year is between 50 and 250;
2. Annual turnover is between 2,500,000 euro and 10,000,000 euro in dinars;
3. Average value of assets for the business year (at the beginning and the end of the year) is between 1,000,000 euro and 5,000,000 euro in dinars.

Business entities which show lower values for at least two indicators are considered as small enterprises, while those which exceed the values for two indicators are considered large enterprises.

3. MEASURES FOR SUPPORTING SMES IN EU

Having in mind the significance and role of SMEs, the EU Commission Council have adopted strategic and documents and plans relevant for the development and encouragement of SMEs and entrepreneurship (European Commission SMEs, web site).

The European Charter for Small Enterprises was accepted in June 2000, by the leading countries of EU. It prompts the significance of small enterprises and entrepreneurs for the growth, competitiveness, and enhancement of employment in EU. The Charter also states obligations of EU member countries, as well as the European Commission, in order to enhance the environment for SMEs.

The EU has recently attached special attention to the further development of SMEs, so the European Commission adopted a special document in June 2008, titled "A Small Business Act" for Europe

(Commission of the European Communities, 2008) that establishes principles and actions for the SME sector in EU countries. Having a goal to anticipate negative influences of the coming Economic crisis, the *European Commission Plan for Economic Recovery* was adopted, i.e. measures for supporting SMEs (European Commission SMEs, web site).

The main principle of the last Plan, worth 200 billion euro, emphasizes financial and administrative measures to support SMEs, which are key for renewal of economic growth and stable employment in EU. These measures include providing better access to credit and acceleration of reforms provided by the law - Small Business Act for the SME sector. The plan of economic recovery was adopted on 26th November 2008, and represents the EU response to the Global economic crisis. Similar plans were adopted by accession countries including Serbia.

The Plan contains coordinated fiscal stimulus averaging 1,5 % of EU GDP. This funding should be split so that 170 billion euro should be invested member countries of EU into the national economies. The remaining 30 billion EUR (about 0,3 % of EU GDP) will be provided from EU funds and will increase the funding for the SME sector.

European Investment Bank (EIB) will provide a package of 30 billion euro for crediting SMEs, and these funds will be distributed through commercial banks in member countries by 2011. This sum represents an enhancement of about 1/3 compared to the sum EIB originally aimed for SME credit.

EIB will start the application of finance instruments form the EU Program for Competitiveness and Innovations, and will also use a special fund for sources of funding

of micro-credit organizations. Besides, EIB will add approximately 1 billion euros annually to its package for crediting medium size enterprises.

In the case of SMEs exposed to high risk markets, EIB will provide the conditions under which the credit risk could be shared with partner banks or under which the mezzanine financing could be provided. Additional billion euros will be at disposal through European Investment Fund, for indirect (mezzanine) financing.

Along with that, the Economic recovery plan comprises certain measures for reduction of administrative demands for SMEs, mitigation of their cash flows, and helping to individuals that are becoming entrepreneurs.

4. A REFLECTION ON GLOBAL ECONOMIC TRENDS

There exist no unified positions about actual consequences of the impact of global economic crisis, which is the greatest one in the last seven decades. Little agreement exists in terms of its length, possible depth, duration, as well as precise measures to be taken in order to reorganize economies for recovery. Positions are not unified even among the most significant international financial institutions.

This years' *World Economic Forum* held in Davos, from January, 28th 2009 – to February 1st 2009, was entirely devoted to the problems attached to global economic crisis (World Economic Forum, 2009). The summit argued the effects of the crisis and possible measures for alleviating its consequences. Special attention has been devoted to financial regulation, sustainable development, globalization, social exclusion

and global management.

“The world is going through a historic crisis of trust in values, systems and institutions. It is time to reshape the real world”, warned Klaus Schwab, the founder and the president of *World Economic Forum*. This particular thought was an essential topic of the Forum. The causes of the crisis as well as its spreading were analyzed. The depth of the crisis and particular measures for alleviating the consequences were debated. Topics included the achieved effects of the taken measures, as well as defining *global measures*, as the only proper response to the *global crisis* (Soros, 2002).

Simply put, the Forum in Davos started the quest for a new type of World Order, and the quest continued at Forum of the Group of 20 most developed economies, on 2nd April 2009 in London (London Summit, 2009). Analyzing the causes of the Crisis, there was almost a consensus that it was derived from the “flaws” of the market, which usually occur during the period of high rates of economic growth and greed for endless profit making.

Analyzing the applied measures for alleviating consequences experts warned about the rising problem of *trade protectionism*. Protective measures in trade introduced by several countries with the largest share in global exchange, has brought a dose of seriousness in finding the solution to the problem. It is clear that trade perfectionism carries *financial protectionism* alongside, which makes the world economy dangerously susceptible to a type of protectionism that could endanger markets of the developing countries, and their SMEs which are dependent on foreign banks' loans. That is why is it important to carry out London Summit's decisions, which

anticipate the battle against protectionism.

Although there is no final global response to the global crisis, implementation of some anti-recession measures is obviously necessary, and results will be carefully monitored. One must bear in mind that it takes a considerable amount of time for first results of taken measures to be shown.

5. INFLUENCE OF THE GLOBAL ECONOMIC CRISIS ON THE REAL AND BANKING SECTOR IN SERBIA

Through the analysis of strategic principles and goals, as well as the chosen economic policy and measures for achievement of desired goals, it can be seen that all of them including those for the SME sector these are quite well positioned in Serbia. Having in mind the actual situation which includes inherited problems, as well as newly-created difficulties from the global economic crisis, it is clear that numerous planned development goals are unfulfilled. The present situation in the real sector in Serbia is characterized by the stagnation and diminishing of economic activity, caused by the global economic crisis. The decrease of industrial production by 17.4 % in the first six months of 2009 is the strongest evidence of the effects of the global crisis on the real sector. This will demand reinventing strategies of technological development of Serbian enterprises (Stavrić & Stamatović, 2003), as well as implementing contemporary aspects of reengineering of a firm (Stamatović & Ljutić, 1995).

In the last few months, more than ever since the year 2000, the Serbian banking sector has been in the center of attention. Serious questions are raised about the influence of the global economic crisis on

the economies of Eastern and South-Eastern Europe, and this question goes along with the question of the fate of the banks in this area. Having a history of previous illiquidity, and because of rigorous monetary policy of the National Bank of Serbia, this phenomenon was something banks in Serbia became aware of. As a result it can be said that times of cheap credits have passed. Although Euribor and Libor have a declining trend, the risk of State loans is rising, which as a consequence has the fact that sources of foreign loans for banks are getting more costly. Margins for Serbian banks, therefore, must inevitably grow.

Analyzing the characteristics of crediting arrangements (prices, conditions of installment, etc) for SMEs, it can be concluded that credits are very expensive nowadays. This is independent from whether they are long or short-term credits, i.e. whether they are taken in dinars (with or without a currency clause) or in foreign currency. Should we add very rigorous conditions for providing credits (mortgage on the real estate property and other guarantees), it becomes clear that credits are not only expensive, but also hard to obtain at the moment (NBS, 2009). Obviously under the global economic crisis access to credit for SMEs in Serbia became even more stringent.

One of the basic markers of macro-economic moves in the Republic of Serbia after the year 2000 has been a high trade deficit, i.e. deficit of the current account, as seen from the following Table 1 (Vemić, 2008).

Table 1, shows a constant growth of deficit, which, even before global economic crisis was threatening to endanger macro-economic stability and cause the crisis in balance of payments, i.e. the currency crisis.

Table 1. Serbian foreign trade performance from 2001 to 2007

	2001	2002	2003	2004	2005	2006	2007
Exchange rate in millions of euro							I-XI
Exports of goods	1,922.2	2,870.4	2,441.0	2,831.6	3,608.3	5,102.5	5,854.8
Exports of goods to EU	892.4	960.7	1,202.3	1,456.5	2,117.6	2,942.9	3,321.9
Imports of goods	4,759.2	5,956.6	6,585.5	8,623.3	8,439.2	10,462.6	12,047.3
Imports of capital products	-	-	1,779.4	2,495.3	1,971.6	2,429.8	3,088.9
Import of intermediary products	-	-	2,251.9	2,830.6	3,027.6	3,781.4	4,432.8
Trade deficit	-2,837.0	-3,754.7	-4,144.3	-5,791.7	-4,831.0	-5,360.1	-6,192.4

The trends in 2008 have shown continued deficit tendencies. When the global economic crisis emerged, and sharpened, the deficit decreased because both exports and imports fell (NBS, web site). Along with the low level of competitiveness, Serbian imports are characterized by inconvenient sector and geographical structure. Intermediate goods make up more than 50 % of overall export, and if energy export and agricultural products are added it can be stated that sector structure of Serbian export is also unfavorable.

As for the geographical structure of Serbian exports, it is obvious that 88.2 % of the export is realized on the EU and CEFTA markets. On the other hand, 90% of exports to CEFTA countries relate to the market of Bosnia and Herzegovina, Montenegro and FYROM. Concentration as high as this, directed towards only several countries can have negative side effects on further increase of exports. That is why one of the main assignments of Serbian export policy after the global economic crisis must be directing companies towards new markets. The

research on SME conditions in Serbia, before the escalation of the global economic crisis in the second half of the year 2008, revealed relatively favorable trends (Ministarstvo ekonomije i regionalnog razvoja, 2008). However, the diagram, in the Figure 1, shows the data of the SME sector share in total export and profits which indicate an escalation of effects of the global economic crisis on SMEs already in the 2008 when a slight decrease of SME share in exports and profit was first registered.

The tendency from the graph, in the Figure 1, explicitly confirms the introducing presumptions from our work that Global economic crisis has a significant impact on SME. This also implies that recommendations for greater support to this sector in Serbia were justified.

6. THE ROLE AND SIGNIFICANCE OF FOREIGN DIRECT INVESTMENTS IN OVERCOMING THE GLOBAL ECONOMIC CRISIS IN SERBIA

It is clear that the inflow in the whole

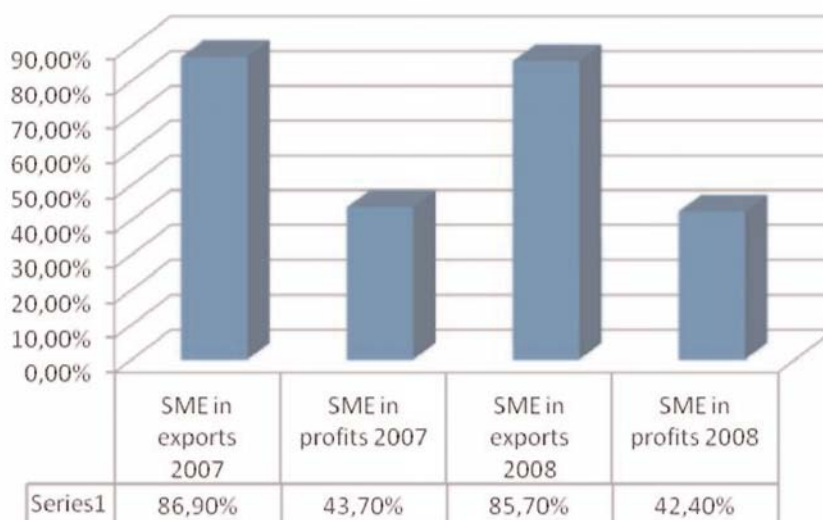


Figure 1. SME shares in profit and exports before (2007) and during (2008) the global economic crisis (Source: Republican Statistical Office of Serbia)

East-European transitional block will inevitably fall due to the recession in western countries, which were the sources of 80 % of foreign investments. That is how this year's investment performance in the region, according to the newest forecasts will be decreased for over 40 % in comparison to that in 2008.

The occurrence and significance of foreign direct investments are not new in Serbian economy development, and importance of this kind of economic cooperation is indisputable in economic history (Vemić, 2002). The development of the Serbian economy in the transitional era still relies heavily on foreign direct investments, and it moves in two directions: investments in the privatization process, and Greenfield investments. Considering the new circumstances with the global economic

crisis, this year will pass in a survival mode, where great attraction of investments into the region will probably not take place. Let us take a look at the data in the Table 2, from National Bank of Serbia, which depict the inflow of investments in the previous decade, along with the provided data for first two months of this year, and then we can estimate the possible inflows (NBS, 2009).

Analysts believe that the maximum Serbia can attract in this year is approximately 2 billion dollars. Obviously the effect will be a smaller inflow of foreign direct investment in 2009. Other countries in the region are also struggling to attract as much foreign investment as possible. Still, it is believed that Serbia can become a more attractive investment destination due to the stability of its business and political environment and a stable banking system.

Table 2: The inflow of foreign direct investments (in thousands USD) in Serbia in the period 2000-2009

2000.	2001.	2002.	2003.	2004.	2005.	2006.	2007.	2008.	2009 I - II
11,252	35,388	326,454	1,071,410	796,403	1,440,706	4,286,379	2,004,297	2,362,520	649,994

7. NEED TO INCREASE COMPETITIVENESS IN SERBIAN ECONOMY

According to the criteria for measurement of competitiveness of economies, Serbia is ranked only 85th in the world. Obviously the solution for the current crisis is a path that involves strengthening of competitiveness. Serbian economy is dependant on foreign capital inflow, and if it needs greater inflow, then it must reduce the risk for foreign investors, and that again means increasing competitiveness. It is also necessary that the economic policy creates a favorable environment including an appropriate institutional frame, based on corresponding laws and other by-laws, as well as consistent, objective and efficient implementation of the mentioned legislation. The fact is that financial stimuli are not the prevailing factors for serious investors. When they decide about stimuli and environment investors prefer a place where there is nothing paid to them, but where there is a certainty that the investment will pay off by itself, and where their profit could be maximized.

If governments provide more stable legislation, harmonizing domestic laws to the EU, this safety would positively affect long-term investments of foreign investors. The role of the government is not to invest in companies and to govern the economy, but to look after the health of public finance, to encourage the entry of competition in the infrastructure sector, and reduce barriers for investments. Economists, government officials and the World Bank seem to agree that the key barriers of investing into Serbia are bureaucratic and administrative ones while the previous development period of potential investments in Serbia was marked

by the political risks.

Along with vast bureaucracy issues, not only in Serbia, but in the whole East-European transition region, investors are also concerned about poor infrastructure, lack of expert workforce, growth of salaries, corruption and political instability in the. That is why it is reforms should be completed in areas with the most significant barriers for investments.

One should also be aware that barriers to Greenfield investments are much greater than barriers foreign investors confront when taking over the existing companies, i.e. through the process of privatization. Along with previously mentioned low level of competitiveness when attracting foreign direct investments, Serbia also has enormous problems with the competitiveness of its goods and services offered in foreign markets.

The old, non-functional technologies, poor quality, unattractive packaging, lack of certified items, impossibility of crediting sales and high prices are the main reasons why Serbian products are not competitive, even in comparison to those from some surrounding countries. The Global Competitiveness Index has shown that in the year of 2008, Serbia only took the 85th place among 134 countries measured by that index. Whether or not Serbia will succeed in changing the structure of its exports like other advanced transition economies did earlier will depend to a great extent on the FDI performance.

8. THE ROLE AND SIGNIFICANCE OF STATE SUBSIDIES IN THE GLOBAL ECONOMIC CRISIS

The State institutions continue providing

the usual backing for the development of SME sector in Serbia, which is, among other things, visible in providing grants for particular programs, as well as credits under quite favorable financial conditions (The Development Fund of the Republic of Serbia) for certain programs (Vemić, 2008). Nevertheless, it is necessary to develop other market mechanisms of SME (Stamatović & Vemić, 2008).

Within its strategy of alleviating the consequences of the Global economic crisis, the Government has provided certain funds for subsidizing interest rates on credits. Available sources of finance for this purpose are not sufficient for more systematic and long-termed solutions. That leaves the Government with the long-term responsibility to find and realize relevant measures and mechanisms. The consequences of the global economic crisis seriously influence the liquidity of the economy, particularly the illiquid 61,285 SMEs unable to pay their debts. It is now of crucial importance to ensure the delay of repayment of foreign debt, i.e. to execute refinancing of the debts of private companies in Serbia.

Solving this matter is important because the companies would, if forced now to pay their debts, buy foreign currency, and in that way lower their internal liquidity. The State has also reserved significant funds for other possible type of interventions, i.e. for possible rehabilitation of banking system, if by some chance a banking crisis would occur, and foreign headquarters of domestic banks stay passive, which does not seem possible at the moment. If this situation by any chance occurs, the State could become co-owner in some banks it rehabilitates, in the proportion of the provided assets, which is not unusual practice nowadays, having in

mind that rehabilitation program of UK and USs banks is also performed in this manner.

9. CONCLUSION

The results of scientific research of the authors significantly point to the chronically lacking basic skills and knowledge of entrepreneurs that inhibit the adjustment to the global economic crisis. The constant learning process in this area is crucial for the survival of SMEs in the conditions of the global economic crisis.

The SME business training and the direct financing services would make a starting point for further development of these enterprises after the eventual recovery from current crisis. Such a model of an institutional support to the development of SMEs and entrepreneurship demands a proactive approach owners and managers in the further learning and successful mastering of basic skills of financial and marketing management.

Current training of our entrepreneurs and managers is inappropriate for the development needs of the SME sector which is unable to adjust to the global crisis. Much better results could be accomplished by mastering relevant financial and marketing tools, and if information technologies were applied in business.

The next precondition for successful recovery of the SME sector is profitable cooperation with large enterprises which would ensure a new cycle of economic growth.

Finally the assignments of the reformed economic policy in the accelerated transition of Serbian economy should be focused on the visible removal of restrictions for SMEs, as well as on protection of this sector from

the excessive government intervention monopoly and possible protectionism that can emerge from the global economic crisis.

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ЕФЕКТИ ГЛОБАЛНЕ ЕКОНОМСКЕ КРИЗЕ НА МАЛА И СРЕДЊА ПРЕДУЗЕЋА У СРБИЈИ

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Извод

Тренутно стање интернационалних економских турбуленција представља једну од најдеструктивнијих економских криза у последњем веку, можда са много далекосежнијим ефектима од иједне раније кризе. Укупни интернационални економски систем, готово све индивидуалне националне економије и посебно рањиве привреде у транзицији, какве су у земљама југоисточне Европе, су погођени. Разумљиво је да су мала и средња предузећа посебно погођена кризом и турбуленцијама на тржишту те је њихова позиција веома нестабилна у новим тренутним економским околностима. Проблеми се јављају у смањеној тражњи, тежем приступу извозним тржиштима и посебно тржиштима капитала у циљу опоравка нестабилних економија.

Кључне речи: Глобална економска криза, мала и средња предузећа, протекционизам, конкуренција

/rlinks/uslovi_kreditiranja_msp.pdf

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