# ECONOMIC DEVELOPMENT OF ENTREPRENEURSHIP I SME SECTOR IN DUBROVNIK 1

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**Undergraduate thesis / Završni rad**

**2020**

*Degree Grantor / Ustanova koja je dodijelila akademski / stručni stupanj:* **RIT Croatia / RIT Croatia**

*Permanent link / Trajna poveznica:* https://urn.nsk.hr/urn:nbn:hr:229:957017

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*Download date / Datum preuzimanja:* **2024-03-29**

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2020.

# Economic Development of Entrepreneurship and SME sector in Dubrovnik city

SENIOR PROJECT

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RIT CROATIA | Spring, 2020.

**Abstract**

This paper investigates the current economic state of SME and entrepreneurship in the city of Dubrovnik. Highlighting the importance of the SME sector and the cooperation between governmental institutions with the business owners for improving the current environmental ecosystem in the city of Dubrovnik are emphasized. Observing the economic indicators over 2,275 business entities that are within the categorization of SME in the last three years there is a trend of moderate growth described in economic characteristics of number of entities, their profitability and efficiency. Being a member of European Union Croatia gained additional approaches for developing the SME sector where the city of Dubrovnik due to the high touristic orientation recognized the importance of this economic sector for building a more sustainable ecosystem as a long term goal.

## 1. Importance of entrepreneurship

The importance of entrepreneurship has gained a significant role in today's economies. It represents an important mechanism for economic development since it has a close relevance to innovation, employment and welfare effects (Schumpeter, 1934; Acs and Audretsch, 1988; Wennekers and Thurik, 1999; Baumol, 2002). There are many forces which influence economic development, such as demographic and technological changes where developed countries are trying to increase the awareness of entrepreneurial potential and the use the entrepreneurial potential to make further improvements to boost the economy of the country. These dynamics are changing the business environment by giving a wider opportunity pool

for local people on the market. In the last decade, public and private organizations, governments and the general public are trying to cope with these rapid changes since the human characteristic has become crucial for development of the economy (Bessant and Tidd, 2011). The city of Dubrovnik gained global touristic reputation over the past years, which resulted in a higher living standard for local people. Longer seasonality with high circulation of tourists gave the city of Dubrovnik many new business opportunities to develop. Entrepreneurial and small companies became more and more popular career paths for people in this region since the market became bigger. According to the Global Entrepreneurship Monitor Report there is a growing perception of opportunities but unfortunately the intentions for actually starting the business are low (GEM, 2017). There are four main areas for development of the current entrepreneurial sector on the national level, and those are: institutional framework, financing, awareness (education) and increasing the visibility of businesses (National Strategy for the Development of Social Entrepreneurship, Croatia, 2017). These areas are currently not well developed or they did not gain enough attention from the governmental institutions, which is why those became the main objectives of the Strategy. Current financial framework does not go in favor of entrepreneurs which is why the institutional support from non-public as well as public bodies needs to develop better systematic financial support and unique mechanisms for developing this sector of economy. This goes in hand with institutional framework where again, the bureaucracy needs to work for the people instead vice versa. With a bigger opportunity pool, promoting entrepreneurship at all levels of education will help bring the importance of economic distribution of this sector which will bring more awareness to public and nonpublic bodies as well as the people of Croatia. At least, these objectives with positive outcomes can increase the diversity of businesses with better competition among the same. Since Dubrovnik County has the highest

percentage of development index in the country we can see there is a high potential for building a sustainable economy of this sector (GEM Report, 2017). Croatia belongs to an efficiency-driven economy when it comes to development level but it is still lagging before other European developed countries (GEM Report, 2017). To stimulate the growth, government with other institutions must consider to readjust the current unstable regulations and adjust financial mechanism to stimulate this sector. Also, the high importance towards economic development through entrepreneurship and the SME sector is the strong cooperation between both nonprofit and public sectors (National Strategy for the Development of Social Entrepreneurship, Croatia, 2017) where good collaboration and better commitment for this goal would be created. According to the National Strategy for Entrepreneurship Education Development (GOV Croatia, 2010) entrepreneurship is one of the key competences that can drive economic development in Croatia. Therefore, entrepreneurial education that involves improvement of personality traits, attitudes, abilities and people's skills would be of a higher importance in the developing process of this economic sector (Karajic, 2014"Culture of Entrepreneurship – Croatia case"). Understanding of entrepreneurship in economic development gained significant focus in Dubrovnik which can be seen by increasing numbers of businesses in the last 10 years.

### 1.1. Defining entrepreneurship in terms of economic development

Although entrepreneurship gained significant popularity in the last 30 years, we can see a drastic shift towards this sector in the last 10 years. Introducing the National Strategy for the Development of Social Entrepreneurship (2013) Croatia, being a part of the European Union received a green light for implementation of activities towards improvement of entrepreneurship in Croatia. While there is no clear and simple definition of entrepreneurship,

J.B. Say stated that "the entrepreneur shifts economic resources out of an area of lower productivity and moves them into an area of higher productivity" (Toma, Grigore, Marinescu, 2014). Meanwhile, Schumpeter (2014) defines entrepreneur as an innovator and coordinator of productivity and change. Entrepreneurship has contributed to economic development in many aspects such as job creation, economic growth and also it impacts national prosperity. Development of entrepreneurship stimulates competition since many new enterprises are created and it also allows people to see new opportunities which creates more innovative ideas. With expanding SME sector entrepreneurs create more diverse ecosystems and bring variety among businesses in one destination. The common characteristics of entrepreneurs are persistence, dedication, leadership and their drive for high achievements, with risk taking distinguishing them in the talent pool and giving them advantage to create values with better strategic actions.

## 2. Entrepreneurial environment in Croatia and their challenges

According to Global Entrepreneurship Monitor (GEM, 2017) entrepreneurial environment consists of many components including microeconomic and macroeconomic policies. Croatia is still behind the countries that go under the same category, efficiency–driven economies. The main component for Croatia, stated by Global Entrepreneurship Monitor (GEM, 2017) is access to money where entrepreneurs are lacking the sources of capital for business investments. Besides the financial infrastructure another crucial components are government policies towards entrepreneurship. Highly insufficient bureaucracy and taxation which are not aimed to support the entrepreneurial framework developed an entrepreneurial gap between aspiration of innovation among people and actual realization of the entrepreneurial activity. The fact that the TEA index did not change over the last five years (8%) shows that new

businesses, startups and those who are working 42 months after the opening are not perceiving a sustainability of their business performance due to an insufficient bureaucracy and high competition on the market. Also the perception of people who have the intention of opening an entrepreneurial business entity stayed the same over the last three years (22%). The main reason people exit entrepreneurial activity is an inadequate profitability which is closely related to the governmental policies and framework of low institutional support. Due to the governmental improvements towards this economic sector and their challenges the attitudes of entrepreneurs have changed where the percentage of fear of failure decreased by 8.9 in a single year (2018). Croatia has a high competence for bigger entrepreneurial activity and the lack of education on second educational levels and higher might be the reason for lagging behind the other efficiency-driven economies in the European Union. Another crucial factor in development through entrepreneurship and a SME sector is the slow implementation of planned actions which comes back to institutional framework where bureaucracy can be slow and often too challenging for people to enter in entrepreneurship and/or a SME sector. Unfortunately, there is a decline in index of policies towards environmental activities and regulatory framework from 2013 and 2014 which clearly shows the need to make better effort in this field (CEPOR, SME and Entrepreneurial sector, 2015).

## 3. Entrepreneurial activity in the city of Dubrovnik

Dubrovnik is a well-known tourist destination where many domestic people saw the business opportunities and according to Croatian Chamber of Trades and Crafts (HOK, 2017) we can see the improvements in this sector where there was an increase of 38 percent in the last five years towards entrepreneurial potential. Only in 2018 there was an entrepreneurial increase of 13 percent which also resulted in having a lowest employment rate of 13 percent

(Croatian Chamber of Trades and Crafts, HOK, 2018). Croatia has 32,7 business people on every hundred by population according to HOK (2019) where only Dubrovnik in 2019 had more than 2000 open businesses which made Dubrovnik the second city in the country by the number of SME and entrepreneurial businesses. These results by Global Entrepreneurship Monitor Report (GEM, 2017) and Croatian Chamber of Trades and Crafts (HOK, 2019) clearly show a high potential for further improvements of entrepreneurship and the SME sector with a wide range of many different activities for implementations towards economic development. Many different governmental policies and initiatives were established in the last decade where European Union acknowledged the importance of entrepreneurship and the SME sector in economic development where their main aim was to remove the challenges and help to improve the environment for this economic sector. Being a member of European Union, Croatia has the privilege to adopt those initiatives and implement those to insure the economic growth from entrepreneurship and the SME sector. Dubrovnik is the second in the country by the number of small and medium size businesses which is why the city recognize the National Strategy and Small Business Act (European Union, 2018.) to gain the economic growth and recognition of this sector. Several measurements have been implemented to increase the opportunity of economic development in service and trades in the city of Dubrovnik (OECD, 2003. *Croatia Enterprise Policy Performance Assessment)*. By investing in entrepreneurial education and their promotion, facilitating regulatory rules and bureaucratic system with better financial support it shows that this sector can easily be improved for a long term goal. According to the European Union, adopted initiatives such as European Charter of Small Enterprises and Small Business Act can be one of the key approaches towards strengthening innovation and entrepreneurship in Croatia (European Union, 2004. *Priručnik za procjenu učinaka (PEU) na malo I srednje poduzetništvo (MSP)*). The importance of

implementations of these governmental acts in Dubrovnik city can play a crucial role in building sustainable entrepreneurial state and further development of this economic sector. The relation in the last three years between SME businesses and their productivity were examined in the city of Dubrovnik.

## Methodology

This paper investigates the entrepreneurial activity and SME sector in the city of Dubrovnik and suggests some possible methods for further improvement. The research was carried out with a use of qualitative content analysis method. The official data and existing factual projects were gathered from institutions that have the mission to monitor the state and development of the SME sector and entrepreneurship. In the secondary research various case studies were analyzed to classify definitions of entrepreneurship and the SME sector and their importance to economic development in the city of Dubrovnik. To define entrepreneurship, a small and medium enterprises theoretical method was used. According to Accounting Act (2007) defining the SME entrepreneurial business do not exceed following criteria selection: the existing business entities that do not exceed 250 employees and their official location is within the city of Dubrovnik, achieve annual turnover to 260 million Croatian Kuna and have total assets up to a value of 130 million Croatian Kuna. Those businesses were observed to explain the current state of SME and entrepreneurship in the city, using different economic indicators (revenues, profitability, taxation…) Exploring various case studies on this topic gave a better overview of the level of entrepreneurial activity in Croatia as well as in the City of Dubrovnik. The analysis method has been used to evaluate existing constraints towards development of the SME sector and observation of existing policies, measurements and

initiatives in this economic sector. Using quantitative characteristics of entrepreneurship and the SME sector certain current activity was analyzed to see under which conditions entrepreneurship and SMEs development has been realized and under which conditions has been successfully implemented. In the primary research, the overall dynamics of entrepreneurial activity and SME sector in overall Croatia and Dubrovnik city were analyzed based on various sources of information and level of development of the current SME sector and entrepreneurial activity. Data were covered from governmental institutions like Croatian Chamber of Economy, Chamber of Commerce, Croatian Chamber of Trades and Crafts (HOK), Financial Agency, Ministry of Economy, Entrepreneurship and Crafts and other existing official projects such as Global Entrepreneurship Monitor Report Croatia (GEM, 2017) and Small and Medium Enterprises Report (CEPOR, 2018) – Croatia from SME and Entrepreneurship Policy Center. Different organizations participated and were examined in this study where several conditions on the national scale were explored. Around 130 000 organizations are operating in Croatia that are within this sector, where only in Dubrovnik County the number of organizations within the entrepreneurial sector are around 4007 (HOK, 2018). After examination of those organization's performance and activity the main focus gained small and medium enterprises in Dubrovnik city which has around 2200 organizations registered in the city of Dubrovnik (HOK, 2019). Furthermore, different dynamics of this economic sector were analyzed. Enterprise structure and size (Croatian Chamber of Economy, 2016, 2017, 2018) that are explaining the position of the city of Dubrovnik among the other cities in Croatia with the financial results like revenues and expenses (Croatian Chamber of Trades and Crafts, 2016, 2017, 2018) that are describing the entrepreneurial market in the city. Salary rates were examined in the last three years that shows the governmental approach in developing this sector (Ministry of Economy, Entrepreneurship and Crafts, 2016, 2017,

2018). Legally binding like short and long term assets and liabilities were compared to see the productivity of the current market (Financial Agency, 2016, 2017, 2018). Export and import business activity and investments for long term assets shows the impact on the consumers and the economy of this sector in Dubrovnik (Croatian Chamber of Trades and Crafts, 2016, 2017, 2018). Comparison method has been used between different Croatian regions to measure Dubrovnik's opportunities and differences in attitudes towards entrepreneurship and the SME sector and their development. Finally, several different approaches have been evaluated to see the best possible model for Dubrovnik's economic development from entrepreneurship and the SME sector where different European models and approaches were analyzed (Eurostat, 2020). The sources of the sampling for finding the economic characteristics of Dubrovnik city in entrepreneurship and SME sector was the Financial Agency (FINA, 2019) database of entrepreneurs with comprised analysis of Global Entrepreneurship Monitor Report (GEM, 2017), SMEs and Entrepreneurship Policy Center Report (CEPOR, 2018) and Croatian Chamber of Trades and Crafts (HOK, 2019).

## Results

The aim of this paper is to observe the current economic state of Dubrovnik in terms of small and medium size business entities and entrepreneurship and suggest possible approaches for improvement of entrepreneurial environment. The sources of the sampling for finding the economic characteristics of Dubrovnik city in entrepreneurship and SME sector was the Financial Agency (FINA, 2019) database of entrepreneurs with comprised analysis of Global Entrepreneurship Monitor Report (GEM, 2017), SMEs and Entrepreneurship Policy Center Report (CEPOR, 2018) and Croatian Chamber of Trades and Crafts (HOK, 2019).

According to Croatian Chamber of Economy (2018) the total number of business entities that are under the criteria of SME in the city of Dubrovnik in 2018 were 2,275 where 66,7 % had a positive cash flow. These 1,518 businesses recognized the opportunity of touristic destination and National Strategy for improving their efficiency which results in over 27 % increase in revenues as well as 21 % increase in expenses in the last three years. According to the Financial Agency there was an increase of 39 % of profit without tax and a decrease of 36 % in expenses without tax which is the result of new tax regulations that are implemented for the development of the entrepreneurial sector. There is a trend of overall moderate growth in the last three years in the entrepreneurship and SME sector in the city of Dubrovnik which shows the implementation of the National Strategy for improving the entrepreneurial state in Dubrovnik city. Since more than sixty percent of all businesses are showing positive productivity there is a steady increase of 14 % in the employment of this sector in the city of Dubrovnik. Sixty percent of SME businesses operate on a local market without the export activities which shows the competitive advantage of a domestic small market like Dubrovnik where the majority of businesses are within a service and trade sector (Ministry of Economy, Entrepreneurship and Crafts, 2018). The Ministry recognized the opportunity of development in Dubrovnik where the average monthly net salaries were increased by 5 percent over the past three years which helps the overall competitiveness of the market and brings many new opportunities for people to invest more in this economic sector. According to the Financial Agency (2018) there was a significant increase (22 %) of short term assets as well as the short term liabilities (14 %) with a decrease of 2 % of long term assets and 4 % of long term liabilities which defines the touristic market in the city of Dubrovnik. With implementation of new governmental regulation and new taxation framework in 2015 SME businesses experience moderate increase of productivity and efficiency comparing the post-recession

time after 2008 with an increase of 17 % of overall capital in this sector (Ministry of Economy, Entrepreneurship and Crafts, 2018). High flow of tourists and different touristic demands brought the city an increase of import (52 %) and also a significant increase of import (61 %) (FINA, 2018). According to Croatian Chamber of Trades and Crafts (2018) the number of businesses with an import activity grew by 28 % and a slower growth of business with export activity by 7 %. Upon accession the competitiveness of this economic sector grew stronger and Dubrovnik gained a better position among the other Croatian cities who are heavily touristic oriented which results of Dubrovnik being the most competitive in Croatia in this sector.

## Discussion

There is a trend of steady growth in the last three years in the entrepreneurial and SME scene in the city of Dubrovnik. We can see the number of SME businesses which are operating with a negative cash flow is less than forty percent which clearly shows the strength of this economic sector in this touristic destination. The overall perception of people in this industry are somehow misunderstood since there is an increase of competitors, higher number of new entries in the market and with that competitiveness might be harder to obtain the effective performance of a business. With slower implementation of new regulations towards the improvement of this economic sector the business owners have difficulty to match their business operations with continuous changes from Ministries and other models on a national level. The Ministry of Economy recognized the economic importance of this sector and its importance of improving the same where bureaucratization works more towards the business owners and helping them operate more productively and efficiently. Unfortunately in the beginning of 2020 the pandemic of Covid-19 drastically changed the perception of the

upcoming touristic season where the expectation of business performance drastically decreased to the point of having the lowest performance of SME businesses in the past ten years. The tourism collapse for the upcoming season of 2020 will have a major effects on the overall industry of Dubrovnik especially for the SME and entrepreneurial sector where their liquidity of cash is the lowest among other bigger business entities. The government of Croatia has highly recognized the importance of the SME sector in overcoming the Covid-19 situation for the upcoming year and many additional new regulations were implemented to minimize the effects of the pandemic. New European Union's funds are created to ease the SME business performance in the next year. Also for those SME business entities with the lowest liquidity of cash Croatian Chamber of Economy introduced the new credit program with minimal interest rate to support these entities to overcome the struggling upcoming year. These measurements are of high importance for the stability of this economic sector and for a further more sustainable ecosystem in the city of Dubrovnik. Looking beyond the pandemic situation the government of Croatia recognized the importance of the SME sector and its further development where there are continuous new regulations from the national level as well as European Union to build a more sustainable ecosystem of SME and entrepreneurial sector in the city of Dubrovnik (Čučković N., Bartlett W. 2007). Besides the local mindset of not supporting this sector enough from the national level there is a clear moderate growth of the same and it is more vivid in this current pandemic situation where the support from the national level is precise and fast since the ongoing situation with Covid-19 is unpredictable. The current pandemic situation shows the need for faster implementation of new regulations and improvement of current institutional framework that works better towards the business owners where better cooperation will bring faster sustainable economic situation in the city of Dubrovnik.

# Appendix

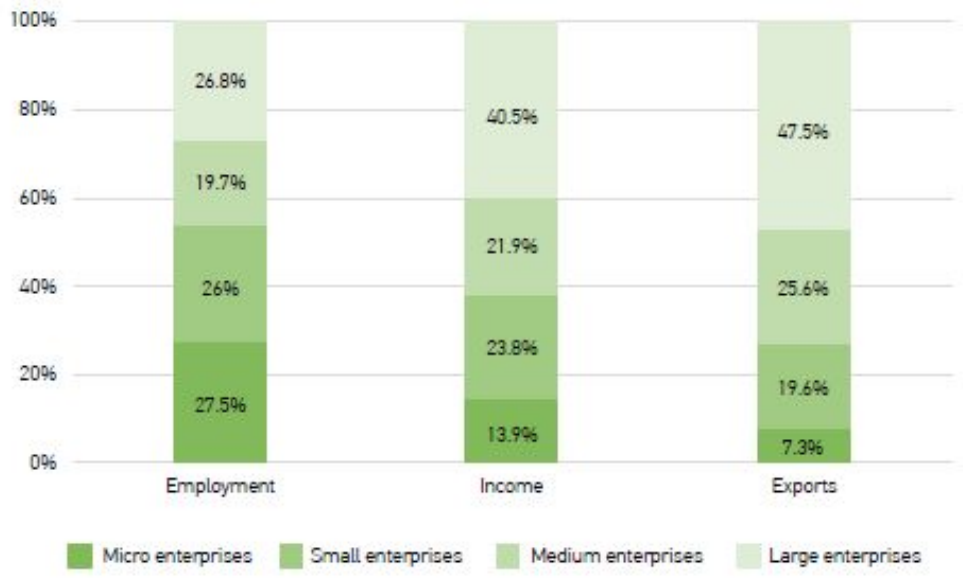


*Figure 1 (employment, income and export by the sector) FINA*

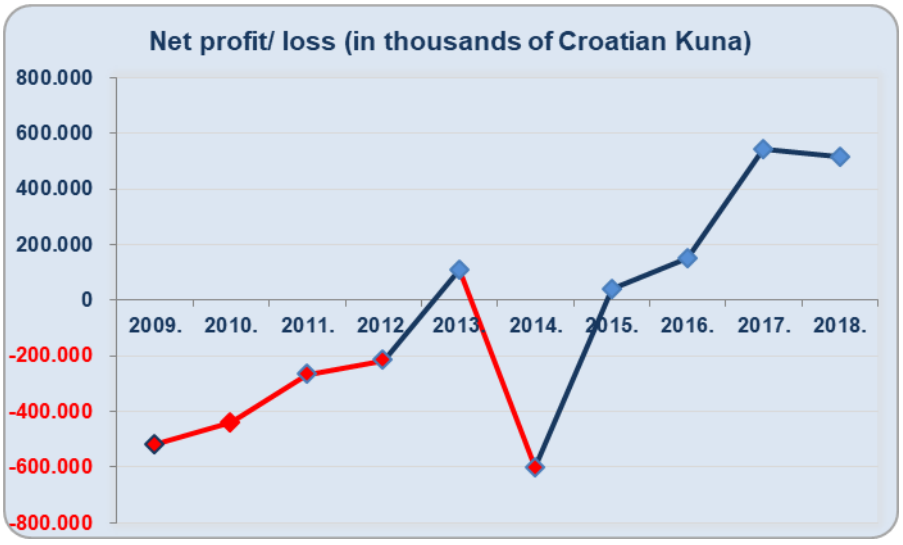


*Figure 2 (Net profit/loss) FINA 2019*

*Figure 3 (number of employees) HGK 2019*

| | The City of Dubrovnik | (in thousands of HRK) | | |
|---|---|---|---|---|
| Description | 2016. | 2017. | 2018. | Source |
| # of businesses | 1.946 | 2.127 | 2.275 | Croatian Chamber of Economy |
| # of businesses with positive cash flow | 1.265 | 1.380 | 1.518 | Croatian Chamber of Economy |
| # of businesses with negative cash flow | 681 | 700 | 757 | Croatian Chamber of Economy |
| # of employees | 10.819 | 11.717 | 12.383 | Croatian Chamber of Economy |
| Total revenue | 6.009.332 | 7.102.057 | 7.634.537 | Croatian Chamber of Trades and Crafts |
| Total expenses | 5.761.998 | 6.526.475 | 7.003.460 | Croatian Chamber of Trades and Crafts |
| Profit without tax | 624.317 | 842.746 | 870.307 | Financial Agency |
| Expense without tax | 376.982 | 267.164 | 239.230 | Financial Agency |
| Tax profit | 77.124 | 104.336 | 116.708 | Financial Agency |
| Net salaries | 735.889 | 814.422 | 889.812 | Ministry of Economy, Entrepreneurship and Crafts |
| Average monthly net salary | 5.668 | 5.792 | 5.988 | Ministry of Economy, Entrepreneurship and Crafts |
| Long term assets | 10.758.864 | 10.901.098 | 11.064.862 | Financial Agency |
| Short term assets | 3.256.198 | 3.701.508 | 4.004.354 | Financial Agency |
| Capital | 5.600.600 | 6.009.814 | 6.559.634 | Ministry of Economy, Entrepreneurship and Crafts |
| Long term liabilities | 5.033.112 | 4.840.889 | 4.795.443 | Financial Agency |
| Short term liabilities | 2.956.274 | 3.443.385 | 3.372.000 | Financial Agency |
| # of businesses with export activity | 102 | 107 | 110 | Croatian Chamber of Trades and Crafts |
| # of businesses with import activity | 94 | 107 | 121 | Croatian Chamber of Trades and Crafts |
| Export | 857.839 | 1.253.261 | 1.387.733 | Financial Agency |
| Import | 81.948 | 124.032 | 124.714 | Financial Agency |
| Investments for long term assets | 137.945 | 367.541 | 322.368 | Croatian Chamber Investments for Trades and Crafts |

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