

Analysis of the Efficiency of Small Independent Retailers in Serbia

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Abstract

Due to overall importance special attention is paid to the theoretical and practical analysis of the performance of small independent retailers. Considering that, this paper analyzes the specifics of economic and financial status of trade entrepreneurs, i.e. small independent retailers in Serbia for 2008 - 2012 period. Despite very "complex", i.e. appalling business conditions in Serbia in the last period, the results (of almost all observed indicators) show "relatively" satisfactory economic and financial position of the trade entrepreneurs in Serbia.

Keywords: Market Share, Business Strategy, Solvency, Economy, Profitability.

JEL Code Classification: F65, L81, M40

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1. Introduction

In contemporary theoretical and practical research due to its importance special attention is paid to the analysis of the performance of small independent retailers (Aslan & Elci, 2009; Coca-Stefaniak et al. 2005; Knego & Blaženka, 2011; Vojvodić, 2011; Hamad & Duman, 2013; Tajeddini, 2013; Lukic, 2012; Lukic, 2013; Lukic, 2014; Agriculture and Agri-Food Canada, August 2012). In this context we examine the advantages and disadvantages, problems and strategies of business operations as a function of competing against the large chain retailers. With that in mind, this paper analyzes the factors of economic and financial position of the trade entrepreneurs, and small independent retailers (with a dominant share in total number) in Serbia (which are obligated to submit annual financial statements to the Business Registers Agency). In addition to the specific factors, their economic and financial position is greatly affected by the overall unfavorable business conditions in Serbia. Key features of general business conditions in Serbia are: low growth rate of industrial production, budget and foreign trade deficits, high unemployment, low standards of living, low purchasing power, high inflation, reduced banks credit loans (because of their own problems), expensive bank loans, financial indiscipline, high percentage of accounts receivable and other. The general perception is that the reason for the recession, which is reflected on the decrease in purchasing power, is structural in its nature, and is to a lesser extent dependent on global macroeconomic situation.

The specific factors of economic and financial position of the trade entrepreneurs - small independent retailers in Serbia (which are thoroughly analyzed in this paper) are: market share, labor productivity, liquidity and solvency, cost efficiency, profitability, merging strategy, private brand, the effects of the application of new concepts of cost management (especially Toyota business principles), and the importance of applying modern information technology. In the context of the analyzed problem, cost efficiency has particular importance among them. Generally speaking, the application of modern information technology improves operational efficiency and reduces actual costs, for example with the supply chain management. Lately a lot of is done in reducing the cost of goods sold with putting pressure on suppliers, and with efficient use of information technology in managing supply chain. Considerable attention is also focused on the reduction of other operating expenses, such as energy consumption. The study on the example of the 30 largest FMCG companies found that they had managed to reduce costs by an average of 1% in ten-year period (Filipovic, 2013).

In the context of the analysis of key factors, it is particularly pointed out that their properly integrated control can significantly contribute to improving the economic and financial position of the trade entrepreneurs – small independent retailers in Serbia in the future, by following the examples of countries with developed market economies.

2. The Importance of Small Independent Retailers

The empirical research show that small enterprises in the retail sector in the European Union take part in the total number of enterprises with 4.20%, 15.78% of the employees and with the added value of 15.95%. Therefore, their role is very significant in terms of satisfying the needs of consumers, in creating added value and sustainable development of the retail sector and the national economy. What is particularly specific is that the productivity of small enterprises is lower compared to large ones. This is a general conclusion, given their performance features (see: Eurostat; GFK Markets – An Insight into May 2013 UK Retail Durable Sectors; Germany – Retail Foods, 8/22/2013; USDA GAIN Report Number: GM13031; Assessing the Supply / Retail Distribution Environment September 2010).

According to available data (May 2013) small independent retailers in the United Kingdom participated in the total sales of durable goods by 8%, and with 9% in 2012 (GFK Markets – An Insight into May 2013 UK Retail Durable Sectors). The share of small independent food stores (with factory prices) in the total number in Germany in analyzed year was: 2007 – 36.61%, 2010 – 31.73% and 2012 – 30.04% (author's calculation of database: Germany – Retail Foods, 8/22/2013, USDA GAIN Report Number: GM13031). Lately, consumers in Germany increasingly prefer small food shops, including convenience stores and independent retailers. In Germany, small independent retailers participate in the total sales of food products to approximately 9% and in Spain to 50% (Assessing the Supply / Retail Distribution Environment September 2010).

The participation of small independent retailers in organic food sales is significant. So, for example, the share of small independent retailers in sales of organic food in the United Kingdom by observed years amounted to: 2004 – 22.1%, 2008 – 18.8% and 2012 – 18.7% (Organic Market Report 2013, Soil Association).

The share of small independent retailers in sale of pharmaceutical products (medicines) is also significant. In the United States in 2011 they participated in total medicines retail with 18%. The average gross margin of small independent pharmacies in the United States was 22.6% in the period of 2006 – 2010. Recently, it increased slightly so that in 2010 amounted to 24.0%, but it is still beneath the industry average (2010 – 25.4%) (Retail Pharmacy Trends, 2012, McKesson).

In Serbia, there has been unfavorable macroeconomic environment of all business entities recorded lately, including trade entrepreneurs – small independent retailers respectively (Table 1). Such environment appropriately reflected on the economic and financial position of trade entrepreneur, i.e. small independent retailers in Serbia.

Concentration in retail is significant factor of economic and financial position of small independent retailers. The big retailers dictate business conditions on the

retail market. Small independent retailers should adjust to them by using the appropriate successful business strategies (GFK Beograd – Potrošač u Srbiji u 2012. i budući trendovi). They largely dictate the terms of business of small independent retailers, i.e. they are exposed to their strong competition. Despite the significant share of large retail chains on the retail market in Serbia, the percentage of purchasing goods in small shops, is however high – over 60 per cent (GFK Beograd – Potrošač u Srbiji u 2012. i budući trendovi).

Table 1: The Main Macroeconomic Indicators in the Republic of Serbia

Description	2012	2011
Gross domestic product (in millions of RSD - fixed prices, 2005)	1.855.173,4	1.888.146,7
The growth rate of GDP	-1,7	1,6
Industrial production	97,1	102,1
The annual rate of inflation (consumer price index - CPI)	12,2	7,0
Exports (in millions of euros)	8.836,8	8.441,4
Imports (in millions of euros)	14.782,3	14.250,0
The foreign trade deficit (in millions of euros)	5.945,5	5.808,6
Number of employees (in thousands)	1.727	1.735
Gross earnings (in RSD)	57.430	52.767
Net earnings (in RSD)	41.377	39.976
Exchange rate of euro against the RSD (31. Decemeber)	113,72	104,64

Source: Statistical Office of the Republic of Serbia, the National Bank of Serbia. According to: Serbian Business Registers Agency.

In Western Europe there is a growing importance of hypermarkets, supermarkets and Cash & Carry to the detriment of small and traditional shops. This, however, is not the case in Eastern Europe where small shops dominate with more than 53% (Markovic, 2013).

As the data in the table show there is a significant purchase in small retail shops in Serbia, over 60%, what is not the case in countries with developed market economies and some of the Central and Eastern Europe countries. Given that, special attention must be paid to the improvement of the economic and financial position of the trade entrepreneur i.e. small independent retailers in Serbia (Bubić & Hajnrih, 2012; Markovic, 2013).

Serbia has significant daily (household) consumption in small retail shops (Markovic, 2013). In 2012 in certain retail formats it amounted to: hypermarkets – 8%, supermarkets – 37%, discounts – 0%, and small shop/other – 55% (Markovic, 2013). This, however, is not the case in other countries of Central and Eastern Europe, with the characteristic of increased food products sales in supermarkets and hypermarkets (Machek, 2012; Markovic, 2013).

In order to provide more comprehensive consideration of the specifics of retail formats in the sector of food products in Serbia (in relation to other countries,

especially ones with the developed market economies), Table 2 displays the types of “C Market” retailer stores, Belgrade, Serbia, which sells food products.

Table 2: Types of Stores of the Retailer “C Market”, Belgrade, Serbia

Types of stores (participation in %)	2010	2009	2008
Hypermarkets	5	5	5
Supermarkets	23	24	23
Cash & Carry	6	7	6
Mini markets	23	23	21
Traditional stores	30	30	32
Other	12	12	12

Source: EPIC “C Market” AD Beograd, Company Profile, February 2012.

As the data in the table show observed retail company has domination of small shops. It is, therefore, in line with the general characteristics of the structure of retail formats in Serbia. Following the example of retailers of countries with developed market economy, we should in the future strive for the structure of retail formats in Serbia with more hypermarkets and supermarkets, including Cash & Carry, or big stores. The change in the structure of retail formats in that direction will be partly influenced by the coming of foreign retail chains in the retail food market in Serbia.

In addition to domestic, there is an important role of small independent Chinese traders in the supply of customers with non-food products. They are known to offer goods at low affordable prices which correspond to customers, regardless of the quality of products, given the low purchasing power of the population in Serbia (Korać, 2013). Therefore, according to expert estimates, they fit into the retail environment in Serbia and have business operations in almost all cities.

In Serbia, there is large number of micro-enterprises with a dominant share of small shops which also on their own way contribute to improving the supply of people with needed products and services and creating additional value of total trade and economy in Serbia as a whole. The economic and financial position of the micro enterprises is significantly different (it is worse) to trade entrepreneurs in Serbia. In Serbia, a large number of small independent retailers operate within the “gray economy” by selling goods at much lower prices compared to other (legal) retailers which, to some extent, negatively reflects on their overall performance. The impact of entrepreneurs on the performance of trade and economy of Serbia is very significant.

Thus, for example, in 2012 trade entrepreneurs participated in total number of entrepreneurs of the Serbian economy with 41.84 %. That same year, they participated in the total number of employees in Serbian economy with 1.42%, in total trade with 7.35% and in entrepreneurship of Serbia with 32.45%. In 2012 participation of all the entrepreneurs in creating a total operating income of the

economy of Serbia was 25.53%. The participation of trade entrepreneurs in creating total operating revenue of Serbia in 2012 amounted to 1.39%, 3.81% of total trade, and overall entrepreneurial sector of the Serbian economy 54.72% (Note: Author's calculation. Source: The Republic of Serbia – Business Registers Agency). Based on the analysis of the data general conclusion may be reached – there is a significant impact of entrepreneurs on the performance of total trade and the economy of Serbia. They must therefore be given special attention in the future as part of a general strategy of Serbian economy development and, in particular, the Serbian trade development strategy. In accordance with their nature and importance they should be provided with favorable business conditions (tax, credit, social, etc.) in order to be more competitive in the retail market of Serbia.

3. Productivity and Cost Efficiency of Small Independent Retailers

In this paper labor productivity of trade entrepreneurs in Serbia will be analyzed on the basis of trends in operating income (business revenues) per employee. Table 3 shows the dynamics of labor productivity of trade entrepreneurs in Serbia for 2008 – 2012 period.

Table 3: The Dynamics of Labor Productivity of Trade Entrepreneurs in Serbia, 2008 – 2012

	Number of entrepreneurs	Evaluation of growth of entrepreneur shops–open/(closed)*	Number of employees	Operating income per employee (in thousands of RSD)*
2008	10 163	(540)	18 874	5 631
2009	9 558	(605)	17 784	5 732
2010	8 958	(600)	15 506	6 568
2011	8 785	(173)	15 603	7 036
2012	8 234	(551)	14 278	7 970

Note:* The author's calculation.

Source: The Republic of Serbia – Business Registers Agency.

During the observed period there were some adverse economic conditions for trade entrepreneurs in Serbia, especially in the 2012, in relation to the 2011. It is partly indicated by the evaluation of number of entrepreneurs shops expressed through the permanent tendency of closing of small independent stores rather than their openings, ranging from 173 (2011) to 605 (2009). It reflected as continuous decrease of number of employees in trade entrepreneurial sector in Serbia from year to year. Among other things, decreased number of employees has partly caused an increase in the labor productivity of trade entrepreneurs in Serbia in all analyzed years.

As a measure of productivity, gross value added per employee amounted to 6.84 euros with the trade entrepreneurs in Serbia in 2012 (Author's calculations based on data: Entrepreneurs in the Republic of Serbia 2012, August 2013, Working Paper, The Republic of Serbia – Serbian Statistical Office, Belgrade, No. 83). It is

much lower (almost four times) compared to the labor productivity of small trade enterprises in the European Union (Eurostat).

Cost-efficiency of trade entrepreneurs in Serbia will be analyzed on the basis of trends in operating revenues, operating expenses and coverage of operating expenses with operating income. Table 4 shows the trade entrepreneurs dynamics coverage of operating expenses (business expenses) with operating income in Serbia for 2008 – 2012 period.

Table 4: Trade Entrepreneurs' Operating Expenses Coverage with Operating Income in Serbia 2008 – 2012

	Operating income (millions of RSD)	Operating expenses (millions of RSD)	Coverage of operating expenses with operating income (operating income/operating expenses) *
2008	106 295	103 942	1.02
2009	101 945	100 007	1.01
2010	101 844	99 786	1.02
2011	109 794	107 745	1.01
2012	113 808	111 909	1.01

Note: * The author's calculation.

Source: The Republic of Serbia – Business Registers Agency.

The information in the table show that the cost-effectiveness of trade entrepreneurs in Serbia is at very low level. Coverage of operating expenses with operating income is almost on the “break even”, i.e. on the breakpoint level. It is therefore necessary to apply new concepts of cost management (primarily Toyota business principles, Kaizen, Lean and others) to improve the cost-efficiency of trade entrepreneurs in Serbia in the future (Lukić, 2011a; Lukic, 2011b; Lukic, 2012; Lukic, 2013).

4. Liquidity and Solvency of Small Independent Retailers

Liquidity of trade entrepreneurs in Serbia we be analyzed based on the dynamics of the current liquidity (current assets/current liabilities) and net working capital (current assets - current liabilities) denominated in the total amount, a percentage of operating income in relation to stock. Net working capital shows what part of current assets is financed by long-term sources of funds. The bigger, the much more short-term borrowings from banks or financial markets can be taken. Table 5 shows the movements of current liquidity and net working capital of trade entrepreneurs in Serbia for the period 2008 - 2012.

Current liquidity of trade entrepreneurs in Serbia in the observed period was "satisfactory" given the financial indiscipline of the Serbian economy, but unsatisfactory in relation to the golden rule of banking (2 working capital : 1 current liabilities) and "industry standards" (Industry Norms - Key Business Ratios -

Benchmarking Ratios). Financing of current assets from long-term sources of funds, as the dynamics of the total amount of net working capital shows, the net working capital percentage of operating income and the ratio of net working capital and inventories, is at a very low level. In the observed period net working capital in operating income participated between 2.61% and 3.13%, only slightly more than 15% of stocks were financed by long-term sources of funds. All in all, liquidity of trade entrepreneurs in Serbia is very low compared to the relevant "industry standards", so appropriate financial measures must be taken in the future in order to improve it.

Table 5: Current Liquidity and Net Working Capital of Trade Entrepreneurs in Serbia, 2008 – 2012

	Current liquidity	Net working capital (in millions of RSD)	Net working capital (in % of business income)	Net working capital / Inventory
2008	1.11	2 778	2.61	0.15
2009	1.10	2 674	2.62	0.15
2010	1.12	3 065	3.00	0.16
2011	1.13	3 443	3.13	0.17
2012	1.12	3 410	2.99	0.17

Note: Author's calculation.

Source: The Republic of Serbia - Business Registers Agency.

5. The Effectiveness of Asset Management of Small Independent Retailers

To evaluate the effectiveness of trade entrepreneurs in Serbia property use we will use the following indicators: 1) the turnover of fixed assets (operating income / fixed assets), 2) the turnover of working capital (operating income / working capital), 3) Inventory turnover (operating income / inventory), short-term receivables, investments and cash turnover (operating income / short-term receivables, investments and cash), 4) short-term liabilities turnover (operating income / current liabilities), 5) operational cycle (time to collect receivables + inventory turnover duration), and 6) cash cycle (time to collect receivables + inventory turnover duration - days account receivable). Table 6 shows the efficiency of trade entrepreneurs property use in Serbia for the period 2008 - 2012.

The efficiency of use of fixed assets by trade entrepreneurs in Serbia in observed period increased from year to year (except 2009). At the same time, the efficiency of use of working capital decreased until 2010 and slightly increased until 2012. The situation is similar with the efficiency of use of stocks (given their high share in total current assets), short-term receivables, investments, cash and short-term liabilities.

Days account receivables, investments and cash is shorter than the duration of short-term liabilities settlement. This means that trade entrepreneurs in Serbia

partly credited their sales to customers from short-term credit funding sources (primarily suppliers).

Table 6: Indicators of Efficiency of Trade Entrepreneurs in Serbia Property Use, 2008 – 2012

	Fixed assets turnover	Working capital turnover	Inventory turnover		Short term receivables, investments and cash turnover		Short term liabilities turnover		Operational cycle	Cash cycle
	Ratio	Ratio	Ratio	Days	Ratio	Days	Ratio	Days	Days	Days
2008	20.46	3.85	5.87	62	11.20	32	4.28	85	94	9
2009	20.27	3.74	5.79	63	10.62	34	4.15	87	97	10
2010	21.06	3.57	5.57	65	9.98	36	4.00	91	101	10
2011	21.80	3.67	5.73	63	10.22	35	4.15	87	98	11
2012	22.35	3.76	5.72	63	11.00	33	4.23	86	96	10

Note: Author's calculation.

Source: Republic of Serbia - Business Registers Agency.

Operational cycle is unsatisfactory, while the cash cycle is satisfactory, compared to industry standards for retailers. So, for example, the average operational cycle in Europe in retail is 69.8, a cash cycle is 26.6 days (European Working Capital, Annual Review 2012 - Working capital: never been better What the top performing companies are doing differently, PWC). Therefore, in the analyzed period, trade entrepreneurs in Serbia were in liquidity position: The improvement of the operating cycle is a measure for improvement their overall business and financial performance.

6. Profitability of Small Independent Retailers

Profitability of trade entrepreneurs in Serbia will be analyzed with the application of Dupont analysis, so-called strategic profit model. In other words, we will analyze the rate of return on sales – net profit margin (net income / operating income), the rate of return on total assets – asset turnover (net income / assets), the rate of return on equity – return on net worth (net income / equity), and the impact of assets turnover (operating income / assets) and financial indebtedness-financial leverage (assets / equity) on profitability.

The rate of return on assets is a function of the rate of return on sales and asset turnover. Adequate control of these factors may affect the achievement of the target return on assets. Table 7 shows the yield of the total assets of trade entrepreneurs in Serbia for 2008 - 2012 periods.

During the observed period the return on assets rate of trade entrepreneurs in Serbia was between 4.45% (2010) to 5.13% (2008). Until 2010 it showed a tendency of decline, and from that year until 2012 a slight increase. This tendency is in accordance with the movement of influential factors - the rate of return on

operating income and asset turnover in the analyzed period. Adequate control of these factors can contribute to the improvement, i.e. achievement of the required rate of return on assets of trade entrepreneurs in Serbia in the future. This applies particularly to cost control (the cost of sold goods and operating expenses), due to the fact that the increase of prices can increase sales revenues only slightly, concerning the very low purchasing power of the population in Serbia - so there are more opportunities with the increasing of cost efficiency. As a function of that, it is necessary to use the available assets in all forms more efficiently.

Table 7: Return on Assets of Trade Entrepreneurs in Serbia, 2008 – 2012

	Net profit margin x	Asset turnover =	Return on assets
2008	1.64%	3.13	5.13%
2009	1.49%	3.04	4.52%
2010	1.51%	2.95	4.45%
2011	1.52%	3.04	4.62%
2012	1.44%	3.10	4.46%

Note: Author's calculation.

Source: The Republic of Serbia - Business Registers Agency.

The rate of return on equity is a function of the rate of return on sales, assets turnover, and financial indebtedness (financial leverage). Adequate control of these factors may affect the achievement of the target return on equity. Table 8 show the contribution of capital of trade entrepreneurs in Serbia for 2008 - 2012 period.

Table 8: Return on Equity of Trade Entrepreneurs in Serbia, 2008 – 2012

	Net profit margin x	Asset turnover x	Financial leverage =	Return on net worth
2008	1.64%	3.13	4.99	25.61%
2009	1.49%	3.04	5.01	22.69%
2010	1.51%	2.95	5.04	22.45%
2011	1.52%	3.04	4.81	22.22%
2012	1.44%	3.10	4.86	21.69%

Note: Author's calculation.

Source: The Republic of Serbia - Business Registers Agency.

During the observed period the rate of return on capital of trade entrepreneurs in Serbia ranged from 21.69 (2012) to 25.61% (2008), and has manifested a tendency to decline by 2012 when it slightly increased. On average, according to descriptive statistics, the rate of return on equity was 22.93% (std. deviation 1.54208), and the rate of return on operating income - 1.52% (std. deviation .07382), turnover of assets - 3.05 (std. deviation .06907), and financial indebtedness (financial leverage) - 4.94 (std. deviation .10085). Only in 2008 the rate of return on equity was higher than the average.

In the analyzed period the correlation between the turnover of assets, financial indebtedness, and the rate of return on equity of trade entrepreneurs in Serbia was

weak (sig. > 0.05). According to individual variables it was strong only between the rate of return on operating income and rate of return on equity (sig. = 0.013 < 0.05) (Table 9). It is quite understandable when one takes into account the fact that the movement of the rate of return on operating revenue is in accordance with the "industry standards" (Industry Norms - Key Business Ratios - Benchmarking Ratios). The negative correlation between the assets turnover and financial indebtedness (financial leverage) means: the higher the turnover of assets - less financial indebtedness (financial leverage) and vice versa. In the future, in order to increase the return of equity of trade entrepreneurs in Serbia it is necessary to find optimal relationship between turnover of assets and financial indebtedness (financial leverage).

Table 9: Correlation Matrix

		Net profit margin	Asset turnover	Financial leverage	Return on net worth
Net profit margin	Pearson Correlation	1	.338	.312	.950
	Sig. (2-tailed)		.578	.609	.013
	N	5	5	5	5
Asset turnover	Pearson Correlation	.338	1	-.338	.493
	Sig. (2-tailed)	.578		.578	.399
	N	5	5	5	5
Financial leverage	Pearson Correlation	.312	-.338	1	.419
	Sig. (2-tailed)	.609	.578		.482
	N	5	5	5	5
Return on net worth	Pearson Correlation	.950(*)	.493	.419	1
	Sig. (2-tailed)	.013	.399	.482	
	N	5	5	5	5

*Correlation is significant at the 0.05 level (2 - tailed)

Note: Author's calculating; output of the statistical programme SPSS.

In 2012 BEX index calculated for trade entrepreneurs in Serbia amounted to 1.554. BEX index greater than 1 - company is good. This means that the great business success of small independent retailers. (See more: Belak, V., Aljinovic Barac, Z. (2008): Secrets of Capital Markets, Belak doo, Zagreb, Croatia; According to: Bubić & Hajnrih, 2012). That represents their business excellence. Besides, this conclusion is consistent with the results of their efficiency research by using ratio analysis and strategic profit model. So, we should not ignore the fact that their satisfactory business success was achieved in the conditions of unfavorable macroeconomic environment in Serbia.

7. Conclusion

In general, the obtained research results based on the Serbian Business Registers Agency original empirical data, for the period 2008 - 2012 show that the economic and financial position of the trade entrepreneurs and small independent retailers in

Serbia, despite the unfavorable macroeconomic environment are on the "satisfactory" level, i.e. profit performances are above break-even point. It is understandable when one takes into account the fact that about 65% of the purchase is done in small shops.

Despite the very difficult economic circumstances, trade entrepreneurs in Serbia continued long-term profitable business in 2012, with a slight increase in the volume of activity. Compared to the previous year (2011) they have achieved higher earnings, and slightly improved positive net working capital. In carrying out its activities they, however, used borrowed funds, so that the decrease of their own share in total sources of funding resulted in a further increase of indebtedness. All this reflected on their liquidity, solvency and profitability .

Lately, there is an increasing productivity of trade entrepreneurs in Serbia, but it is significantly lower than the productivity of small businesses in the retail sector in the European Union.

Notwithstanding the unfavorable macroeconomic environment, liquidity and solvency of trade entrepreneurs in Serbia is satisfactory. However, with respect to the defined standard it is unsatisfactory. In order to increase their, and all business entities, liquidity and solvency in the future, it is necessary, to improve the "financial discipline" in the Serbian economy.

The efficiency of using assets is satisfactory. Credit sales were partly financed by loans from suppliers. Operational cycle is worse, a cash cycle is better than the average for retailers in Europe. By improving operating cycle, the cost efficiency can be improved and thus the profit positions of trade entrepreneurs in Serbia in the future. This is primarily achieved by applying new concepts of cost management (primarily based on Toyota's principles of business), the concept of managing relationships with customers and suppliers, and modern information technology.

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