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## IMPACT OF COVID-19 ON THE FINANCIAL PERFORMANCE OF SMALL AND MEDIUM-SIZED ENTERPRISES OPERATING IN REPUBLIC OF SRPSKA

**Summary:** *The aim of this study is to analyze the effects of coronavirus disease (COVID-19) on the financial performance of small and medium-sized enterprises (SMEs) operating in Republika Srpska. The hypothesis tested in the research is that COVID-19 had a stronger negative impact on the sales, profit and employment of the SMEs in Republika Srpska compared to performance of large enterprises. In order to test the hypothesis we will gather and analyze empirical data on three selected performance indicators (sales, profit and employment) of more than 10,000 SMEs in Republika Srpska in the three year period 2017-2019 and compare the data with performance in year 2020, in which the enterprises were affected by COVID-19 crises. Also the SMEs data will be compared with performance indicators of large enterprises in the same period 2017-2020. Our empirical results confirmed set hypotheses that COVID-19 crises had a stronger negative impact on the financial performance of SMEs compared to large enterprises. In year 2020, in which companies faced the COVID-19 crisis, there was stronger decrease of SMEs' sales compared to total sales decrease of large companies. Also, while SMEs' profit and employment decreased in 2020 compared to 2019, large companies recorded an increase of profit and employment. This research confirmed the vulnerability of small and medium sized companies in times of crises compared to large one, and the need for governments to pay special attention to these enterprises.*

**Key words:** *small and medium sized enterprises, financial performance indicators, Republika Srpska, COVID-19*

**JEL classification:** *E24, O1, L25*

### INTRODUCTION

The COVID-19 crisis, which started at the beginning of 2020, severely affected not only the health of the people but also affected societies and economies throughout the world. The enterprises faced a variety of problems such as a decrease in demand, cancelation of export orders, supply chain disruptions, raw material shortage and transportation problems. Government authorities of countries throughout the world announced measures to prevent the spread of disease in the form of lockdowns, quarantine, travel restriction and the ban on certain businesses. This all has led to a reduction in economic activity. This study is aimed at analyzing the effects of COVID-19 crisis on the financial performance of small and medium-sized enterprises operating in Republika Srpska.

SME's represent an important part of many economies. According to the Annual report on European SMEs 2018/2019, SMEs participate with 56.4% in value added and with 66.7% in total employment in the European Union.

According to the Annual report on SMEs in Republika Srpska for 2018, SMEs and entrepreneurs accounted for 99,8% of all business entities in the Republic of Srpska, participated with 73% in total sales, 75% in net profit, 71% in export, and with 71% in employment.

The hypothesis set in this research is that the crisis caused by the outbreak of COVID-19 virus had a more negative impact on the financial indicators of SMEs in Republika Srpska than on large companies.

Different studies show that SMEs, in comparison to large enterprises, usually have limited access to financial resources and they are dependent on banks' lending, paying higher interest rates (Beck et al. 2008; Bourletidis and Triantafyllopoulos 2014). A recent study conducted by Harvard Business School also reported that due to the current outbreak of corona virus, many small businesses are financially fragile (Bartik et al. 2020). Also, SME's limited technological and managerial capabilities may reduce their preparedness for long crises (Caballero-Morales 2021).

The objective of the paper is to explore the impact of COVID-19 on selected business performance indicators: sales, profit and employment of SMEs in Republika Srpska.

The paper is structured as follows. After the introductory section, Section 1 explores the influence of COVID-19 on the global economy while Section 2 explores the effects of COVID-19 on the macroeconomic indicators of Republika Srpska economy. The sample and the methodology of the research are presented in Section 3. This section also explores the impact of COVID-19 on the financial performance (total sales, profitability and employment) of small and medium-sized enterprises operating in Republika Srpska. At the end the main conclusions of the research are presented.

## **1. IMPACT OF COVID-19 ON THE GLOBAL ECONOMY**

The COVID-19 crisis has had a severe effects on the global economy. As of 23 April 2020, 26.5 million jobs were lost in the US alone along with contraction in manufacturing, reduction of domestic demand for non-food goods, reduction of foreign demand for US goods exports, supply-chain disruptions and plant closures (Eggers 2020). Also, in China, considered as a "factory of the world", there have also been disruptions in supply chains (Tang et al. 2021).

The most vulnerable countries are those with weak health infrastructure, heavily dependent on trade and tourism, heavily indebted, and dependent on unstable capital flows. According to a recent report of the International Monetary Fund (IMF 2021) the COVID-19 outbreak had important consequences for global GDP growth that was estimated to -3,3 percent in 2020. US GDP was estimated to -3,5 percent in 2020, Euro Area GDP to -6,6 percent, United Kingdom GDP -9,9 percent and the emerging markets and developing economies GDP to -2,2 percent. Among the most hit countries are: Spain, with real GDP growth of -11 percent in 2020, United Kingdom with -9,9 percent, Italy with -8,9 percent, France and Mexico with -8,2 percent and India with real GDP growth of -8 percent. In Germany real GDP decline (4,9 percent) was lesser than the Euro Area average of -6,6 percent, while Nordic economies (Denmark, Island, Norway and Sweden) had the best performance of advanced European economies with GDP decline of 2,4 percent. Russian average GDP in 2020 was estimated to -3,1 percent, Southeastern European EU member states (Bulgaria, Croatia, Romania) to - 4,5 percent, Southeastern European Non-EU member states (Albania, BiH, Serbia, Montenegro, North Macedonia) to -3,5 percent. China achieved the best result in 2020, with real GDP growth rate of +2,3 percent as well as Turkey with +1,8 percent (Ibid).

Table 1. Overview of the IMF World Economic Outlook Projections  
(Percent change) (International Monetary Fund 2021)

	Year over Year		
	2020	Projections	
	2021	2022	
<b>World Output</b>	<b>-3,3</b>	<b>6,0</b>	<b>4,4</b>
<b>Advanced Economies</b>	<b>-4,7</b>	<b>5,1</b>	<b>3,6</b>
United States	-3,5	6,4	3,5
Euro Area	-6,6	4,4	3,8
Germany	-4,9	3,6	3,4
France	-8,2	5,8	4,2
Italy	-8,9	4,2	3,6
	-		
Spain	11,0	6,4	4,7
Japan	-4,8	3,3	2,5
United Kingdom	-9,9	5,3	5,1
Canada	-5,4	5,0	4,7
Other Advanced Economies	-2,1	4,4	3,4
<b>Emerging Market and Developing Economies</b>	<b>-2,2</b>	<b>6,7</b>	<b>5,0</b>
Emerging and Developing Asia	-1,0	8,6	6,0
China	2,3	8,4	5,6
India	-8,0	12,5	6,9
ASEAN-5	-3,4	4,9	6,1
Emerging and Developing Europe	-2,0	4,4	3,9
Russia	-3,1	3,8	3,8
Latin America and the Caribbean	-7,0	4,6	3,1
Brazil	-4,1	3,7	2,6
Mexico	-8,2	5,0	3,0
Middle East and Central Asia	-2,9	3,7	3,8
Saudi Arabia	-4,1	2,9	4,0
Sub-Saharan Africa	-1,9	3,4	4,0
Nigeria	-1,8	2,5	2,3
South Africa	-7,0	3,1	2,0
<i>Memorandum</i>			
Emerging Market and Middle-Income Economies	-2,4	6,9	5,0
Low-Income Developing Countries	0,0	4,3	5,2

Governments of most countries recognized that there would be strains in the business sector caused by COVID-19 crises and they undertook various measures.

One of the financial restructuring measures that are most adequate in the case of COVID-19 crises in order to overcome the problems and prevent the deepening of crisis is deferred payments or debt rescheduling (Duvnjak 2020). Central banks have provided unprecedented liquidity support.

According to IMF (2021) the global economy is projected to grow at 6 percent in 2021, moderating to 4.4 percent in 2022. That is an important improvement from an estimated contraction of -3.3 percent in 2020. Projection for the global economy in 2023 is +3,5 percent, in year 2024 +3,4 percent and in year 2025 and 2026 + 3,3 percent.

Projection for developed countries in 2021 is GDP growth at + 5.1 percent, moderating to +3.6 percent in 2022, +1.8 percent in 2023, +1.6 percent in 2024 and +1.5 percent in 2025 and 2026. On the other hand, projection for emerging markets and developing economies are more optimistic forecasting GDP growth in 2021 to + 6.7%, moderating to + 5% in 2022, + 4.7% in 2023, + 4.6% in 2024, + 4.5% in 2025 and + 4.4% in 2026.

These GDP projections (annual percent change) for the world, advanced economies and emerging markets and developing economies are shown in the Figure 1.

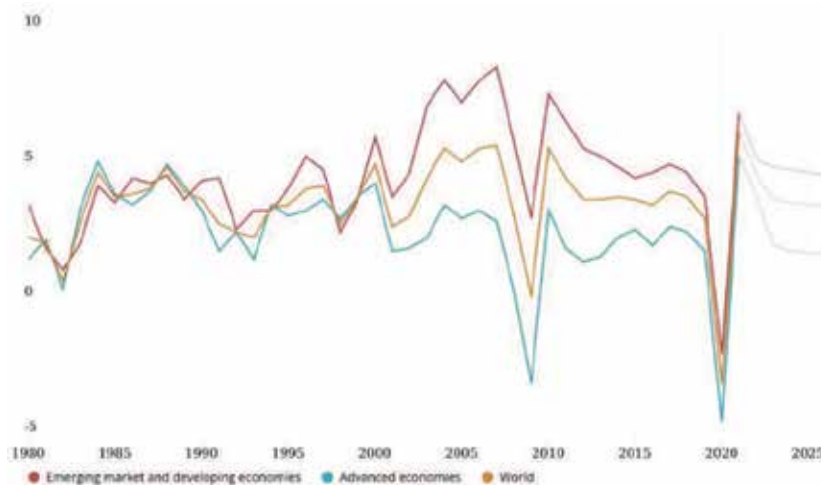


Figure 1. Real GDP growth (International Monetary Fund 2021)

## 2. IMPACT OF COVID-19 ON THE ECONOMY OF REPUBLIKA SRPSKA

The outbreak of Corona-19 virus has had a severe impact on the economy of Republika Srpska in 2020. According to the Republika Srpska Institute of Statistics, real GDP growth rates of Republika Srpska were -6,8% in the second quarter of 2020, -3,4% in the third quarter and -2,4% in the fourth quarter of year 2020 (Republika Srpska Institute of Statistics 2021). Although the official data has not yet been published, the real GDP growth rate in Republika Srpska for 2020 will be around -2,8 percent based on quarterly real GDP growth rates in 2020.

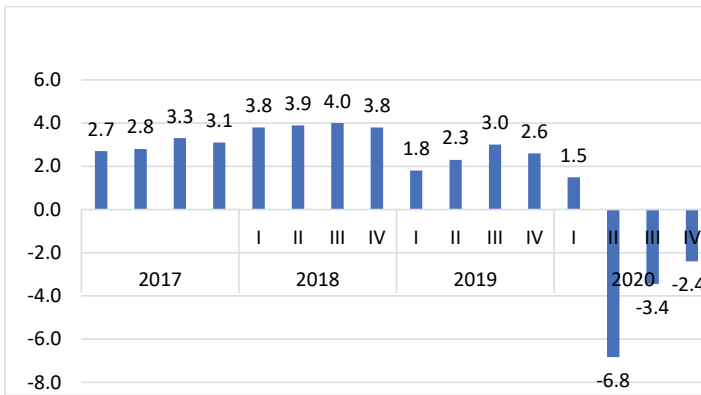


Figure 2: Quarterly GDP in Republika Srpska, Real Growth Rates (Authors, based on the Republika Srpska Institute of Statistics data Quarterly release number 96/21 and 85/18)

What is important is that compared to GDP decline in 2020, there was no decline in the employment. At the end of 2020, there were 274,227 employees in Republika Srpska, which is an increase of 0.68% compared to 2019. The number of employees in business legal entities at the end of 2020 amounted to 232,546, which is an increase of 0.87%, while the number of employees in entrepreneurs amounted to 41,681, which is a slight decrease of 0.35% (Republika Srpska Institute of Statistics, 2021).

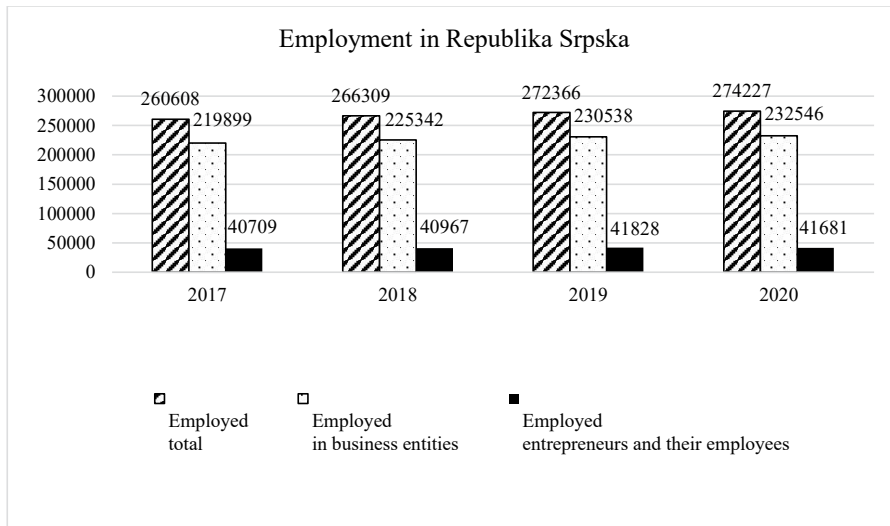


Figure 3. Employment in Republika Srpska (Authors, based on Republika Srpska Institute of Statistics data)

There was no decline in the employment in Republika Srpska due to active measures of Republika Srpska Government aimed at supporting entrepreneurs and enterprises that were banned from

working, which had a complete or partial cessation of work, or worked with a reduced volume of business due to crises and measures related to COVID-19. Thus, for March 2020, the Government of Republika Srpska paid contributions and taxes for salaries for 11,898 business entities that were banned from work, for April 2020 paid the lowest salary with contributions for 41,377 workers, while for May 2020 it paid salaries, taxes and contributions for workers of economic entities who were banned from working during May. Other measures of Republika Srpska Government include: moratorium on payment of tax obligations, reduction of non-tax payments of business entities, a three-month moratorium on the principal and interest repayment of the Investment and Development Bank of Republika Srpska loans, non-billing of default interest of the state electricity supply company "Elektroprivreda Republike Srpske" etc. Also, the Investment and Development Bank of Republika Srpska reduced the interest rates for corporate loans.

Through the special Government Guarantee Program designed for mitigation of the consequences of the COVID-19, easier access to financial resources for small and medium enterprises has been provided. The effects of these measures were remaining the number of employees in economic entities at the level that was before the outbreak of COVID-19 crisis.

### **3. IMPACT OF COVID-19 ON THE FINANCIAL PERFORMANCE OF SMALL AND MEDIUM-SIZED ENTERPRISES OPERATING IN REPUBLIKA SRPSKA**

#### **3.1. The Sample and the Methodology**

The aim of this study is to examine the impact of COVID-19 on selected performance indicators of SMEs operating in Republika Srpska: total sales, net profit and employment.

We set the following hypothesis which will be tested in the research:

H1. COVID-19 had a stronger negative impact on the total sales of SMEs in Republika Srpska compared to performance of large enterprises.

H2. COVID-19 had a stronger negative impact on the net profit of SMEs in Republika Srpska compared to performance of large enterprises.

H3. COVID-19 had a stronger negative impact on the employment of SMEs in Republika Srpska compared to performance of large enterprises.

In order to test the hypothesis we will gather and analyze empirical data on three selected performance indicators of SMEs in the three year period 2017-2019 and compare the data with year 2020, in which the enterprises were affected by COVID-19 crises and measures. Also the SMEs data will be compared with performance indicators of large enterprises in the same period 2017-2020.

According to the Law on changing the law on development of SME's (Official Gazette of Republika Srpska number 84/19) the small and medium enterprises in Republika Srpska are those enterprises that employ less than 250 employees along with annual sales turnover up to 97,89 million KM (50 million EUR).

The sample is represented by all small and medium sized enterprises, legal entities, from Republika Srpska that employ less than 250 employees, whose total annual sales is less than 97.790.000 KM (equal to 50 million EUR) and that have reported a corporate income tax. The sample is compared with large enterprises, legal entities, that employ more than 250 employees, whose total annual sales is more than 97.790.000 KM (50 million EUR), and that have reported a corporate income tax. The source of information is the Republika Srpska Tax Administration.

In Republika Srpska in 2020, out of a total of 10,437 taxpayers (legal entities) that have reported a corporate income tax, 10,319 or 98.9% are small and medium enterprises, while 118 or 1.1% are large enterprises.

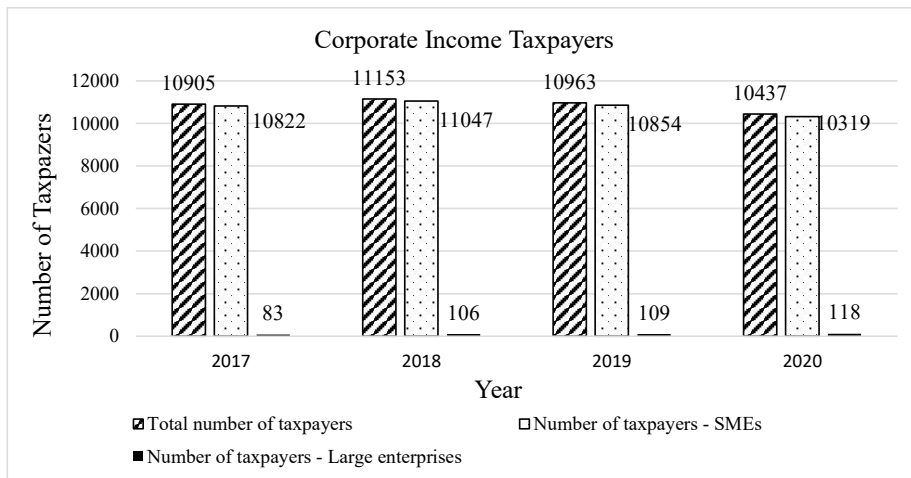


Figure 4. The Sample - corporate income taxpayers in the period 2017-2020 (Authors' processing of Republika Srpska Tax Administration data)

However, the Figure 4 shows that the total number of corporate income taxpayers in 2020 is the lowest compared to the previous three-year period 2017-2019. Thus, e.g. the total number of corporate taxpayers in 2020 is lower by 526 taxpayers or by 4.8 percent compared to 2019, out of which the number of taxpayers – SMEs is lower by 535 taxpayers or 4.9 percent, while the number of taxpayers - large companies is higher by 9 taxpayers, or 8.3 percent compared to 2019.

In the next sections the research results are presented - the impact of COVID-19 on total sales, profitability and employment of the SMEs from Republika Srpska compared with the performance of large enterprises.

### 3.2. Impact of COVID-19 on total sales

Figure 5 shows a comparison of the total sales trend of the SMEs and large enterprises in Republika Srpska in the period 2017-2020.

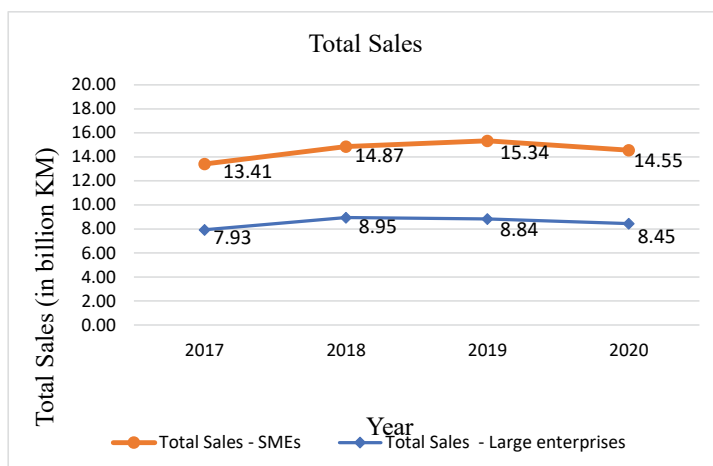


Figure 5 Total sales trend in the period 2017-2020 (Authors' processing of Republika Srpska Tax Administration data)

Figure 5 shows that the total sales of small and medium sized enterprises increased in the period 2017-2019 at an average annual rate of 7%. Also, in the same period, total sales of large enterprises in Republika Srpska increased at an average rate of 5.8% per year. In year 2020, in which companies faced the COVID-19 crisis, we see a decrease of total sales compared to 2019 for both, SMEs and large companies, but the decrease in SMEs' total sales was stronger (-5.2%) in relation to total sales decrease of large companies (-4.4%).

### 3.3. Impact of COVID-19 on profitability

Figure 6 shows a comparison of the pre-tax profit trend of the SMEs and large enterprises in Republika Srpska in the period 2017-2020.

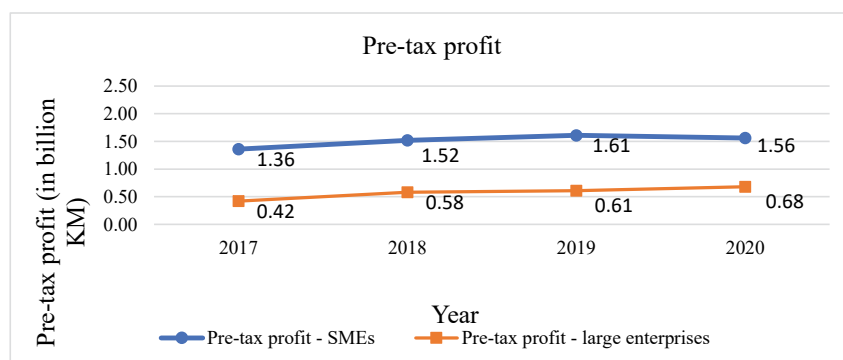


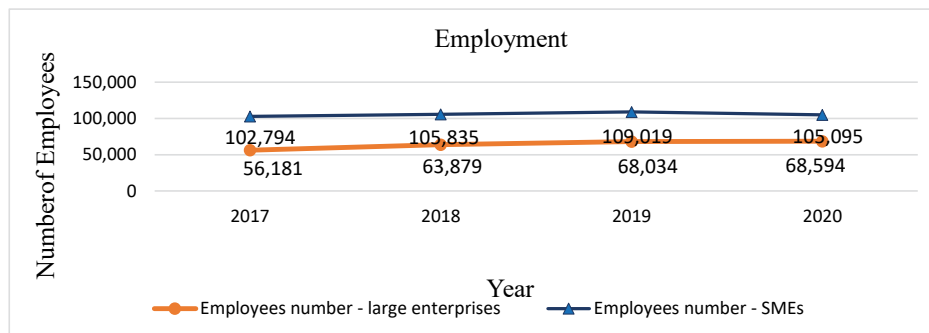
Figure 6. Pre-tax profit trend in the period 2017-2020 (Authors' processing of Republika Srpska Tax Administration data)



Figure 6 shows that the pre-tax profit of small and medium sized enterprises increased in the period 2017-2019 at an average annual rate of 8.7%. Also, in the same period, the pre-tax profit of large companies in Republika Srpska increased at an average rate of 21.2% per year. In year 2020, in which companies faced the COVID-19 crisis, SMEs' profit before tax decreased by 3.1% compared to 2019, while large companies recorded a profit before tax growth of 12.5%.

### 3.4. Impact of COVID-19 on employment

Figure 7 shows a comparison of the employment trend of the SMEs and large enterprises in Republika Srpska in the period 2017-2020.



Figure

7. Employment Trend in the Period 2017-2020 (Authors' processing of Republika Srpska Tax Administration data)

Figure 7 shows that the number of employees of SMEs increased in the period 2017-2019, at an average rate of 3% per year, while the number of employees of large companies increased at an average rate of 10% per year. In year 2020, in which companies faced the COVID-19 crisis, the number of employees in SMEs decreased by 3.6% compared to 2019, while the number of employees in large companies increased by 0.82%.

## CONCLUSION

The research confirmed set hypotheses that COVID-19 crisis had a stronger negative impact on the financial performance (total sales, profitability and employment) of small and medium enterprises operating in Republika Srpska compared to large enterprises. In year 2020, in which companies faced the COVID-19 crisis, there was stronger decrease of SMEs' total sales (-5.2%) as compared to total sales decrease of large companies (-4.4%). While SMEs' profit and employment decreased in 2020 (by 3.1% and 3.6% respectively) compared to 2019, at the same time large companies recorded an increase of profit (by 12.5%) and employment (by 0.82%). This research confirmed the vulnerability of small and medium sized companies in times of crises compared to large one, and the need for governments to pay special attention to these enterprises.

## APPENDIX

- Republic Statistical Office for the period 2017 - 2020 (employment records).

- The Tax Administration of the Republic of Srpska (employment records).

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