

## SMEs sector and its role in economic development of Kosova

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### Abstract

Since 1999 Kosovo has undergone a transition from a socialist system of the former Yugoslavia in a free market economy. Economic transformations that have occurred after the war in Kosovo have been associated with changes in the structure of companies. Micro, small and medium enterprises have been increasing these years. Under the Yugoslav system, the bulk consisted of social enterprises. Therefore the private sector took the brunt of economic development. With the privatization of socially owned enterprises, many employees who previously have remained unemployed have set up their businesses by creating new jobs. However, the rate of development of SMEs has been very slow due to unfavorable environment that existed in Kosovo. Increasing competition from foreign companies has also had a negative impact on competitiveness enterprises.

Entrepreneurship in many countries is seen as a driving force of economic development and movement toward a market economy. Many countries make efforts to create a more favorable environment for businesses with the aim of development and economic growth.

The purpose of this paper is to analyze the role of small and medium enterprises in the economic development of the country. Also, this paper will diagnose the current situation of small and medium enterprise and identifying problems, obstacles and barriers that businesses face in their development. Finally is reviewed the impact of the development of SMEs in GDP, and finding the appropriate policy measures to support enterprise development in the country. The methodology of the paper will be descriptive, based on secondary data, and also made a comparative analysis between Kosovo and the region countries.

**Keywords:** Small and Medium Enterprises, economic development, employment

JEL Classification: O11, O17, O23

### 1. Introduction

In any economy, the SMEs sector is considered as the engine of economic growth, GDP, particularly in creating jobs. SMEs are characterized by flexibility and react quickly to changes in the external and internal environmental. The functioning of micro, small enterprises based on the experience of the owner in terms of management and business knowledge to take advantage of opportunities. The role that played small and medium enterprises in economic activity is very important. Many countries both developed and developing countries consider the SMEs are a useful tool for economic growth and development. This leads to the creation of new employment opportunities in a higher degree and in the shortest time possible. SMEs in Kosovo are more engaged in domestic trade and services. Production is rare for product's export and almost non-existent. Its resources are unused or little used. Agricultural sector which accounts for perhaps a third of gross domestic product is not developed too much. Unemployment in Kosovo is widespread and remains a major challenge to sustainable development. According to

recent World Bank report in 2009 estimates that poverty in Kosovo is 34 percent of the population. According to the report, little more than a third of the population lived below the absolute poverty line with 1, 55 euro per day, while 12 percent live below the extreme poverty line by 1, 02 euro.<sup>1</sup> Referring to data from the Statistical Office of Kosovo, unemployment in Kosovo is over 40 percent.<sup>2</sup> This burden of unemployment is felt most by young people as they try to build a career. Order to bring economic growth and development in the country, the government should give priority and strong support of small and medium enterprise sector. SMEs development is very important in increasing employment and reducing extreme poverty. The literature suggests that the promotion of business should be a priority strategy for addressing ongoing problems of unemployment and poverty.

Many economists, including the World Bank have shown that the blooming of SMEs are essential for sustainable

<sup>1</sup> [www.worldbank.org](http://www.worldbank.org)

<sup>2</sup> [www.esk.rks-gov.net](http://www.esk.rks-gov.net)

development of the country, and the importance of providing strategic support for development of this sector can not pay attention. Although the government has adopted a national strategy for SME development, the success achieved so far is not great. Often the environment in which businesses operate is not in their favor, for example, SMEs struggle to access finance on favorable terms of credit, despite the increasing number of banks and microfinance institutions. Also, great concerns to them are high interest rates. The average interest rate on the loan stood at almost 14.6 percent.<sup>3</sup>

This study argues that the development of SMEs in Kosovo is critical for economic development. The purpose of this paper is to assess the contribution of SMEs to economic development.

## 2. The role of SME sector in economic development

The level of SMEs development has an important role in economic development. SMEs are the backbone of the private sector which constitute over 90% of enterprises in the world and constitute 50-60% of employment.<sup>4</sup>

SMEs make a vital contribution to the development process for the following reasons:<sup>5</sup>

- SMEs are labor-intensive and tend to lead to a more equitable distribution of income than large enterprise. They play an important role in generating employment and thus alleviating poverty, often providing employment opportunities at reasonable rates of remuneration to worker from poor households and woman who have few alternative sources of income.
- SMEs contribute to a more efficient allocation of resources in developing countries. They tend to adopt labor-intensive production methods and thus more accurately reflect the resource endowments in developing countries where labor is plentiful and capital is scarce. To the extent that these enterprises operate in "informal" markets, the factor and product prices they face also provide a better reflection of social opportunity costs than the prices faced by large enterprises.
- SMEs support the building of systematic productive capacities. They help to absorb productive resources at all levels of the economy and contribute to the establishment of dynamic and resilient economic systems in which small and large firms are interlinked. They also tend to be more widely dispersed geographically than larger enterprises, support the development and diffusion of entrepreneurial spirit and skills, and help to reduce economic disparities between urban and rural areas.

The importance of SMEs to longer-term economic stability derives from their size and structure which, under adequate conditions i.e. well developed factors market, allow them the flexibility and ability to weather adverse economic conditions. SMEs are more labor-intensive than larger firms and, therefore, have lower capital costs associated with the creation of jobs. Consequently, SMEs play an important

role in fostering income stability, growth, and employment. Modern economies operate as complex networks of firms in which a firm's competitive position depends, in part, on the efficiency of its suppliers. Therefore SME's competitiveness affects the competitive position of the economy as a whole. In addition, SMEs improve the efficiency of domestic markets and make productive use of scarce resources, such as capital, facilitating long-term economic growth.

## 3. SMEs sector in Kosovo

Kosovo's economy after the war has been driven by international aid, public sector and remittances.<sup>6</sup> The role of the private sector, especially of SMEs has been relatively weak. Kosovo is still in transition, where entrepreneurship and small and medium business creation and expected to play a crucial role in modern path towards a free market and therefore towards the development and growth. In Kosovo dominates clearly an imbalance between exports and imports. One reason is that Kosovo SMEs are not competing at international level. They can not export their goods and services abroad so negatively affects GDP, create jobs and economic growth. Most goods that exported are metals and minerals. There is an unfavorable environment in Kosovo for businesses; also, there is a lack creative entrepreneurship. Over 50% of all SMEs operating in the commercial sector are characterized by small investment.<sup>7</sup>

After the war and the establishment of the UNMIK in Kosovo enabled temporary registration of the business until March 2003 and since then become permanent registration of business.

After the year 1999, intensity for the opening of enterprise and registration was very high where the number of enterprise registration in the year 2000 was 29564 and that number grew steadily till the year 2010 where the total number of enterprise registration is 103755.(see the table below).<sup>8</sup>

<sup>3</sup> [www.bqk-kos.org](http://www.bqk-kos.org)

<sup>4</sup> Hobohm.S "Small and Medium-Sized Enterprises in Economic Development: The UNIDO Experience"

<sup>5</sup> Hobohm.S. *Small and Medium-Sized Enterprises in Economic Development: The UNIDO Experience*

<sup>6</sup> Qeveria e Republikës së Kosovës: *Strategjia e zhvillimit të NVM-ve në Kosovë 2012-2016*, pg. 12

<sup>7</sup> Qeveria e Republikës së Kosovës: *Strategjia e zhvillimit të NVM në Kosovë 2012-2016*, pg. 12

<sup>8</sup> MTI, Agjencia për mbështetjen e NVM-ve: *Raporti vjetor i NVM*, 2011, pg.21

Table.1. Trends of registration in Kosovo

| Trends of registration in Kosovo |              |              |              |              |              |              |              |              |              |              |              |               |
|----------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|
| Year                             | 2000         | 2001         | 2002         | 2003/1       | 2003/2       | 2004         | 2005         | 2006         | 2007         | 2008         | 2009         | 2010          |
| Temporary registrations          | 29564        | 40094        | 54412        | 56514        | 28652        | 23775        | 23519        | 23415        | 23046        | 22613        | 21676        |               |
| Permanent registrations          |              |              |              | 0            | 27920        | 39257        | 50591        | 55884        | 61191        | 68316        | 75681        | 6398          |
| <b>Total</b>                     | <b>29564</b> | <b>40094</b> | <b>54412</b> | <b>56514</b> | <b>56572</b> | <b>63032</b> | <b>74110</b> | <b>79299</b> | <b>84237</b> | <b>90929</b> | <b>97357</b> | <b>103755</b> |

Source: Annual report of SME, 2011-MTI

There are differences in terms of classification of enterprises by number of employees. In the following table is presented classification of enterprises according to the European Union and World Bank.<sup>1</sup>

Table.2. Classification of SME by number of employees by World Bank and European Union

| Size   | Number of employees (World Bank) | Number of employees (European Union) |
|--------|----------------------------------|--------------------------------------|
| Micro  | 1 - 5                            | 1 - 9                                |
| Small  | 6 - 25                           | 10 - 49                              |
| Medium | 25 - 250                         | 50 - 249                             |

Size of SMEs in Kosovo is defined by law to support SMEs nr.2005/02-15 & Law Nr. 03 / I-031, where the number of employees is the only criterion of classification of the size of an enterprise. Kosovo has adopted classification of enterprises by number of workers from European Union countries.

Table.3. Registered enterprises in Kosovo by the number of employees, 2010

| Size enterprise | Number of employees | Number of enterprise |
|-----------------|---------------------|----------------------|
| Micro           | 1 - 9               | 102,070              |
| Small           | 10 - 49             | 1,406                |
| Medium          | 50 - 249            | 221                  |
| Large           | 250 and more        | 58                   |
| <b>Total</b>    |                     | <b>103,755</b>       |

Source: ARBK<sup>2</sup>

From the above data the number of micro enterprises is higher than those of small and medium enterprises. If we compare with previous years there has been a positive development of SMEs in Kosovo.

Table.4. Registered enterprises in Kosovo by the type of property, 2010

| Property type                           | Number of enterprise |
|-----------------------------------------|----------------------|
| Individual Business                     | 93,129               |
| General Partnership                     | 3,383                |
| Limited Partnership                     | 90                   |
| Limited Liability Company               | 6,170                |
| Joint Stock Company                     | 368                  |
| Foreign-owned enterprise                | 486                  |
| Social Enterprise                       | 16                   |
| Public Enterprise                       | 12                   |
| Agricultural cooperative                | 68                   |
| Other-under the jurisdiction of the AKP | 33                   |
| <b>Total</b>                            | <b>103,755</b>       |

Source: AKBR<sup>3</sup>

In Kosovo dominates individual business registration where 90% are registered, limited liability company 5.08%, general partnership 3.2%, and other businesses by type of property are under 1%.

SMEs contribute in GDP and serve as promoters of development. In Kosovo, micro, small and medium enterprises have had an impact on GDP growth presented in the table below.

<sup>1</sup> Mustafa.M, Kultllorci.E, Gashi.P & Krasniqi.B "Biznesi i vogël dhe i mesëm" fq.20-21

<sup>2</sup> [www.arbk.org](http://www.arbk.org)

<sup>3</sup> [www.arbk.org](http://www.arbk.org)

Table. 5 Contribution of enterprise in GDP

| Size enterprise | Number of enterprise | Currency (€)            | GDP(%)       |
|-----------------|----------------------|-------------------------|--------------|
| Micro           | 14,968               | 656,885,164.33          | 16.79        |
| Small           | 1,210                | 667,585,914.82          | 17.07        |
| Medium          | 185                  | 369,455,655.16          | 9.44         |
| Large           | 58                   | 528,558,359.84          | 13.51        |
| Total           | <b>16,421</b>        | <b>2,222,485,094.15</b> | <b>56.81</b> |

Source : Annual report of SME, 2011<sup>4</sup>

#### 4. Barriers of SMEs in Kosovo

There are many factors that prevent small and medium enterprises in Kosovo to do and develop their businesses. Some of them are listed below:

- Insufficient rule of law.
- High rates of interest from creditor institutions.
- Consistency of poor electricity which affects more the manufacturing sector.
- Higher taxes.
- Lack of infrastructure.
- The informal sector including unfair competition and massive illegal imports.
- Lack of domestic demand.
- Complicated procedures for travel abroad.
- Lack of skilled labor and appropriate equipment.
- Lack of raw materials.
- Financial problems.
- Difficulties in obtaining credit.
- Difficulties in building permits.

Below is a summary of the results of the latest report "Doing Business 2011". Kosovo is ranked 119 out of 183 countries worldwide.<sup>5</sup>

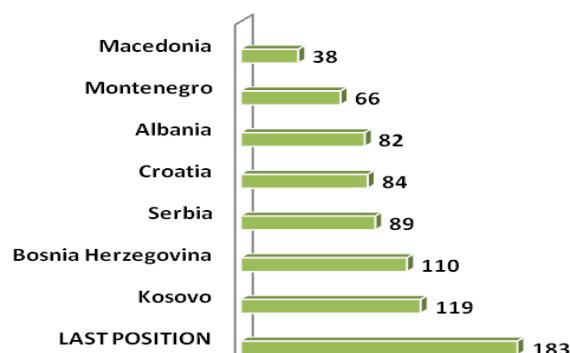
Table.6. Ease of doing business rank in Kosovo

| Ease of doing business rank | Starting business | Dealing with construction permits | Registering property | Getting credit | Protecting investors | Paying taxes | Trading across borders | Enforcing contracts | Closing business |
|-----------------------------|-------------------|-----------------------------------|----------------------|----------------|----------------------|--------------|------------------------|---------------------|------------------|
| 119                         | 163               | 173                               | 65                   | 32             | 173                  | 41           | 130                    | 155                 | 31               |

Source: www.doingbusiness.org

Table presents Republic of Kosovo ranked 119 on the ease of doing business from 183 countries worldwide. If we compare it with the region, Kosovo remains the last of them. Among the countries of the region Macedonia is ranked 38, Montenegro 66, Albania 82, Croatia 84, Serbia and Bosnia 89 and Herzegovina ranked 110 as the ease of doing business.(see fig. below).

Fig.1. Ease of doing business rank in the Balkans



<sup>4</sup> MTI, Agjencia për mbështetjen e NVM-ve: Raporti vjetor i NVM, 2011, pg.24

<sup>5</sup> www.doingbusiness.org

## 5. Employment effects of SME

SMEs play a significant role in creating new job. Considering the structure of employment in Kosovo, particularly employment categories of enterprises (micro, small, medium and large), and the results are presented in the table:

Table.7. Number of employees in SMEs sector in Kosovo

| Categories by number of employees | Number of enterprises | Number of employees |
|-----------------------------------|-----------------------|---------------------|
| 1 - 9                             | 102070                | 171393              |
| 10 - 49                           | 1406                  | 23380               |
| 50 - 249                          | 221                   | 22026               |
| 250 and more                      | 58                    | 66658               |
| <b>Total</b>                      | <b>103755</b>         | <b>272457</b>       |

Source: Annual report of SME, 2011-MTI

The table above shows that in Kosovo dominate micro enterprises (1 - 9 employees) which represent the largest number of employees, 171393 or 62.9%. In small enterprises are employed 23,380 employees, or 8.73%, in medium enterprises are employed 22,026 or 8.58%, implying that the sector of micro, small and medium enterprises employed a total of 216,799 employees expressed in percentages are 79.59%. A characteristic of large enterprises (over 250 employees) is that they cover social and public enterprises too (KEK, PTK, etc.).<sup>1</sup> In large enterprises are employed 75 886 employees. Taking this into account, it appears that Micro, Small and Medium Enterprises cover 62.24% of total employment in Kosovo.

## 6. Discussion and analysis

It has not been easy to assess the role played by the SMEs in Kosovo's postwar development. Development of entrepreneurship hasn't been a dynamic process in Kosovo influenced considerably by changes in domestic business environment as well as the external influence, which is typical for a small country with open economy. Development of entrepreneurship through SMEs development formation has supported at a certain level economic development in Kosovo, the growth in employment and decrease in unemployment.

SMEs have important role to play: to accelerate economic growth through the growth of their output contributions to gross domestic product (GDP), and to reduce poverty through employment creation and income generation effects of their generated output growth. Output and employment increases in MSME lead output and employment to increase in the rest of the economy through three main linkages: production, investment, and consumption. Kosovo's economic development is associated with a large number of micro, small and medium enterprises. Kosovo's economic development is associated with a large number of micro, small and medium enterprises that are growing and making up over 99% of total number of enterprises. Despite progress, the business climate in Kosovo reflects the numerous problems that relate to the degree of informality, regulatory,

environment, etc.

Development of SME sector, regarded as the most efficient economies in transition that generates sustainable economic growth, employment and poverty alleviation. Kosovo has been a growth of 4.0% in 2010.<sup>2</sup> This increase has occurred as a result of investment by the government of Kosovo, but certainly SME sector has a contribution that it is estimated that about 43.3% to GDP and employing about 62.24% in the private sector. The SME sector has had a constant development over the years of transition. Referring to data from AKBK by MTI, the number of active entities by the end of 2010 is 103.755. Most of them are registered by type of ownership as individual businesses, the limited liability companies and partnerships. It would be favorable to stimulate the organization of enterprises in the form of joint stock companies (corporations), as an optimal shape, which would affect the investment of smaller amounts of financial funds that hold individuals and families, and at the same time would help the financing of projects that can not be funded by own resources and bank loans. SMEs in Kosovo face with multiple barriers which inhibits starting their business or development. For greater utilization of capacity of SMEs unfair competition should be eliminated, monetary and financial policies to mitigate financial funding shortages should be implemented, stabilizing macro policies should be applied, and free trade agreement should be signed and applied with countries of the region and beyond. In order to be competitive SMEs should improve the quality of products and services by utilizing technological innovation, and stimulating qualified personnel.

## 7. Conclusions and recommendations

Analysis of SME development based on statistical data shows that have influenced Kosovo's economy and particularly the pace of its growth. In a synthetic form of the main conclusions, which affect policy issues are:

- SMEs in Kosovo make up the majority of the repertoire of enterprises. More dominates micro enterprises and small ones.

<sup>1</sup> MTI, Agjencia për mbështetjen e NVM-ve: Raporti vjetor i NVM, 2011, pg.25

<sup>2</sup> [www.mti-ks.org](http://www.mti-ks.org)

- SME performance has been an increasing trend not too high. From 103755 to registration of enterprises employed 272,457 employees.
- SMEs may in future provide more jobs for the labor market in Kosovo, because they are more dynamic type of future enterprises. So be developed specific policies to support these developments.
- The SMEs obstacles are numerous, which are mainly connected with the operation of the business environment such as energy, infrastructure, informal economy, tough competition, and bad-designing / non-execution of legislation, etc.  
Drawing on data can precede the following findings:
  - Increase the efficiency of the judicial system to protect the economic rights.
  - Specialization of knowledge in the fields of information and technologies.
  - Use the tax system to increase the competitiveness of local products.
  - Power supply 24 h.
  - Creation of relief funds for SMEs to access finance and funding development programs.
  - Through formal and informal education to raise the level of learning and culture of entrepreneurship.
- Stimulation of specific sectors, in order to replace imported products with local products.
- Creating favorable environment for business start-up and making lines according to World Bank report "Doing Business".
- Strengthen the capacity of market regulatory mechanisms to reduce and eliminate unfair competition in the market in Kosovo.
- To define the position of Kosovo within the mechanism of action is CEFTA and bilateral and multilateral free circulation of goods and services in Serbia and CEFTA member countries and the EU countries.
- Central Bank to influence the commercial banks to reduce interest rates for business loans.
- Facilitate the procedures for obtaining a visa for travel to foreign countries, especially to be treated with priority businessmen's applications for business purposes.
- Initiate a review of fiscal and customs policies to the import of machinery, new technology and raw materials for the needs of SMEs.

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