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Microfinance institutions as a strategic tool for strengthening Serbia's financial system, promoting financial inclusion, and supporting inclusive economic growth

Ivana Ostojić[a*], Predrag Petrović[a]

[a] Institute of Social Sciences, Centre for Economic Research, Belgrade, Serbia

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Abstract

Microfinance can act as both a financial and developmental tool for Serbian MSMEs by improving access to credit, promoting inclusion, building capacity, fostering innovation, and supporting regional and green development. The demand for microfinance is driven by exclusion from mainstream finance and the need for small, flexible, and accessible financial products. The research investigates how microfinance would contribute to the stability of the Serbian financial system and to the inclusive growth of the MSME sector. Results of the study indicate that there is a significant demand for microcredit in Serbia, and microfinance would contribute to the stabilization of the domestic financial system, as well as to the improvement of the financial position of MSMEs. Research confirmed that there is a mismatch between the currently available banking products and the financial needs of MSMEs. It was also verified that microfinance would stimulate employment in Serbia and facilitate the establishment of enterprises.

Keywords: *microfinance institutions, MSMEs and entrepreneurs, inclusive economic growth, financial inclusion, financial system*

1. Introduction

The private sector plays a key role in fostering economic development. Micro, small and medium enterprises (MSMEs) and entrepreneurs represent an important part of every national economy, as well as a factor of economic and social stability. The sector of small and medium-sized enterprises contributes to employment growth. MSMEs strengthen public finances through tax contributions, drive sustainable economic development and social welfare, and serve as a cornerstone for building a competitive, knowledge-driven economy. Small and medium-sized enterprises are carriers of creativity and innovation, directly influencing the level of investments and aggregate demand. Due to their flexibility, they easily adapt to market changes. Especially for small businesses, a high degree of market flexibility, combined with low fixed costs and profitability of capital investment, represents a significant determinant and comparative advantage. Development of small and medium-sized enterprises encourages the productivity and efficiency of the entire economy, strengthens the entrepreneurial spirit, technological progress, and competition (Ostojić, 2023, p. 90).

Small and medium-sized enterprises are catalysts of economic development. Small businesses intensively strengthen the fundamental goals of the economy, thus becoming the backbone of economic progress. SMEs represent 99% of businesses in the EU. They generate approximately two-thirds of private-sector jobs and have created around 85% of new jobs in recent years (Eurofound, 2025). In developing countries, SMEs contribute approximately 50% of employment and 40% of GDP. The World Bank estimates that SMEs in emerging markets generate 7 out of 10 formal jobs (Carvajal & Didier, 2024). A detailed study across 99 developing economies reveals that SMEs (250 or fewer employees) generate around 86% of jobs, and this figure increases even further (93%) in countries with net positive job creation (Demirgüç-Kunt, 2011). Financial instruments and policies in the field of microfinance are strategically designed to support the objectives of sustainable development, with more than half of the Sustainable Development Goals being directly addressed through their implementation.

Microcredit financial institutions are present across both developed European countries and the neighboring transition economies. Microfinance refers to the provision of loans of up to 25,000 euros, specifically intended to meet the financial

*Corresponding author
E-mail address: ivanaostojic27@yahoo.com; iostojic@idn.org.rs

needs of micro-enterprises and entrepreneurs, as well as other businesses that face difficulties in obtaining conventional loans (European Microfinance Network, 2024). Microfinance is an important factor in the economic development of micro, small and medium enterprises and entrepreneurs and the creation of new jobs. A financial system is enriched and improved by the diversity of financial institutions. For small and medium-sized enterprises, microfinance institutions are more important than banks. According to research, one of the 3 basic problems faced by small and medium-sized enterprises in Serbia is insufficient access to finance (Sedlak et al., 2016).

In Serbia, small and medium-sized enterprises have access to various sources of funding, including commercial banks, leasing companies, factoring companies, business angels, the capital market (through the issuance of shares and corporate bonds), and alternative investment funds (Radulović & Radulović, 2021). In Serbia, commercial banks remain the predominant source of financing for micro, small, and medium-sized enterprises and entrepreneurs. In addition, national development programs by the Ministry of Economy, the Ministry of Science, Technological Development and Innovation support the financing of small and medium-sized enterprises. Support for the development of small and medium-sized enterprises can be provided by other institutions such as the Development Fund of the Republic of Serbia, Development Agency of Serbia, Insurance and Export Financing Agency, the National Employment Service, the Development Fund of AP Vojvodina, the Guarantee Fund of AP Vojvodina, the Fund for Innovation Activities, the Provincial Secretariat for Economy and Tourism. Development finance institutions such as the European Investment Bank (EIB), the European Bank for Reconstruction and Development (EBRD), the European Fund for Southeast Europe (EFSE), the International Finance Corporation (IFC), and the German Development Bank (KfW) also play a role in improving access to finance for small and medium-sized enterprises in Serbia.

The paper will analyze options for financing the growth and development of MSMEs available in Serbia, other than banks. Serbia’s financial sector is highly dominated by banks, with few alternative or non-bank microfinance institutions. Banks in Serbia typically require high collateralization (often real estate), while many MSMEs lack fixed assets. Credit risk assessment is still document-heavy and based on past financials, not on business potential or cash flow. This means many micro and small enterprises have to rely on banks, which tend to have stricter requirements, higher costs (administrative, collateral), and are less flexible. The paper will explore how the availability of microfinance institutions bridges this gap by offering tailored financial products such as microloans, which are more accessible to smaller businesses. This support enables MSMEs to invest in growth, innovation, and job creation, promoting sustainable economic growth. Microfinance contributes to diversifying Serbia's financial system, which is predominantly banking-centric. By introducing microcredit financial institutions, microfinance enhances the financial infrastructure, making it more inclusive and supportive of MSME growth.

2. Literature review

Microfinance has emerged as a vital financial instrument designed to provide access to credit, savings, and other financial services to individuals and enterprises excluded from the formal banking system. MSMEs, often constrained by limited capital and collateral, rely on such mechanisms to sustain growth, enhance productivity, and generate employment. The intersection of microfinance and MSMEs has been widely studied, as both are seen as engines of poverty reduction and inclusive economic development. The demand for microfinance is driven by exclusion from mainstream finance and the need for small, flexible, and accessible financial products. It is evolving beyond credit toward a full range of financial services tailored to the micro-entrepreneurs. Financial instruments and policies related to microfinance are designed to fulfill the goals of sustainable development. Financial instruments related to microfinance are projected to address more than half of the Sustainable Development Goals, with an estimated budget allocation of €1.95 billion by 2027 (European Commission, 2020).

Beck, Demirgüç-Kunt, & Levine (2005) argue that improved access to finance leads to higher firm entry rates and growth in small businesses. In developing economies, microfinance institutions provide small-scale, short-term loans with flexible repayment structures, which are critical for MSMEs’ working capital needs (Ledgerwood, 2013). For MSMEs, this bridging function is essential because they are often excluded from formal banking due to their small scale, lack of collateral, or informal nature. Microfinance institutions reduce transaction costs, manage risk, and create mechanisms for monitoring repayment, thereby enabling MSMEs to access working capital and invest in growth opportunities (Ledgerwood, 2013). Microfinance institutions play a critical role in bridging the financing gap for MSMEs by pooling savings and providing loans (Robinson, 2001). Many MSMEs face credit constraints caused by limited collateral, insufficient credit history, and high administrative costs associated with small loans. According to Stiglitz and Weiss (1981), these constraints can lead to credit rationing, where firms are denied loans even if they are willing to pay higher interest rates. Microfinance helps to alleviate such constraints by using group lending, peer monitoring, and flexible collateral requirements, allowing smaller businesses to obtain financing that would otherwise be inaccessible (Beck, Demirgüç-Kunt, & Levine, 2005).

Sen (1999) emphasizes that beyond financial capital, microfinance enhances social and human capital, increasing MSMEs’ resilience and entrepreneurial capacity. Sen’s (1999) capability approach emphasizes that development is not only about financial resources but also about enhancing individuals’ freedoms and abilities. Microfinance contributes to the empowerment of MSME owners by improving access to financial resources, strengthening decision-making capacity, and facilitating skill development. This approach recognizes that social capital, knowledge, and entrepreneurial capabilities are equally important in sustaining business growth, particularly for women-led and marginalized MSMEs (Pitt & Khandker, 1998; Armendáriz & Morduch, 2010).

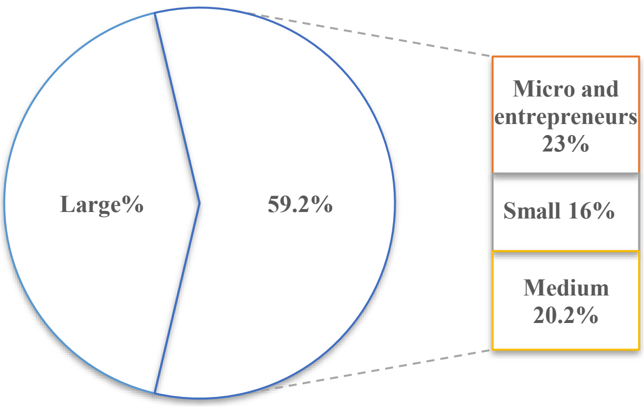
The Pecking Order Theory of Financing posits that firms prefer internal financing over external financing due to information asymmetry and the costs of external borrowing (Myers & Majluf, 1984). For MSMEs, which often have limited retained earnings, microfinance can serve as a critical first source of external capital. By providing small loans without stringent collateral, microfinance institutions help bridge the gap until MSMEs can access more traditional forms of finance. Studies in South Asia and Sub-Saharan Africa show that microfinance loans improve firm profitability, asset accumulation, and employment generation (Banerjee & Duflo, 2010). On the contrary, Karlan and Zinman (2011) found limited or no impact of microfinance on long-term business growth, with credit often diverted to consumption rather than productive investment. A study Microfinance and sustainable development of MSMEs and entrepreneurs in Serbia finds that introducing microfinance institutions would contribute positively to the establishment, growth, sustainable development and positive business performance of micro, small and medium enterprises and entrepreneurs (Ostojić, 2023).

Resource-Based View (RBV) suggests that firm resources, including financial, human, and social capital, are key drivers of competitive advantage (Barney, 1991). Microfinance contributes by providing MSMEs with financial resources that complement existing human and social capital. Access to credit allows MSMEs to invest in technology, expand operations, and enhance market competitiveness, thereby translating financial support into sustainable performance improvements (Ledgerwood, 2013). Ledgerwood and White (2006) emphasize that providing diversified services helps MSMEs manage risks and invest in growth. Institutional capacity and governance are crucial for achieving both social and financial objectives.

3. Research

The micro, small, and medium enterprise sector, along with entrepreneurial activity, constitutes a critical driver of economic development in Serbia. According to the latest available data, in 2020, more than 400,000 active small and medium-sized enterprises and entrepreneurs make up 99.9% of all enterprises, employ 65.1% of workers, generate 66,4% of turnover, create 59.2% of gross value added (GVA-value added at factor costs) and participate with 39.5% in exports and 54.7% in imports of the non-financial sector of the Serbian economy (Ministry of Economy of the Republic of Serbia, 2022, p. 12). The COVID-19 pandemic, which began to affect the economy at the end of the first quarter of 2020, has drastically reversed the previous development trends and halted the favorable cycle from the last quarter of 2019, when an exceptionally high economic growth rate was achieved. The pandemic had a major impact on the operations of the SME sector in 2020, as it led to a sharp slowdown or even in some areas thwarted the successes that the SME sector had achieved over the past decade.

Figure 1. Entrepreneurs, micro, small, medium, and large enterprises in Serbia (share in gross value added of the non-financial economy), 2020.



Source: Ministarstvo privrede. (2022). *Izveštaj o malim i srednjim preduzećima i preduzetništvu za 2020. godinu*

The MSME sector records a profitability rate of 37%, while the most successful sectors are the processing industry and trade, followed by the achieved values of financial indicators. Within the MSME sector of the processing industry, sectors with lower technological complexity and lower productivity (labor and resource-intensive activities) dominate. In terms of international trade, MSMEs account for 39.5% of total exports and 54.7% of total imports within the non-financial economy. Moreover, they contribute approximately 66.4% to the overall turnover of the non-financial sector (Ministry of Economy of the Republic of Serbia, 2022).

MSMEs contribute to the gross value added of the non-financial economy with almost 60%, which confirms their relevance in driving economic growth and development. Looking at the data from Table 1, in comparison with neighboring countries, analyzing the participation of basic indicators of MSMEs in the non-financial business economy (number of enterprises, gross value added, and employment), Serbia does not lag behind the other observed countries in the region, nor the average of the European Union. Also, according to the number of small and medium-sized enterprises and entrepreneurs per 1,000 inhabitants, Serbia does not lag behind the average of the European Union. However, by analyzing data on gross value added per employee, which defines the level of productivity, as well as the number of employees per company, there is a significant lag behind neighboring countries. In Serbia, the gross value added generated by the micro, small, and medium-sized enterprises amounts to approximately €15,600 per employee. Within the regional context, only Bulgaria reports a lower level of gross value added, with €13,800 per employee. By contrast, the average gross value added per employee in the European Union is significantly higher, at €40,000, with Slovenia, recording €32,400 per employee, being the closest to this benchmark. Furthermore, notable structural differences exist in firm size: while the average number of employees per enterprise in the EU is 3.7, Serbian enterprises employ, on average, only 2.5 workers (Ministry of Economy of the Republic of Serbia, 2022).

Table 1. Comparative analysis of performance indicators in the MSME sector, 2020.

Country	Participation of MSMEs in non-financial business economy			Productivity (000 EUR)	Number of employees per company
	Number of enterprises	Employment	Gross value added		
Serbia	99.8	64.2	59.2	15.6	2.5
Slovenia	99.8	73.2	65.3	32.4	3.3
Romania	99.7	66.1	55.9	16.5	5.2
Hungary	99.9	68.7	55.1	19.8	3.2
Croatia	99.7	67.4	63.7	20.6	4.6
Bulgaria	99.8	74.0	64.1	13.8	4.4
EU-27	99.8	65.2	53.0	40.0	3.7

Source: Ministarstvo privrede. (2022). *Izveštaj o malim i srednjim preduzećima i preduzetništvu za 2020. Godinu.*

MSME sector in Serbia requires further advancement to achieve substantial improvements in financial performance and enhance its overall competitiveness, particularly in relation to neighboring countries. Current data indicate that the sector contributes slightly more than 30% to Serbia's gross domestic product, whereas in neighboring economies such as Hungary, Croatia, and the Czech Republic, this share is significantly higher, ranging between 50% and 60% of gross domestic product. Moreover, while MSMEs in Serbia account for approximately 40% of the country's total exports, their contribution in developed economies typically ranges from 60% to 70%, underscoring the need for strategic measures to strengthen the sector's role in economic development and international trade (Organisation for Economic Co-operation and Development, 2025).

Small and medium-sized enterprises (SMEs) in underdeveloped countries frequently encounter substantial challenges in their business operations, particularly in securing adequate financing. In contrast to larger corporations, SMEs often face significant barriers in accessing financial resources. This issue is evident in Serbia as well, where the so-called "missing middle" emerges as a situation in which enterprises with strong potential for growth and job creation are unable to obtain the financing necessary to support their development (Morduch, 1999). Lack of finance, especially at the beginning of a business, when negative cash flow very often occurs, threatens to become a brake on the future development of a particular company over time, because development most often cannot be fully financed from its own accumulation, but must also accept the additional risk that comes with using external sources of financing (Rashid & Jabeen, 2018).

Small and medium-sized enterprises (SMEs) frequently fail to meet the eligibility requirements necessary for accessing bank loans. Consequently, business owners are often constrained to rely on internal sources of financing, such as personal savings, retained earnings, or the sale of assets. Recent survey data indicate that approximately 85% of small businesses in Serbia are initially financed through the owners' own resources (Antić, 2025). Banks approve loans to the MSME sector with caution, requiring the fulfillment of certain conditions such as a good credit history, capital and turnover requirements, and a low debt-burden ratio (Chukwuma, 2017). Banks may increase lending to MSMEs without adequate financial reporting or collateral, especially during credit pushes backed by donor lines or incentives. Weak borrower information leads to poor underwriting, higher default rates and higher non-performing loans, which undermine banks and can tighten future credit for everyone (a pro-cyclical effect).

The Serbian banking sector has faced challenges with non-performing loans for years. Therefore, tightening lending standards for micro, small, and medium-sized enterprises appears to be a sensible option. This is supported by the fact that micro-enterprises and entrepreneurs may encounter difficulties in accessing financing, preparing business plans, gaining market presence, and growing their businesses. Also, one of the problems for MSMEs is insufficient loan collateral. Following the global pandemic, companies were further weakened, as reflected in the decline in income, cash flow, and liquidity. Large companies are in a much more favorable situation because they have access to the capital market. Additionally, research indicates that a significant number of low-value loans can compromise banks' profitability by increasing costs (Arhinful, et al., 2025). For all the previously mentioned reasons, micro, small, and medium-sized enterprises and entrepreneurs are often discouraged from borrowing because they are unable to meet the demanding criteria, they fear rejection, or believe their application will be unsuccessful.

Table 2. A cross-country examination of financing sources for MSMEs

Serbia	Bulgaria	Romania	Czech Republic	Croatia	Slovenia	Hungary
Banks	Banks	Banks	Banks	Banks	Banks	Banks
Leasing	Leasing	Leasing	Leasing	Leasing	Leasing	Leasing
Factoring	Factoring	Factoring	Factoring	Factoring	Factoring	Factoring
-	Microfinance	Microfinance	-	Microfinance	Microfinance	Microfinance
-	-	Crowdfunding	Crowdfunding	Crowdfunding	Crowdfunding	Crowdfunding
-	REITs[1]	REITs	REITs	-	REITs	REITs
-	-	Corporate bond market	Corporate bond market	Corporate bond market	Corporate bond market	Corporate bond market
-	Credit unions	Credit unions	Credit unions	Credit unions	Credit unions	Credit unions
-	Venture capital	Venture capital	Venture capital	-	Venture capital	Venture capital
-	Business angels	Business angels	Business angels	Business angels	Business angels	Business angels
-	Private equity	Private equity	Private equity	-	Private equity	Private equity

Source: Author's research

Table 2 indicates that financing options for micro, small, and medium-sized enterprises (MSMEs) in Serbia are more limited compared to those available in neighboring countries. According to the United Nations Development Programme (2021), Serbian MSMEs predominantly rely on short-term bank loans, although urgent financial needs are sometimes met through credit card financing. In contrast, businesses in neighboring countries typically have access to a broader range of financing instruments. In Serbia, SMEs can draw upon various funding sources, each characterized by distinct conditions, associated risks, and differing levels of accessibility. The availability and ease of access to these sources are influenced by the enterprise's type, stage of development, and sector of activity. In practice, commercial banks constitute the primary source of financing for MSMEs, whereas capital markets and alternative investment funds remain underutilized due to structural and regulatory constraints. However, leasing and factoring are increasingly popular for improving liquidity, and business angels/venture capital funds are growing in relevance, especially for Information and Communication Technology (ICT) startups and innovation-driven sectors. If MSME lending becomes concentrated in a few banks or tied to specific sectors (e.g., construction, trade), shocks to those firms or sectors can transmit to the banking sector. That threatens financial stability and may force macroprudential tightening that disproportionately hurts small firms and slows inclusive growth.

Until 2005, the domestic financial system encompassed microfinance institutions, including savings banks and credit cooperatives. However, in the current regulatory framework, only commercial banks are authorized to provide microfinance services to the SME sector. The provision of microfinance could play a critical role in enhancing access to finance for micro, small, and medium-sized enterprises. According to the European Investment Bank's findings on the multiplier effect of investments in micro, small and medium-sized enterprises, every euro invested in the MSME sector generates an increase in GDP equivalent to 1.5 times the invested amount (European Investment Bank, 2024). Micro, small and medium-sized enterprises in Serbia are completely dependent on the banking sector. This makes the financial market vulnerable to unforeseen external shocks in the banking sector, and highlights the importance of establishing alternative, competitive sources of funding (Financial Stability Board, 2022). The significance of establishing and developing microcredit financial institutions is underscored by the estimated annual shortfall of funds for MSME operations, which represents the gap between the demand for and supply of microcredits, and amounts to approximately one billion euros (European Commission, 2020). Although the Czech Republic, a neighboring country, currently lacks established microfinance institutions, its estimated demand for microcredit is substantially lower than in Serbia, approximately one-fifth of the Serbian demand (Table 3).

[1] Real Estate Investment Trusts

Table 3. Annual unsatisfied demand for microloans in euros

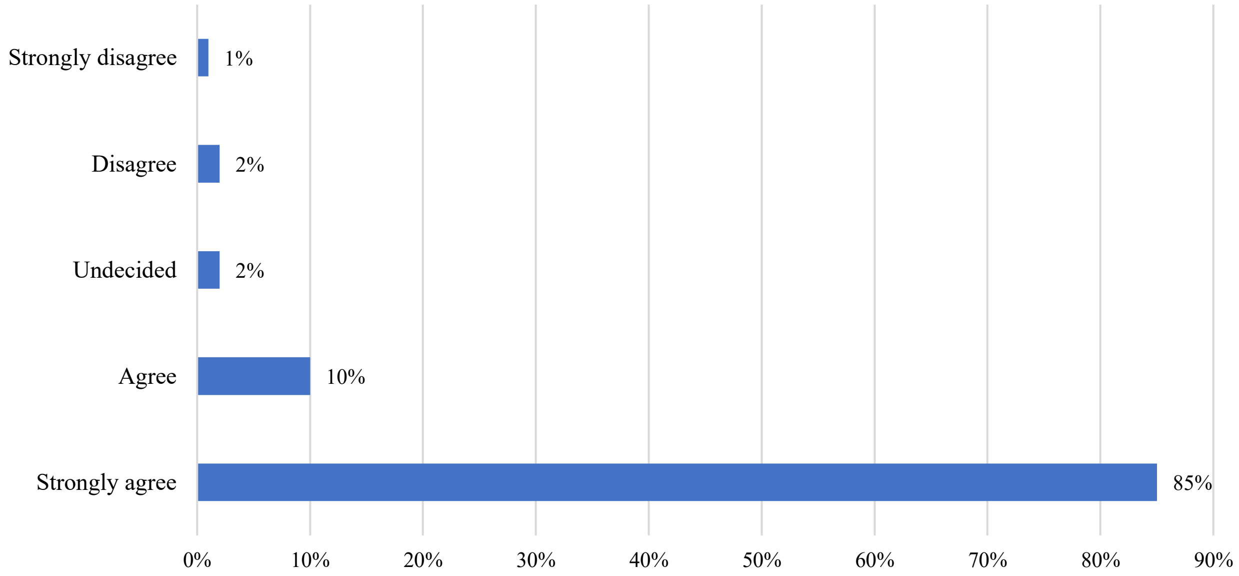
Country	Financial gap
Slovenia	37 200 000
Slovakia	80 844 650
Montenegro	169 728 654
Czech Republic	208 900 000
Hungary	283 284 181
North Macedonia	528 670 363
Romania	862 632 947
Serbia	1 022 490 958

Source: European Commission. (2020). *Microfinance in the European Union: Market analysis and recommendations for delivery options in 2021–2027* (Final report). Directorate-General for Employment, Social Affairs and Inclusion. https://op.europa.eu/en/publication-detail/-/publication/a9f1c5e4-3b62-11eb-b27b-01aa75ed71a1/language-en

The European Investment Bank advocates the utilization of microcredit financial institutions as a strategic approach to address the financing challenges faced by micro, small, and medium-sized enterprises in Serbia. EIB also recommends the establishment of the Microfinance Capital Enhancement Equity Fund as a form of support for all newly introduced non-banking financial institutions, as well as the Microfinance First-Loss Portfolio Guarantee, whose basic function would be to grant microloans to small and medium-sized enterprises and entrepreneurs who currently do not have the opportunity to find adequate sources of financing due to non-fulfillment of lenders' credit criteria (European Investment Bank, 2017). The European Commission identifies Serbia, alongside Austria, Germany, and Greece, as one of the four countries in which microloans are exclusively provided by banks, highlighting the monopolistic position of the banking sector in these markets (European Commission, 2020). Microcredit activities are legally regulated in Romania, Albania, Montenegro, and Bosnia and Herzegovina. In contrast, in North Macedonia, Slovenia, Slovakia, Hungary, Bulgaria, and Croatia, microcrediting is not subject to specific legal regulation; however, commercial banks do not hold a monopolistic position in the provision of lending services.

The absence of a formally adopted Law on Non-Banking Financial Institutions in Serbia constitutes a significant impediment to the development of microcredit financial institutions within the country. Debates regarding the enactment of this legislation have been ongoing for several years, including analyses aimed at accelerating the growth of microfinance and supporting the development of small and medium-sized enterprises. This regulatory gap hinders the strengthening and financing of the micro, small, and medium enterprise sector, which serves as a primary driver of economic activity, thereby limiting contributions to sustainable development. Establishing a comprehensive legal framework for microfinance in Serbia would address the substantial demand for microcredit, promote the sustainable growth of MSMEs, and consequently foster job creation, enhance economic activity, increase the competitiveness of domestic enterprises, support employment growth, and contribute to poverty alleviation. This claim is confirmed by an empirical study conducted with 300 respondents from the financial and business sectors. Half of the respondents are from the banking sector, and the other half are from the business sector. Data was collected using a questionnaire with closed-ended questions. The response rate is high at 99%. The study examines the impact of financial access on the stability of micro, small, and medium-sized enterprises and its implications for inclusive economic growth. Improving access to finance can help MSMEs grow, but if it’s poorly designed or accompanied by weak institutions, it can threaten both individual firm stability and broader inclusive growth. If credit is expanded rapidly without proper credit assessment, very small or early-stage firms can take on liabilities they cannot service, pushing them into insolvency. This raises household and firm vulnerability (many micro firms in Serbia are very small and risk-averse toward debt, but remain underserved). Serbian MSMEs face sizeable financing gaps and many are excluded from formal finance. The study explores strategies to enhance access to finance for micro, small, and medium-sized enterprises through microcredit mechanisms. It examines the potential of microfinance to strengthen the financial position of MSMEs in Serbia and identifies key institutions, beyond traditional banks, that could play a supportive role in this process. To assess respondents’ attitudes toward improving the domestic financial system, a 5-point Likert scale was used: 1) Strongly agree; 2) Agree; 3) Undecided; 4) Disagree; and 5) Strongly disagree. Data processing was conducted with IBM SPSS Statistics 21.

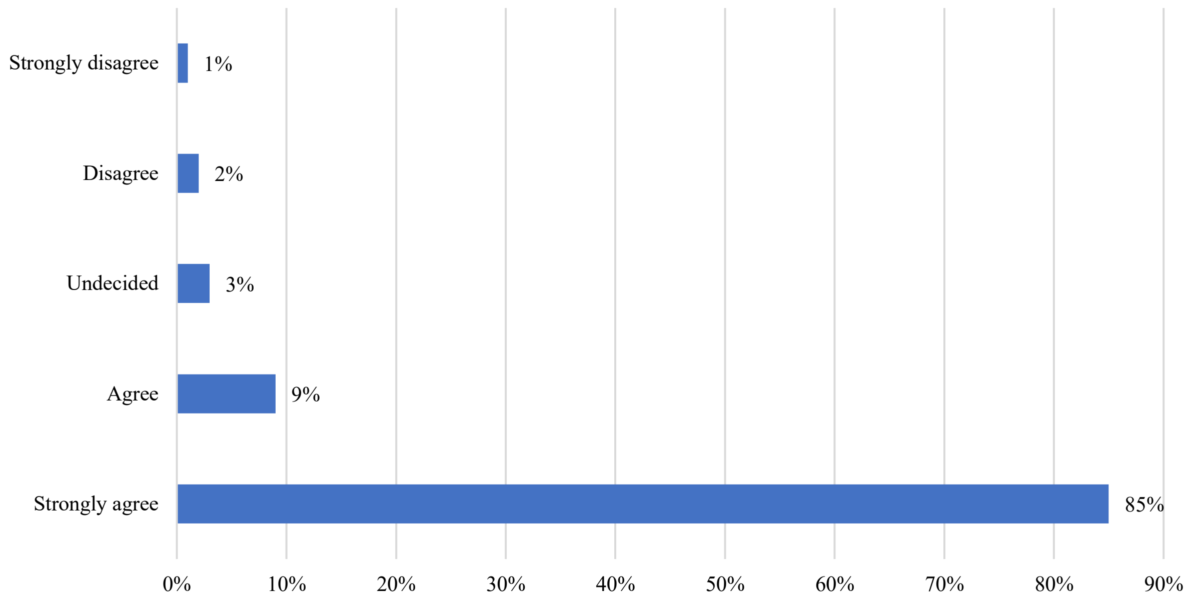
Figure 1. The adoption of the law on non-banking financial institutions would contribute to financial stability



Source: Author's calculation based on SPSS 21.0

The Law on Non-Banking Financial Institutions in Serbia is expected to provide a systematic regulatory framework for microfinance organizations, non-bank credit funds, microcredit programs, group lending, and other similar financing mechanisms. Such regulation is anticipated to enhance financial stability and promote inclusive growth among micro, small, and medium-sized enterprises. In support of this, 85% of respondents expressed agreement with these perspectives (Figure 1 and Figure 2).

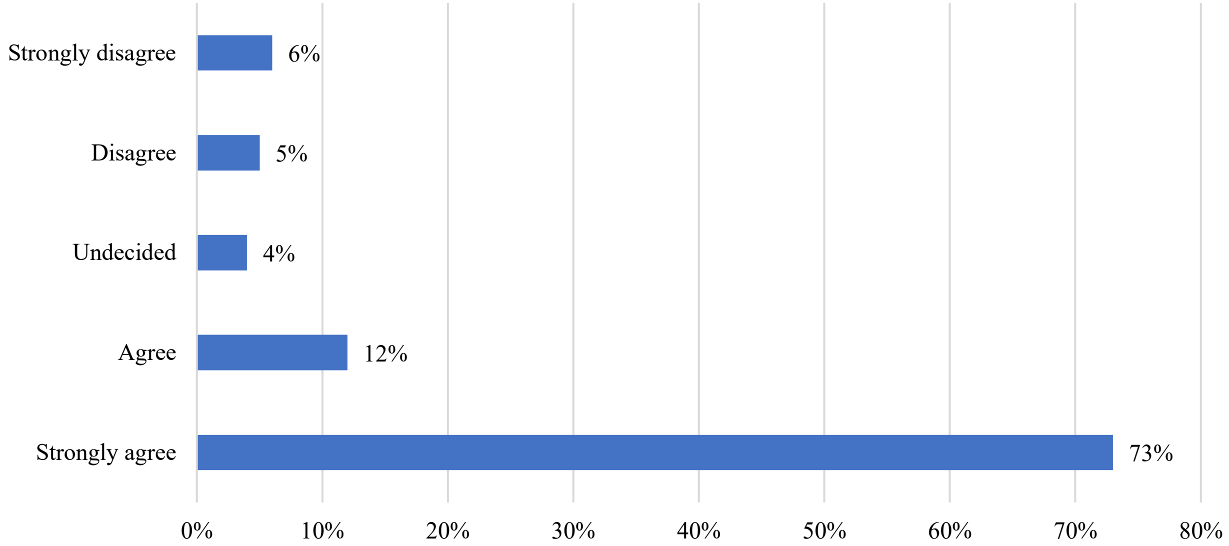
Figure 2. The adoption of the law on non-banking financial institutions s would contribute to MSMEs' inclusive economic growth



Source: Author's calculation based on SPSS 21.0

The introduction of microcredit financial institutions would represent an important step toward strengthening and modernizing the Serbian financial system (73% of respondents agreed with this statement). Despite progress in financial sector reforms, a considerable portion of the population and many small and medium-sized enterprises in Serbia still face limited access to affordable credit. Traditional banks often apply strict collateral requirements and high lending standards, leaving vulnerable groups, such as low-income households, rural populations, women entrepreneurs, and start-ups underserved. Microcredit institutions, by offering small loans tailored to the needs of these groups, could fill this gap, promote financial inclusion, and stimulate local economic activity. In addition, their presence would enhance competition and innovation within the financial sector, diversify financial services, and contribute to poverty reduction and social development. Ultimately, microcredit institutions could complement the existing banking system, creating a more resilient and inclusive financial landscape in Serbia.

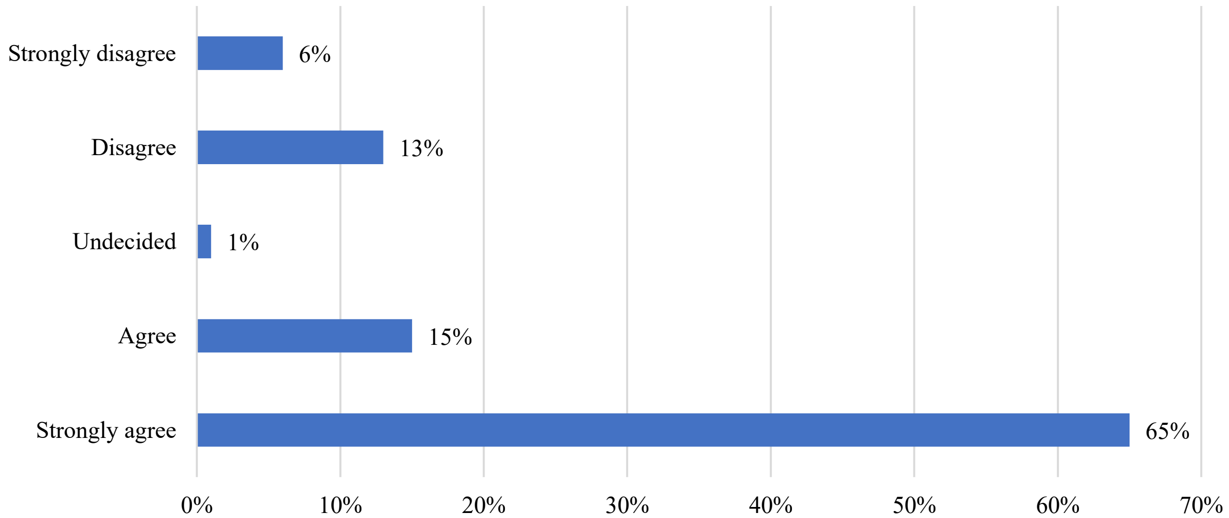
Figure 3. The introduction of microcredit financial institutions would represent an important step toward strengthening and modernizing the Serbian financial system



Source: Author's calculation based on SPSS 21.0

Microfinance in Serbia is increasingly utilized as a strategic instrument for employment creation, extending beyond its traditional role in promoting financial inclusion. It contributes to the generation and sustenance of employment opportunities, particularly within small, rural, or otherwise underserved communities, frequently through the support and development of micro, small, and medium-sized enterprises. Research by the World Bank (2024) indicates that microfinance can play a significant role in promoting employment growth through several mechanisms. First, by providing financial resources to micro, small, and medium-sized enterprises, which often face barriers in accessing conventional bank financing, microfinance enables these enterprises to initiate, expand, or sustain operations, thereby generating employment opportunities. Small-scale businesses, in particular, may utilize microfinance to acquire equipment, recruit additional staff, or diversify product lines and market reach, all of which contribute to job creation. Second, microfinance programs frequently target rural and underserved regions, including farmers and remote entrepreneurs, promoting a more equitable distribution of employment growth across geographic areas. Third, microfinance contributes to indirect job creation. Even in cases where microfinance does not directly employ significant numbers of individuals, the enhanced capacity of small firms can stimulate employment within production, service provision, or supply chain networks. Finally, microfinance initiatives often prioritize women and other vulnerable groups, including individuals typically excluded from formal labor markets. By facilitating their economic participation, microfinance can expand labor force engagement and enhance inclusive employment outcomes.

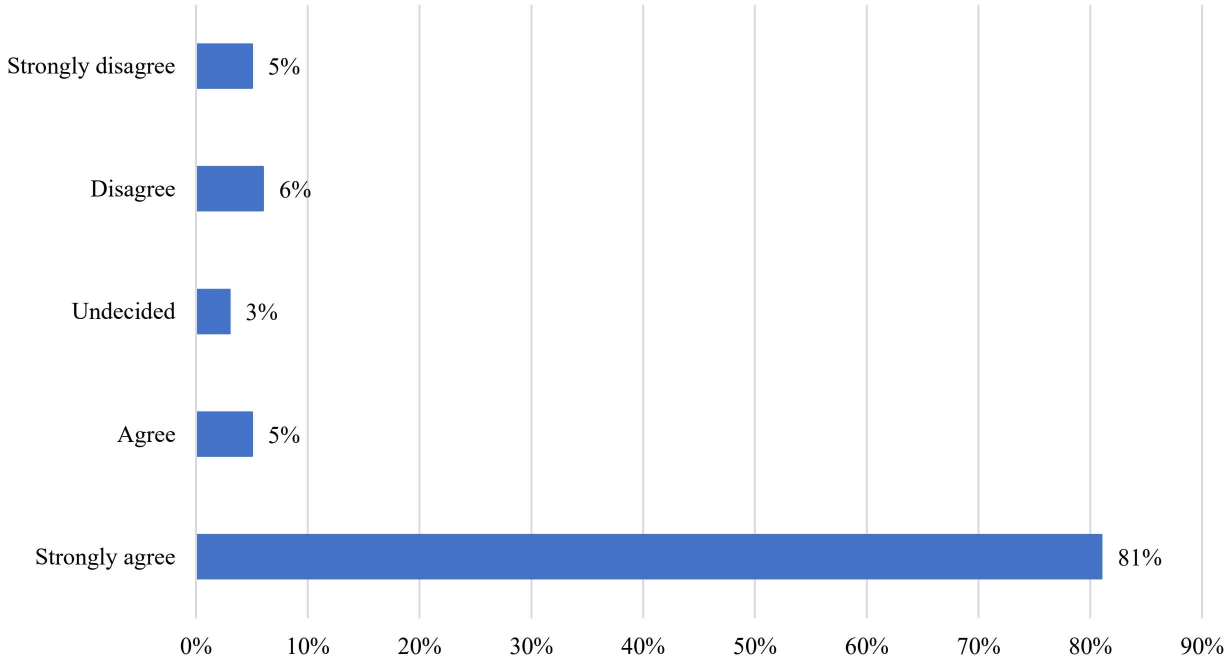
Figure 4. Microfinance programs have the potential to enhance employment opportunities in Serbia



Source: Author's calculation based on SPSS 21.0

In the context of a predominantly bank-centric financial system, microfinance institutions provide specialized financial services designed to address the distinct needs of micro, small, and medium-sized enterprises, thereby promoting their sustainability and growth. Microcredit institutions facilitate the sustainable development of MSMEs by enhancing access to financial resources, which enables these enterprises to invest in expansion, generate employment, and contribute to local economic development. By bridging the credit gap, microfinance supports micro and small enterprises in managing cash flow, acquiring inventory or equipment, and improving productivity - factors that collectively reinforce employment generation and local value creation. Microfinance can boost the growth and development of MSMEs in Serbia, encouraging firm establishment and survival, expanding employment and value-added, and enabling green and digital transitions (United Nations, 2024). Small loans availability combined with basic business training increases the chance that microfirms grow and register formally (allowing them to access larger finance later). Targeted microcredit to productive activities (agri-processing, crafts, services) can increase turnover and hire local labor. Small loans for energy-efficient equipment, digital tools, or e-commerce onboarding can raise productivity and market reach. Microfinance can be directed towards eco-friendly investments (energy efficiency, recycling, sustainable farming), helping MSMEs align with EU Green Deal requirements and Serbia's accession-related obligations.

Figure 5. Microfinance is a pivotal tool in enhancing the business performance of MSMEs in Serbia



Source: Author's calculation based on SPSS 21.0

Commercial banks' product offers in Serbia are poorly aligned with the everyday business activities and financial needs of micro, small and medium enterprises and entrepreneurs. Commercial banks implement a one-size-fits-all retail approach. MSMEs are treated like individuals or large corporates - pricing, documentation and product mechanics don't match small-business realities. High inflation, currency risk, and interest rate volatility make commercial banks cautious. Commercial banks also face with high transaction and documentation costs. Bureaucratic onboarding, collateral-heavy lending and high minimum loan sizes shut out micro and early-stage MSMEs. Compared to some EU markets, digital banking and data analysis tools might be less fully developed for MSME segmentation, so banks don't have as good customer onboarding, risk scoring, and product personalization for MSMEs in Serbia. All of the aforementioned factors contribute to the challenges that micro, small, and medium-sized enterprises face in accessing finance.

4. Conclusion

The financial sector in Serbia is characterized by limited diversification and is predominantly bank-oriented. The range of banking products currently available is often misaligned with the specific needs of micro, small, and medium-sized enterprises (MSMEs). Banks typically perceive MSMEs—particularly micro-enterprises and newly established firms—as high-risk clients due to their limited operational history, small scale, and frequently insufficient accounting records. Consequently, these enterprises face higher risk premiums and more stringent collateral requirements. Moreover, the administrative burden associated with small loans, including credit assessment and ongoing monitoring, is disproportionately high relative to the loan amount, incentivizing banks to prioritize larger clients or larger loan volumes to achieve economic viability. In this context, microcredit has emerged as a critical instrument in the development of

Serbia's financial system, contributing to financial inclusion, economic diversification, and poverty alleviation. However, micro-lending activities are not explicitly regulated or permitted outside the banking sector under Serbian law, as the Banking Law restricts lending and deposit-taking exclusively to licensed banks. Commercial banks offer both short-term and long-term financing to MSMEs, typically requiring collateral and robust financial documentation. Interest rates are relatively high compared to EU averages, and many MSMEs encounter challenges meeting strict eligibility criteria. Additionally, the design of banking products is often insufficiently tailored to the specific operational and financial needs of MSMEs, limiting their accessibility and effectiveness.

The Development Fund of the Republic of Serbia offers favorable loans for startups, working capital, and investment projects. Innovation Fund provides grants and co-financing for innovative projects (startup grants, matching grants, innovation vouchers). Programs through the Ministry of Economy often support equipment purchases and SME competitiveness. IPA (Instrument for Pre-Accession Assistance) funds support competitiveness, innovation, and digitalization of SMEs. Programs like COSME, Horizon Europe, and Western Balkans Enterprise Development & Innovation Facility (WB EDIF) provide access to equity, venture capital, and guarantees. Venture capital and private equity are still underdeveloped but growing (a few funds are active in Serbia, such as South-Central Ventures). Business angel networks are emerging, mainly in tech startups. Crowdfunding (Kickstarter, Indiegogo, and regional platforms like Funderbeam) is used mostly for creative industries and innovative products. Crowdfunding remains underdeveloped relative to global standards-facing challenges like low success rates, limited regulation, and reliance on external platforms or informal workarounds. EBRD, EIF, and EIB provide funding indirectly through local banks. Special credit lines exist for green investments, energy efficiency, and digitalization.

The study investigating the potential contribution of microfinance to the stability of the Serbian financial system and the inclusive growth of the micro, small, and medium-sized enterprise sector revealed a substantial demand for microcredit in Serbia. The findings indicate that the development of the microfinance sector could enhance financial system stability and improve the financial position of MSMEs. A well-established microcredit industry would address the existing market gap in access to finance for micro and small enterprises, a gap primarily resulting from the limited prioritization of the MSME sector by commercial banks and the absence of alternative non-bank financial institutions capable of fulfilling this role. The realization of these objectives requires a supportive legal and regulatory framework, particularly the enactment and implementation of the Law on Non-Banking Financial Institutions. Furthermore, the research identified a misalignment between currently available banking products and the specific financial needs of MSMEs. The study also suggests that the expansion of microfinance services could stimulate employment and facilitate enterprise creation in Serbia.

To further bolster the role of microfinance in MSME development, policy reforms are essential. The World Bank suggests that the Serbian government could play a more active role by providing market-friendly incentives for SMEs to grow and investing in the education of business owners. Microfinance catalyzes the improvement of business results, growth, and sustainable development of MSMEs in Serbia. Through targeted financial services and institutional support, MFIs empower entrepreneurs to overcome financial barriers, leading to enhanced economic activity and job creation. Continued policy support and strategic partnerships are crucial to maximizing the impact of microfinance on Serbia's MSME sector.

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