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## SME ENTREPRENEURSHIP AND ITS CONTRIBUTION TO ECONOMIC ACTIVITY IN THE REPUBLIC OF SRPSKA

### ПРЕДУЗЕТНИШТВО МСП И ЊЕГОВ ДОПРИНОС ПРИВРЕДНОЈ АКТИВНОСТИ У РЕПУБЛИЦИ СРПСКОЈ

**Summary:** *Research on the role and importance of entrepreneurship in economic development is influenced by the orientation of development policies in advanced economies. Considering that the orientation towards entrepreneurial activity and development of small business is present in developed economies, the aim of this research is to determine the impact of entrepreneurial activity of SMEs on the economy in the Republic of Srpska. The methods used in the paper are: analysis, synthesis, induction, deduction, comparison, benchmarking. The results of the research have shown that SMEs in the Republic of Srpska generate more new jobs, achieve higher turnover and create more added value than big companies. However, big firms are more profitable and have higher productivity, leading to the conclusion that development policies should not be rigorously limited to the development of only one sector, but rather to encourage their coexistence.*

**Keywords:** *entrepreneurship, small and medium enterprises, added value, employment, economy.*

**JEL classification:** *M21, L26*

**Резиме:** *Истраживање улоге и значаја предузетништва у привредном развоју подстакнуто је усмјереноићу развојних политика у напредним економијама. С обзиром на то да је оријентација на предузетничку активност и развој малог бизниса присутна у развијеним привредама, циљ овог истраживања је да се утврди утицај предузетничке активности малих и средњих предузећа (МСП) на економију у Републици Српској. Методе коришћене у раду су анализа, синтеза, индукција, дедуција, компарација, бенчмаркинг. Резултати истраживања су показали да у Републици Српској МСП генеришу више нових радних мјеста, остварују већи промет, те стварају више додате вриједности од великих предузећа. Међутим, велике фирме су профитабилније и имају већу продуктивност, што доводи до закључка да се у развојним политикама не треба строго одређивати само за развој једног сектора, него подстицати њихову коезистенцију.*

**Кључне ријечи:** *предузетништво, мала и средња предузећа, додата вриједност, запосленост, привреда.*

**ЈЕЛ класификација:** *M21, L26*

## 1. INTRODUCTION

The influence of entrepreneurship of small and medium-sized enterprises on the economic activity and economic growth, especially on employment is often the subject of professional and empirical discussion. The research of Birch, Acs and many other authors show that entrepreneurship and small and medium enterprises are the main drivers of economic growth and an important part of national economics. There is an agreement that these findings are important for businessmen and creators of economic policy in academic and political circles. One of the main advantages of small companies is that in times of crisis and turbulent business environment they adapt to changes more quickly compared to bigger companies, which gives sufficient reasons to pay special attention to this problem from the theoretical and practical point.

It is common belief that SMEs and entrepreneurship are recognized as a key source of dynamism, innovation and flexibility around the world. Development-oriented SMEs are "entrepreneurial locomotive" that makes a significant contribution to employment and development. In countries that have achieved a lot of poverty reduction in the last three decades (for example in China), the SME sector has played an important role and entrepreneurship has gained importance (Audretsch, Keilbach and Lehmann 2006, 12). However, theoretical and empirical evidence for understanding the role of

entrepreneurship of small enterprises are still not solid (Naude 2008, 47), indicating a need for closer examination of their influence on the economy.

In accordance with the economic parameters, SMEs are characterized by small scale of business, small investment capital and a small number of employees. They structurally fit into the business area that is not covered by big companies doing the jobs for which big companies are not interested or that are not profitable for them. Thanks to its flexibility, vitality and propensity to undertake innovative and risky undertakings, small and medium enterprises can be superior to large business systems in adapting to customer demands and changes in the environment. The speed and ability to adapt have become critical performances to the success of enterprise.

The importance of SMEs is reflected in the fact that the European Commission precisely recognizes this sector of economy as a generator of employment, growth and development in the economics of the European Union (EU). Also, current experiences show that small enterprises make a significant contribution to innovation and productivity. This paper starts from the attitude that entrepreneurship in SMEs is not the main bearer of economic development, but it has a very important role for the stability of the national economics. However, economic development in the Republic of Srpska is still characterized by insufficiently strong support for entrepreneurship and SMEs.

With regard to the unreconciled views of the authors as to whether the contribution of small business or big enterprises to economic development is more significant, there is a research question which of these two sectors has a bigger influence. The subject of this paper is to compare performance indicators of both these sectors in the economy of the Republic of Srpska to determine to which sector priority should be given. The aim of the analysis is to provide recommendation in which direction development policies of the country should be formulated on the basis of these results.

In the first part of the paper the theoretical observations on the connection between entrepreneurship and economic growth are presented. The second part deals with the contribution that the small business and sector of big companies give to economic activity in the Republic of Srpska in terms of employment and the creation of added value. The third part deals with the performance of the business of the mentioned sectors, that is about their financial indicators.

## **2. THE INFLUENCE OF SMALL ENTERPRISES ENTREPRENEURSHIP ON ECONOMIC GROWTH**

The view that big companies have superiority and that they are in the middle of the process of innovation and creation of wealth and well-being dominated in academic circles until the second half of the twentieth century. Giving importance to only big or only small enterprises is still the subject of an uncompromising and completely unfinished debate among theorists. Classicists, like Marxists, they agreed with Adam Smith in the belief that the advantage of economies of scale is of great importance for the efficiency of production. Followers of this idea, among whom Galbraith distinguished, predicted that large companies will prevail in the economic life due to the bigger efficiency as a consequence of economies of scale, and superior technology.

Also, Schumpeter points out that big companies will have an advantage over the smaller ones, taking into account the increasing returns because of volume (Deakins and Freel 2012). This is supported by the observation that big companies are able to distribute the risk of innovation on multiple projects easier while for small enterprises this is difficult to achieve. It is important to point out that Schumpeter primarily explored how market structures<sup>1</sup> rather than company size, influence on the propensity for innovation. On the other hand, Galbraith was more direct in his assessment of the relation between innovation and size of companies emphasizing that the development is exclusivity of big companies. Since development requires significant funds, it can be conducted only by big companies that have the necessary resources (Galbraith 1952, 92).

After 70 years of the last century, there is a visible trend of repeated pointing to the importance of entrepreneurship and encouraging its development by abandoning the concept of exploiting economies of scale as the main driving force in economic development. This has led to a phenomenon that is often called "the new learning" (Acs and Audretsch 1993, 23-35). Empirical studies in the United States and the United Kingdom (Rothwell 1989, 51-64) have shown that, under certain sectoral

<sup>1</sup>Although a high degree of market power often means that it is about a bigger company, these two factors are not necessarily connected.

variations, small businesses can keep up with the big companies in the field of innovation. They can also effectively use the input of research and development for obtaining the output of innovation (Van Dyke et al. 1997, 335). Eventually it became clear that there is no a certain size of company which is especially suitable for innovation. Namely, both large and small enterprises can perform different and often complementary roles. Rothwell marked this by the term "dynamic complementarity" (Deakins and Freel 2012).

When analyzing the importance and contribution of entrepreneurial activities of SMEs to economic growth it should be considered why they now occupy a more prominent place in professional and scientific considerations, than it was the case a few decades ago. Within the frameworks of the Anglo-Saxon economies of Great Britain and North America a decisive event that has contributed to this is considered the paper by David Birch entitled "The Job Generation Process" from 1979 (Deakins and Freel 2012, 42). By his paper Birch shook widely accepted belief that large companies are the main drivers of growth in the economy. His research, based on data corporation of Dun & Bradstreet referring to more than 5.6 million companies, showed that small enterprises in the period between 1969 and 1976 created more than 80% of new jobs in the economy of the United States. The result of the research encouraged him to conclude without any doubt that large companies are not the main creators of new jobs in America.

Following this research, besides a slight denial of statements by some researchers, there are more studies that confirm the results of D. Birch. Therefore, the SME sector is becoming an unavoidable segment of development policies in most countries. The EU as one of the most developed economies of the world, gives the special significance to entrepreneurship sector and SMEs. Recognizing all importance of all the big companies for the development of the EU economics as a response to global challenges, especially in the US progress in the knowledge economics, the European Council in 2005 redefined the broad goals from Lisbon and focused priorities on growth and employment. The European Commission in 2005 started the implementation of the revised Lisbon Strategy giving it the name "Strategy for growth and jobs", in which it showed the special importance of the role of SMEs for economy and economic development (Deakins and Freel 2012). As continuity in the implementation of the Lisbon Strategy, the European Commission in 2010 adopted a new document "Europe 2020: a strategy for smart, sustainable and inclusive growth".

The Global Entrepreneurship Monitoring (*Global Entrepreneurship Monitor - GEM*) clearly indicates the positive relation among entrepreneurships of small enterprises and economic growth starting from the overall objective to demonstrate the extent to which entrepreneurial activity influences on economic growth (GEM 2016/17, 14). As it became more difficult for the big companies to effectively adapt to changes in the environment, so the importance of small enterprises was growing. The restructuring of the economy through the reform process in the Republic of Srpska showed all the inefficiency of big economic systems on the market was, creating space for entrepreneurial activity and the formation of small enterprises. Only the best survived on the market, those enterprises that have successfully gone through the process of restructuring. Newly formed SMEs in private ownership, which were led by successful entrepreneurs, take over slowly the role of big enterprises by giving a special contribution to the growth of the economy, generating jobs and newly created value.

The role of small enterprises sector in the economy was at the most neglected level at the peak of „Fordist" mass production, which was preceded by the oil crisis of the early seventies. However, in the eighties it became clear that the importance of mass production declines and that SME sector takes over a leading role in the economic development.

Recent research on the role of SMEs in economic activity show that the importance of this sector varies depending on the development of the country. More specifically, the small business makes about 16% of the GDP in low-income<sup>2</sup> countries and more than 50% in high-income countries (Edinburgh group 2012, 7).

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<sup>2</sup>In underdeveloped countries, the SME sector is generally big, but mainly operates in the "gray zone".

### 3. CONTRIBUTION OF SMEs ENTREPRENEURSHIP TO THE ECONOMY OF THE REPUBLIC OF SRPSKA

The importance of SMEs in the EU countries is measured and monitored by using three main indicators (number of enterprises, gross value added and number of employees). By observing these three indicators in 2015 it can be noted that the SME sector includes 99.8% of all enterprises in the EU 28 (EU Annual Report on SME sector from 2015 to 2016, 22). They employ 66.8% of workers and generate 57.4% of value added. It follows that the SME sector has a leading role in the economic development of the EU economy, but it does not mean that we should ignore the role of big enterprises because they employ 0.2% to 33.2% of the people and generate 42.6% of added value.

Through these three indicators this paper reviews the contribution of the SME sector to the economic growth of the Republic of Srpska in 2014 and 2015<sup>3</sup>. Unlike developed countries, the economy of the Republic of Srpska is still characterized by weak economic activity that relies primarily on trade or financial and other services. The SME sector has maintained a relatively high share in the basic indicators of the economy in such difficult economic conditions.

Table1. Comparative indicators of development of the entrepreneurial sector of SMEs and big enterprises in the Republic of Srpska

Year	2014	Share(%)	2015	Share(%)
Number of enterprises by size				
SME	26.038	99,78	26.222	99,76
Big	58	0,23	63	0,24
Total	26.096	100,00	26.285	100,00
Number of employees by size of enterprise				
SME	125.539	76,35	127.023	75,28
Big	38.895	23,65	41.700	24,72
Total	164.434	100,00	168.723	100,00
Added value (000 KM)by size of enterprise				
SME	2.794.351	68,8	2.948.492	67,07
Big	1.267.215	31,2	1.447.524	32,93
Total	4.061.566	100,00	4.396.016	100,00

Source: The author according to the data of the Statistical Office of the Republic of Srpska (Statistical Yearbook for 2015 and 2016 and the Annual Notice number 268/16); available at: [www.rzs.rs.ba](http://www.rzs.rs.ba)

At the end of 2015, in the economy of the Republic of Srpska compared to 2014, the number of companies increased by 189 newly-established business subjects, which led to the creation of 4,289 new jobs and partly amortized newcomer wave of the unemployed. Out of that sector of big enterprises it was increased by only five companies, which made share of employees increased from 23.66% to 24.72%. However, this increase of 2,805 employees is not a result of the establishment of new big enterprises, but of transition of the five medium-sized enterprises in the sector of big<sup>4</sup> ones.

Based on the data in Table 1 it can be seen that the contribution of the SME sector to employment and the creation of added value in the Republic of Srpska is even more emphasized than in the EU. The structure of the enterprise is the same because in the observed (RS) and the control group (EU) SME sector dominates with a 99.8% share in the total number of companies. The contribution of this sector to employment and the creation of added value in the RS is about 10% higher than in the control group (75.28% of employees in RS compared to 66.8% in the EU and 67,07% of value added created in the RS compared to 57.4% in the EU). Therefore, small and medium enterprises and entrepreneurs employed around 3/4 of the total number of workers in the economy of RS at the end of

<sup>3</sup>It is difficult to follow the dynamics of entrepreneurship SME over a longer period of time because of the change in method of statistical data of the Statistical Office of RS. Namely, in the Statistical Yearbook only since 2012, the data is observed by the size of the company, not only total. Also, by 2014 the contribution was observed only by the size of the company, and from that year the self-employed entrepreneurs are also included in the analysis.

<sup>4</sup>Enterprises with over 250 employees, with a total annual income exceeding 8.000.000 KM or having an average value of business assets at the end of the financial year exceeding 4.000.000 KM by the Law on the development of SMEs are classified as large companies ("Official Gazette of Republic of Srpska" no. 50/13).

2015. They also created more than 2/3 of the added value in the same year so it can be concluded that the sector of small business is the backbone of employment and economic growth in the Republic of Srpska.

A number of unsuccessful small and medium sized businesses in the Republic of Srpska each year go through the process of bankruptcy and liquidation and they stop working. Based on the annual analyses it can be noted that approximately equal to or higher number of newly established MSP emerge on the market. On the influence of unfavorable factors of the environment in 2014, 569 SMEs stopped working and 4,965 were subjects in the form of entrepreneurs, while 3,242 new entrepreneurs and 839 SMEs were registered. It can be concluded that the entrepreneurial activity is the most organized in the form of craft, a lot more sensitive to the influence of the unfavorable business environment<sup>5</sup> in relation to businesses as legal entities belonging to the SME sector.

Table 2. The structure of business entities in the Republic of Srpska by form of organization (2010–2015)

The structure of SMEs by form of organization from 2010 to 2014					
	2010	2011	2012	2013	2014
LTD	82,45	82,75	83,39	83,74	84,05
J-SC	6,23	5,89	5,58	5,15	4,62
Other*	11,32	11,36	11,03	11,11	11,33
TOTAL	100,00	100,00	100,00	100,00	100,00

\*Partnership, cooperative, public enterprises, health institutions

Source: Ministry of Industry, Energy and Mining of the Republic of Srpska and RZZ RS

According to the organizational structure the most of the small and medium-sized enterprises are limited liability companies (84.05%), joint stock companies 4.6% while other forms of organization (partnership, cooperative, public enterprises, health institutions) make 11.3% (Table 2). At the end of 2014, changes in the structure of SMEs by type of organization are not significantly changed in comparison to 2010.

#### 4. ANALYSIS OF BUSINESS PERFORMANCE OF SME SECTOR AND BIG ENTERPRISES

A precondition for achieving sustainable socio-economic development of the Republic of Srpska is development of economy that builds its long-term competitiveness on private entrepreneurial initiative, knowledge, application of new technologies and innovation. The previous analysis showed that the small business sector has primacy when it comes to contributing to employment and the creation of added value. However, it is useful to analyze other indicators which speak about the business performance in order to determine which sector leads.

Table 3. Turnover and costs of the employed by size of enterprises in RS

Indicators	MSEs	Big	Total	Share of MSEs	MSEs	Big	Total	Share of MSEs
	2014	2014			2015	2015		
Turnover (000 KM)	14.848.151	3.222.574	18.070.725	82,2%	15.042.605	3.469.022	18.511.627	81,3%
The costs of the employed(000 KM)	1.233.481	730.091	1.963.572	62,8%	1.256.600	772.906	2.029.506	61,9%

Source: Author according to the Statistical Office (Statistical Yearbook for 2016 and Structural business of statistics number 60/17); available at [www.rzs.rs.ba](http://www.rzs.rs.ba)

<sup>5</sup>The unfavorable business environment implies high rates of taxes and contributions paid by entrepreneurs, high level of corruption, an inefficient judicial system, i.e. slow resolving of disputes, lack of sources of funding, inadequate entrepreneurial infrastructure and other.

Based on the data in Table 3 it can be concluded that the turnover and staff costs are also higher in SMEs than in big firms. Small and medium enterprises generate for around 4/5 of total turnover and about 62% of the costs of employees.

Bearing in mind that they employ more than 75% of the people, the above mentioned charges are not in complete proportion to this indicator, which leads to the conclusion that the salaries of the employed in the MSP sector are lower than in big companies. This fact is not surprising if one takes into account that the Republic of Srpska is a developing country and that entrepreneurship is predominantly represented out of necessity. A large number of micro-enterprises and self-employed entrepreneurs pay the minimum income to employees, especially in the first years of business that are critical to survival in the market. On the other hand, big companies are able to offer higher salaries, thus attracting skilled labor.

Table 4. Financial performance of enterprises by size in 2014

	Small	Medium	Big
Turnover per employee	109.816	136.848	82.852
Added value per employee	22.936	20.772	32.580
Profitability	13,2	5,8	16,7

Source: Author according to the Statistical Office (Statistical Yearbook for 2016); available at [www.rzs.rs.ba](http://www.rzs.rs.ba)

In Table 4 three performance indicators of enterprises by size are given. The turnover per employee is higher in small and medium-sized enterprises, but big companies lead when we observe the other two indicators. Added value per employee, as a measure of labor productivity is a very important indicator because it is an instrument of efficiency of use of the workforce. As it can be seen in the table, the employed in big enterprises are more productive by about 50%. Also, this sector leads in profitability in relation to small and medium-sized enterprises. Based on the analysis of all these statistical data we can conclude that both sectors have their own advantages and it is the best to ensure their coexistence.

Table 5. Basic indicators of success in doing business in the Republic of Srpska in 2014 (000 KM)

	Total income	%	Gain	%	Loss	%	Income tax	%
Micro	1.708.382	17,87	150.480	20,82	67.119	20,19	13.807	21,55
Small	2.356.435	24,64	184.272	25,49	27.240	8,20	16.057	25,06
Medium	3.506.240	36,67	152.527	21,10	218.129	65,63	12.643	19,73
SMEs	7.571.057	79,17	487.279	67,41	312.488	94,01	42.507	66,35
Big	1.991.672	20,83	235.599	32,59	19.896	5,99	21.560	33,65
TOTAL	9.562.729	100,00	722.878	100,00	332.384	100,00	64.067	100,00

Source: Ministry of Energy and Mines of the Republic of Srpska: Annual Report for the field of SMEs and unincorporated entrepreneurial activity in the Republic of Srpska, Banja Luka, 2016, p.20.

From Table 5 it can be observed that the SMEs had a share of 79.17% in the total of realized revenues at the end of 2014. The share of big enterprises amounted to 20.83%, which indicates a low share of big enterprises in the total income of business entities in the Republic of Srpska. According to the realized profit, the SME sector had a share of 67.41%, while the share of big enterprises and companies amounted to 32.59%. Consequently, small and medium enterprises pay more income tax. These indicators are expected bearing in mind the number of enterprises in this sector. However, it should be noted that they reach a much higher loss compared to big companies. Precisely, medium-sized companies with up to 65.63% dominate in this category.

## 5. CONCLUSION

Based on the research, it was concluded that SMEs had a more significant role in the reporting period than big companies in terms of structure, the growth of added value and number of employees. Taking into account that they make 99.8% of all businesses, employ approximately 3/4 of

the workforce, generate 80% of total turnover and create 2/3 of added value, it is obvious that this sector is the backbone of the economy of the Republic of Srpska. However, this does not mean that big companies should be ignored. The analyzed data showed that big companies are more productive by about 50% than small and medium-sized enterprises and they are more profitable than them. Also, based on the presented data it is concluded that the salaries of employees are higher in big companies. The reason for this is the fact that domestic entrepreneurship is mostly entrepreneurship out of necessity, meaning that micro and small enterprises are often established only in order to ensure the existence of the owner and his family. The salaries of workers in such enterprises are at a minimum level while the big corporations are in a better position to offer higher salaries and thus attract the most qualified workers. This means that both sectors have their own advantages. It would not be rational to expect that the overall economy develops only in a small business or only big corporations. They should be holders of major projects, and small firms their support and cooperators. Therefore, development policy should be formulated to encourage the development of both sectors, and not only one of them.

It should also be noted that the analysis showed worrisome data for midsize enterprises since they reach the lowest profitability (5.8%) and have the biggest share in total realized losses (over 65%). With regard to the fact that this group of enterprises is a "transitional step" from small to big business, its role in the economy is extremely important. Its bad business results indicate the necessity to devote it greater attention in order to formulate a better basis for the creation of big companies.

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