**CHALLENGES OF THE EU AND THE NATIONAL SME POLICY: BETWEEN ADMINISTRATING, MANAGING AND GOVERNING**

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**Abstract**

*Due to the evident fact that the SME sector has become a dominant part of the EU economy, the SME policy is increasingly gaining importance. The complexity of the SME policy measures indicates the difficulties in implementing, controlling and managing the SME policy. This paper provides an overview and analysis of the measures and programs to support SMEs at an EU level and at the level of the Croatian economy. While governments in advanced economies are undergoing a period of rapid reform aimed at enhancing its efficiency and effectiveness, the Croatian government has to create the framework conditions for the development of the SME sector.*

**Key words:** *SME policy, European Union, Croatia*

**1. INTRODUCTION**

European politicians have recognized the importance of the social role of the entrepreneurs (owners of small and medium-sized enterprises). Therefore it is not strange that the policies supporting small and medium-sized enterprises (SMEs) began with the first elections in the European Parliament. Politicians are aware that entrepreneurs perform an important economic and social role: employment and self-employment, contribution to innovation, dynamic efficiency (as opposed to static efficiency of large firms) and competitiveness.

Policy support for small and medium-sized enterprises is not easy to create, and it also very difficult to control its implementation. Dannreuther (2007) also emphasizes the problem of the EU SME policy governance. The SME sector is heterogeneous, even in terms of enterprise size. The European SME definition is important for at least two reasons. The first one is to identify the micro, small and medium-sized enterprises interested in applying for grants or loans aimed at the SMEs, and the second one is to provide the appropriate information on which criteria are to be satisfied in order to benefit from specific legislative provisions for the SMEs (European Commission, 2005). Although there is a definition of micro, small and medium-sized enterprises, sectorial differences make small companies small in one sector or industry, and large in another sector or industry (due to the differences in minimum efficiency size, capital intensity, sunk costs, etc.). In addition, firms themselves have different motives and strategies, some companies are guided by a lifestyle strategy, some are focused on survival, and there are also those that implement innovation and growth strategy, use modern technology, boost growth (slower or faster) or have the intention to achieve growth. The need for reproducing the population of the firms through entry of new firms (in order to compensate for the relatively high failure rates of new businesses) requires effort and active participation of the policy.

According to the report of the European Commission for SMEs (Wymenga et al., 2011), in the European Union more than 19 million enterprises operate in the non-financial sector. SMEs make up 99.8%, while large enterprises make a minor part of the population: 0.2% (Table 1). It is evident that the typical company in the EU is a micro-enterprise. The number of micro-enterprises has a share of 92.1%, while small businesses make up 6.6% and medium-sized enterprises only 1.05% of the total number of enterprises. The average size of a micro-enterprise, measured by the number of employees, shows that micro-enterprises in the EU employ an average of 2 employees, indicating a decrease in the average size of micro-enterprises in relation to the previous reports. Aggregated data for the SME sector shows that this sector employs two-thirds of the employees in the non-financial sector: 87, 5 million employees were in SMEs, where the micro-enterprises employ nearly 30% of total employees.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Micro | Small | Medium | SME  | Large | Total |
| Number of enterprises (1 000) | 19.200 | 1.380 | 220 | 20.800 | 40 | 20.840 |
| Number of employees (1000) | 38.910 | 26.610 | 21.950 | 87.460 | 43.260 | 130.720 |
| Employeess per enterprise (1) | 2 | 19 | 100 | 4 | 1.005 | 6 |

**Table 1.** The number of enterprises, number of employees, total sales and added-value in the EU economy

Source: De Kook et al. (2011, p. 28.), the European Commission’s annual report on SMEs 2010/2011

At the same time, the productivity increases with the size of the enterprise. The lowest productivity measured in added-value is in micro-enterprises (Wymenga et al., 2011). The reasons for lower productivity of small and medium-sized enterprises could be lower capital investments, higher fixed labor costs and using less skilled labor compared to large enterprises.

**2. WHAT DOES EU ACTUALLY DO AND WHAT HAS BEEN DONE UP TO NOW FOR THE SME SECTOR?**

The EU adopts and implements horizontal and vertical measures to encourage SMEs. Horizontal measures are aimed at improving the general business environment, while the vertical measures focus on specific problems such as finance, education, etc. Since 2000, the EU has adopted several important documents related to SMEs. These are:

• the Lisbon strategy as a process that directs the SME policy,
• the European Charter on SME from Santa Feira,
• The Small Business Act (SBA) from 2008 based on the “Think small” principle.

The Lisbon Strategy is a process that gives guidelines to the European SME policy. The recent European strategy, Europe 2020, is the continuation of the Lisbon strategy. The European Charter on SME from Santa Feira has been accepted as a determinant for the development of small and medium-sized enterprises. It consists of ten main principles: education and training for entrepreneurship, cheaper and faster start-up, better legislation and regulation, availability of skills, improving online access, getting more out of the Single Market, taxation and financial matters, strengthening the technological capacity of small enterprises, successful e-business models and top-class business support, stronger development, more effective representation of small enterprises’ interests in the EU and on the national level (European Commission, 2001). Policy makers were expected to become aware of the special interests and needs of small businesses.

The EU recognized knowledge, technology and the creation of added-value as an advantage before the low-wage economies, and also documents the capacity of the SMEs for the growth and innovations as a way to prosperity. The Small Business Act which proclaims the principle “Think small first” is based on the needs of strengthening the SME sectors and has defined the following important tasks: to create an environment in which entrepreneurs and family businesses can succeed and in which they are rewarded for their success, to secure that honest entrepreneurs who are facing bankrupt quickly get another chance, to apply the “Think small first” principle means to take into consideration the characteristics of small and middle-sized businesses when designing laws and to simplify the current regulation, to make the public administrations a support for the needs of the SME, and particularly by promoting the e-government and one-stop-shop solutions, to adapt the tools of the public policy to the needs of the SME, to support the access to SME finances, especially risk capital, micro-loans and mezzanine financing and to develop a legal and business environment that supports the timely payment in commercial transactions, to stimulate SMEs to take advantage of the opportunities which are offered to them by the Single Market, to promote the improvement of the skills of the employees in SMEs and all forms of innovation, to enables the SMEs to turn ecological challenges into opportunities, to support and encourage SMEs to use the market growth outside the EU (European Commission, 2008).

Since it is difficult to establish a strict line between SMEs and entrepreneurship, we will mention the Green paper on Entrepreneurship in Europe, an important strategic document whose aim is to stimulate the growth and development of small and medium-sized businesses and to create a positive environment for entrepreneurship (European Commission, 2003). It has been pointed out in this document that solutions to encourage more people to become entrepreneurs have to be offered, and to create the conditions for the growth of companies.

In addition to the strategic guidance and writing of important documents to support the SMEs, the EU is, in practical terms, providing the SME sector with specific support. We will name some of the most important programs carried out by the EU: The Competitiveness and Innovation Program, known under the abbreviation CIP, was passed by the European Parliament and Council in October of 2006, for the period from 2007-2013 With the budget of approximately 3,6 billion Euros (European Union, 2006). The purpose of the program is to support innovational activities (including eco-innovations), to provide small and medium-sized businesses with a better access to finances, to secure the services for support of the business operations in the region, to encourage the better use of information and communication technologies, to help the development of the information society, to promote an increased use of renewable energies and the energy efficiency. The Entrepreneurship and Innovation Program (EIP) is the first component of the Framework Program for Competitiveness and Innovation with a budget of 2,17 billion Euros for the period from 2007-2013 (European Union, 2006). The target group for this part of the program are the SMEs in the start-up and in the development phase, and the aim is to ease their access to financial resources (the funds for the venture and seed capital, micro-loans for up to 25 000 Euros, loans, guarantees), to encourage them to implement entrepreneurship and innovation culture, to use innovative and ecological technologies, to coordinate their business with the environmental policy and to use renewable energy sources, to improve their business with the use of ICT systems, to form clusters, to form public-private partnerships. Inside the CIP the High Growth and Innovative SME Facility (GIF) was launched. The funds are used to facilitate the launch (GIF 1) or to develop the business operation (GIF 2) of fast-growing innovative small and medium-sized businesses, as an indirect support for loan guarantees of small and medium-sized businesses – the SME guarantee mechanism - SMEG (European Union, 2007). In the framework of the cohesion policy instruments in the period from 2007-2013, the JEREMIE (Joint European Resources for Micro to Medium Enterprises) initiation was launched by the European Commission (The Directorate-General for Regional Policy) for the promotion of better financing in the development of micro, small and medium-sized businesses in the regions of the European Union (European Investment Fund, 2009) The JEREMIE initiation offers the EU member states the opportunity to use a part of the structural founds of the European Union (the European Regional Development Fund - ERDF).

The new Program for the Competitiveness of enterprises and SMEs, called COSME, has a budget of 2.5 billion Euros and its implementation is planned for the period from 2014-2020 (European Commission, 2011). It is actually the continuation of the CIP program. The objectives of the COSME program are: facilitating access of the SMEs to the finances, creating an environment favorable to business creation and growth, encouraging an entrepreneurial culture, increasing the sustainable competitiveness of EU enterprises and helping small businesses to operate outside their home countries and to improve their access markets. The excepted outcomes of the program are: an easier access to finances for entrepreneurs and small businesses, higher rates of self-employment and business development as important sources of job creation. At the national level, it expects to achieve more competitive industries, a higher number of entrepreneurs and higher employment rates.

**3. HOW TO MEASURE THE PERFORMANCE OF THE SME POLICY?**

The SME policy is made and carried out in the EU, as well as on the national level. Besides, the SME policy is linked to other policies: the employment policy, the social policy, the innovation policy, the industrial policy, and the entrepreneurship policy. At the same time, the SME policy is a collection of different measures. It can be a general support policy for the rapidly growing businesses, which can be set up as the government’s trade-off (Lilischkis, 2011). How to control the SME policy, then?

Even though the principles of the industrial policy and the support policy to the SMEs are different, as measures and instruments, it cannot be said that there is no link between them and that small and medium-sized businesses cannot feel the effects of the industrial policy. The industrial policy on the EU level acts on a sector by sector basis (eg. metal, automotive, shipbuilding, textiles, ICT). The industrial policy encompasses all government interventions that are focused on the offers in the economy (firms, industries, sectors) and to influence the industrial structure of the economy and / or its change (Kandžija and Cvečić, 2010). The basic instruments of this policy are subventions and tax exemptions. The policies of SME support and the entrepreneurial policy helps the entrepreneurs to achieve competitiveness and flexibility, it gives him direct support through institutions, but there is also the ever present risk for the entrepreneurs and the possibility of failure. Through the industrial policy the risks brought by competition are spread across the whole society (the problem of the shipbuilding industry in Croatia and two decades of discussions whether it makes sense to separate so much money from the state budget in order to subsidy shipbuilding). The problem of the industrial policy is that it is uncertain whether all businesses deserve to be subsidized.

Different policies can operate simultaneously in one area. As an example we can mention the sectorial EU policy linked to information and communication technologies. Even though the sectorial policy, because of the distribution of businesses in favor of the micro, small and medium-sized businesses, inevitably in this policy enters the support policy for the SMEs, with the added feature of innovation policy characteristic due to the nature of the sector, but also with a special emphasis on businesses with high growth rates.

Also, there is a close connection and a partial overlapping of the SME policy and the entrepreneurship policy. Aernoudt (Table 2) gives a brief comparison of the SME policy and the entrepreneurship policy with the difference in causes of the formation of the policy, objectives, target groups, resources and focuses of the policies.

|  |  |  |
| --- | --- | --- |
| **Policy** | **SME** | **Entrepreneurship** |
| ***Legitimating*** | Market failure | Lack of entrepreneurs |
| ***Objectives*** | To help SMEs with their relative disadvantages (compared to large enterprises) | Be undertaking (start a business, grow, mentality) |
| ***Target group*** | Businesses | Entrepreneurs |
| ***Resources*** | Financial (subsidies) | Mainly non-financial |
| ***Focus on*** | Business environment | Entrepreneurial culture |

**Table 2.** SME and entrepreneurship policy: a comparison

Source: Aernoudt, R., European enterprise policy, according to Aernoudt (2007), <http://www.oecd.og/dataoecd/1/56/39745299.pdf>

According to Aernoudt, the SME policy would be more efficient in an entrepreneurial environment. Every level of society would have their task and thereby function:

- ***individuals*** – to consider entrepreneurship as a career option,

- ***enterprises*** – to adapt to change in order to survive and seize new opportunities

- ***society***– to create a supportive environment where the entrepreneurial initiative and risk-taking is treated as valuable as well as the contribution of enterprises to society.

Since the effects or outcomes of the public sector are realized by a number of organizations, the government performance should not be measured on an organizational level but on the level of policy. The concept of efficiency in the public sector is based on a generally accepted "logic model" of performance in nonprofit and public organizations (Berman, 2006, p. 147), which, in its simplest form, can be showed through a logical sequence:

input → activity →output → outcome → goals.

This model seems to be a linear type function, but the reality is more complex than such a simple function. The outcomes and the effects are subject to influences that come with changes in the political environment. The first problem arises from the output-outcome relationship.

The disrupted relationship output-outcome stems from a number of reasons: the lack of market mechanisms, the politicians who overestimate or underestimate the outcomes, and citizens who inhibit achieving outcomes because of their reactions to government measures. Outcomes or effects are the most important criteria in assessing government performance (Bouckaert and Halligan, 2008). The type and level of outcomes are influenced by the social needs (in the moment of the economic crisis: unemployment and lack of growth). Needs of the society are the base for creating strategic and operational objectives of specific policies.

There are three levels on which it is necessary to analyze and provide support for the SMEs and entrepreneurs (Autio et al., 2007):

- micro-level(the entrepreneur and enterprise) with a focus on the motivation and skills of the entrepreneurs and to help enterprises overcome their resource disadvantages: capital, social capital, reputation, business expertise, technological expertise, innovation on the enterprise level, infrastructure,

- mezzo level (sector/industry): networks (innovation clusters, business networks, financial networks); opportunities (growing markets, new markets, international markets and public markets),

- macro level (national and EU level/environment): creating entrepreneurial culture, innovation and research programs and regulations (bureaucracy, bankruptcy laws).

Outputs are never an end in itself for the government. The most important goal is to achieve the trust of the citizens in all institutions and organizations, especially in public institutions and organizations. The relationship between the effects/outcomes and trust provides the second problem in the government policy (Bouckaert and Halligan, 2008).

The government has a limited amount of resources that it can spend on the SME policy and it attempts to achieve the economic and social welfare. The benefits from the SME policy could even be negative if the funds spent do not have a positive effect on the performance of the enterprise, if the enterprise would have behaved in the same way without the subsidies – the subsidization effect (Lilischkis, 2011). The maximum return of the investment can be less than the total amount spent on incentives for SMEs, for example, due to the inefficiency of the administration. An effective but inefficient policy is inadequate, the effectiveness is considered to be the most important measures of performance.

**4. THE CROATIAN SME POLICY**

Figures show that the Croatian economy, as well as the EU economy, has become a micro-economy and that the “Think Small First” principle also makes sense in the case of Croatia. Table 3 shows that the share of SME enterprises has increased from 99% to 99.5% in nine years.

|  |  |  |
| --- | --- | --- |
|  | 2001. | 2010. |
|  | Number of enterprises | % | Number of enterprises | % |
| Small enterprises | 54.213 |  | 95.004 |  |
| Medium enterprises |  2.203 |  |  1.379 |  |
| SME sector | 56.416 | 99 | 96.383 | 99.5 |
| Large enterprises |  571 | 1 |  375 | 0.5 |
| Total | 56.987 | 100 | 96.758 | 100 |

**Table 3.** The enterprise size distribution in the Croatian economy: 2001 and 2010

Source: CEPOR (2011), [http://www.cepor.hr/SME%godišnjak\_final.pdf](http://www.cepor.hr/SME%25godi%C5%A1njak_final.pdf)>

Economic indicators (Table 4) show that the SME sector accounts for about half of the total Croatian output. It also employs about 2/3 of all employees (as in the EU). The crisis has probably affected the SME sector as the share of SMEs in the Croatian GDP has decreased by almost 2% from 2009 to 2010. The export share of large enterprises (almost 60%) is an obvious indicator that it is necessary to give support to the internationalization of the SME sector.

|  |  |
| --- | --- |
| Indicator | Enterprise size |
| Small | Medium | Large |
| 2009. | 2010. | 2009. | 2010. | 2009. | 2010. |
| GDP (mil. EURO) | 27.511.012 | 26.573.176 | 15.740.035 | 14.604.100 | 38.101.932 | 38.581.047 |
| GDP (%) | 33,8% | 33,3% | 19,3% | 18,3% | 46,8% | 48,4% |
| Employment | 417.979 | 415.320 | 166.916 | 157.147 | 300.394 | 287.341 |
| Employment (%) | 47,2% | 48,3% | 18,9% | 18,3% | 33,9% | 33,4% |
| Export (mil. EURO) | 2.034.310 | 2.409.751 | 2.335.603 | 2.527.198 | 6.405.218 | 7.084.360 |
| Export (%) | 18,9% | 20,1% | 21,7% | 21,0% | 59,4% | 58,9% |

**Table 4.** Enterprise size, GDP, employment and export in 2009 and 2010

Source: CEPOR (2011), p. 14, [http://www.cepor.hr/SME%godišnjak\_final.pdf](http://www.cepor.hr/SME%25godi%C5%A1njak_final.pdf)

The Croatian government, faced with difficult economic conditions, adopts a strategy and set of measures in 2012 to give support to the SME sector and entrepreneurship. An amount of 100 million Euros will be delivered through the following programs: competitive entrepreneurship, loans and guarantees, education for entrepreneurship, improvement of entrepreneurial infrastructures, EU programs and projects, institutional support to entrepreneurship development (Government of the Republic of Croatia, 2012a).

The strategy presents the general and the specific objectives as well as the expected outputs and effects over the three-year period (Government of the Republic of Croatia, 2012b). The final goal is to enhance the competitiveness of the Croatian entrepreneurship by supporting the creation of competitive, innovative and growing entrepreneurships. Specific goals, presented as an implementation of the Entrepreneurial impulse measure, can be achieved at a micro, mezzo and macro level. Micro-level measures are aimed at facilitating access to finances by loans and other forms of financing, education for entrepreneurship in the form of a formal educational system as well as in the form of life-long learning, effective entrepreneurial infrastructure, implementation of the investment supporting law. The mezzo-level goal is to enhance the international competitiveness. The goal of the macro-level is to improve the entrepreneurial culture and business environment.

The main problems of the all governments' strategies and measures up to now:

• problems of implementation and control,

• the lack of consistency and long-run planning.

Outputs that can be a proximate measure of the success of the program are: an increase in the number of enterprises, an increase in the share of entrepreneurs, increasing the TEA index(Total Entrepreneurial Activity index which presents the number of “nascent” and new entrepreneurs as a percentage of the population between 18 and 65 years of age), the number of loans, grants, investments, projects, number of participants in educational programs, etc. The outcomes of the government program are easy to detect: employment, self-employment, competitiveness, innovation and growth.

Despite all the previous failures of the government policy, there is a vital part of the economy that survives and exploits opportunities on the market. Survey evidence from countries in transition suggest that many enterprises are set up, survive and sometimes even grow despitethegovernment, because of the creativity of individuals in mobilizing resources and their flexibility in adapting to hostile external environments (Smallbone and Welter, 2001).

**5. CONCLUSIONS**

To achieve the EU economy competitiveness, as well as in the Croatian economy, it is important to focus on a few things:

• facilitate the entry of new firms, but also allow the honest entrepreneurs in bankruptcy to recover as soon as possible and to start a new entrepreneurial venture,

• facilitate a position for growing businesses,

• provide support for the internationalization of SMEs.

It could be argued that the complementary policies aimed at small and medium-sized enterprises (SMEs general policy support, support for emerging companies, entrepreneurial policy) are necessary to empower the EU economy. Also, the policy should not be taken as a principle for favoring SMEs. Large companies also have an important function in the economy and its advantages.

It is not easy to find a model that would generate the highest innovation rates and the highest growth rates. Many factors influence innovation and growth: the size of the market, the stages of market development, the industries in which enterprises operate, etc. If all relevant factors are not studied and not monitored, policies that favor certain types of enterprises may have poor or no effects to the economy.

The role of the European Union, taking into account the relationship between centralization and subsidiarity, should be to resolve the problems that should be resolved at an EU level, such as joint venture capital market or enhancing opportunities for the internationalization of SMEs, creating a common market and placing a greater emphasis on the Enterprise Europe Network. Member States should find themselves the most appropriate policy in order to address the needs of their SME sector in the most acceptable way (Lilischkis, 2011).

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