



**TECHNIUM**  
SOCIAL SCIENCES JOURNAL

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## **Internal factors affecting the performance of Small and Medium Enterprises in Kosovo**

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**Abstract.** This study aims to provide an understanding of the importance of the SME sector in the socio-economic development of Kosovo and examine in particular the influence of internal factors on them. A cross-sectional survey was conducted with Kosovo SMEs through an anonymous online questionnaire. This study confirms that all internal factors - managerial skills and competencies, business experience, access to finance and technological capabilities, depending on a period, have a significant impact on the performance of SMEs. While access to finance is considered as a major challenge, technology is considered to help improve business performance. However, results revealed that poor managerial skills and competencies, despite having a significant impact on the performance of SMEs, they were also related to access in finance and technological skills, making it difficult to run a business. Training and empowerment of SME managers in key business areas can be an opportunity to improve business performance.

**Keywords.** internal environment, SME performance, managerial competencies and skills, access to finance, technology.

### **1. Introduction**

The main problem that prompted this study was the inadequacy and scarcity of empirical and up-to-date knowledge about the SME sector in Kosovo, which consequently made it difficult for entrepreneurs and researchers to implement and adapt practices and theories. This research addresses in particular the impact of internal factors in the SME sector. Considering that most of the studies by national and international actors did not include the micro-enterprise sector, which constitutes more than 93.1% of the SME sector, as a research subject we also included the micro-enterprise sector along with small and medium enterprises of Kosovo, which are vital to the country's economy, and the impact of factors such as managerial skills and competencies, access to finance and technological capabilities in the performance of their enterprises.

#### *1.1. Small and medium enterprises – concepts and relevance*

The most common determination that distinguishes large and small enterprises is the number of employees [1]. According to Bolton Report [2], describe two main approaches that summarize all definitions: quantitative and qualitative approach [3]. The majority of nations, policymakers,

academics, statistical agencies, and international institutions mainly applying quantitative criteria in defining SMEs. In Kosovo the classification of SMEs is defined by law on foreign investment which entered into force in 2014. This law defines SMEs by the sole criterion of the size of the number of employees, which is in line with the definition of the EU.

Table 1. Definition of SMEs in Republic of Kosovo

	EU definition	Kosovo definition
Micro	< 10 employees, turnover or balance sheet total $\leq$ EUR 2 m	< 10 employees
Small	< 50 employees, turnover or balance sheet total $\leq$ EUR 10 m	< 50 employees
Medium	< 250 employees, turnover or balance sheet total $\leq$ EUR 43 m	< 250 employees

Source: [50]

SMEs play a special role in the economy of Kosovo, accounting for 99.8% of all enterprises in 2016. They generate 81% (56.2% in EU) of the total value added and 76.2% (66.5%) of the total employment in the economy of Kosovo, making a significant deviation comparing to the EU average in the respective accounts (EC, 2019). In addition, the SME sector in Kosovo achieved strong growth rates in terms of value added with 88.5% (11.7% in EU) and employment 27% (6.6% in EU), substantially exceeding the average achievement by EU SMEs [4].

However, their contribution to export is only around 5-6% [4]. The largest value generated by Kosovo SMEs comes from medium-sized enterprises (47% of total value added) representing only 1% of the business population, which employs one-fifth of the total business sector employment, however the value added created by micro-enterprises (13.2% of total value added) remains very low compared to other economies in the region [5].

Services are largest and most important sector of Kosovo's economy contributing significantly to GDP (72.63% of the GDP) and job creation (85.3% of the employment in Kosovo), driven by construction, real estate, and retail [6]. Although the contribution of SMEs is undeniable for the economy of Kosovo, SME sector is characterized by traditional and non-innovative enterprises and often suffers from a lack of skills and training related to business activities; access to finance, poor competitiveness, technological capabilities, etc.

### 1.2. Literature Review

SME sector has always raised the interest of academics to adapt and create applied models and economic theories to achieve the best performance due to their socio-economic importance, specific business characteristics and behavior [7][8][9].

Despite the large role for the economic and social development, growth of small and medium enterprises (SMEs) continues to be challenged by a various number of factors. Based on many empirical studies, it has been pointed out that most of the SMEs do not survive more than 5 years. Considering this conclusion, it is very important to increase attention to the factors that influence such results.

The main characteristics of SMEs tend to derive from their limitation such as personalized management (owner/manager), constraints on resources (management/organization, human

resources, finance) and technological capabilities, limited market impact, and greater flexibility to the external environment [7].

Although the authors have paid great attention to identifying the factors that affect the growth of SMEs, however, they have not yet been clearly defined. But, in an extensive study with 1386 fast-growing small businesses identified four groups of factors that affect the rapid growth of businesses such as entrepreneur's personality, business strategy, resources and capabilities of the business entity and the external environment [7]. Considering that most of the identified factors that affecting SME performance were internal, this study focused only on identifying and influencing internal environment in Kosovo SMEs.

According to [7], "managing the internal environment is usually connected to the degree of performance achievement of a business entity". Considering that studies examining only the impact of internal factors as a whole on the performance of businesses are rare, it increased the interest and attention to perform one.

Internal environmental factors are considered as factors within a business that affect the business and are more controllable by the business entity [10]. Internal factors can influence the performance of a business both positively and negatively. Main internal factors affecting performance can be grouped into three categories - human resources, finance and technology. However, we will focus on the internal factors that challenge SMEs. Therefore, in the literature review we have included factors such as managerial skills and competencies, access to finance, and technological capabilities.

*1.2.1. Managerial competency and skills.* Managerial competencies which consist of a set of skills (human, financial and information), knowledge and attributes that enable an individual or small business owner to perform a specific task or activity within a function [11], are considered as crucial factors that contribute to survival and performance of SMEs. Recently, changes in the global market have increased attention to the impact of competencies and skills on the performance of SMEs. Many authors have found a positive relationship between managerial competencies and the performance of SMEs [12][13][14]. However, a number of studies have examined the relationship between managerial competence and small business failure [15][16][17], and identified that the lack of relevant skills or expertise (supervision of financial, marketing, HR) in basic business management are the major contributors to small business performance and failure [18][19]. In order to ensure a superior performance, a firm or owner must possess appropriate skills and abilities before running the businesses [20]. In Kosovo there is an insufficiency of studies in relation to factors such as managerial competencies and skills. Given the high importance we discussed of managerial competencies and skills in the performance of small and medium firms, it is of great importance to examine the impact of these factors on Kosovo SMEs.

*1.2.2. Access to finance.* Access of SME to finance is considered as main barrier faced by SME in the region [21], impacting growth and development of business entities. Given the characteristics of the sector, the authors find that young firms of small size face greater obstacles when they seek to obtain financial resources [22]. However, it is noted that mostly of the SMEs rely on internal finance, such as existing cash, contribution from the owners, family and relatives, which is often insufficient for SMEs to survive and growth [23]. Kosovo as a developing economy with different market forces which are hindering the competitiveness of local businesses, the necessity of investment has been created in order to grow their businesses. As a result, the demand for external financing has been stimulated, especially for micro-enterprises. Credit is the main instrument of SMEs for funding. The most apparent private sector financing gaps in Kosovo include those for loans to micro-enterprises and for equity finance [24], which MFI struggle to meet the growing demand due to limited funding sources. However,

as a result banking sector have decided to stop serving the microenterprise segment, which is hindering the growth and survival of 93,1% of SMEs. While small and medium loan finance availability is sufficient, high collateral requirements present a major barrier for access to finance by SMEs [24]. The lack of sophistication in areas such as business planning, financial record keeping, and growth management has created a barrier to responding low collateral and equity finance requirements, which have consequently limited credit.

*1.2.3. Technological capabilities.* Technology has become a crucial and inseparable mechanism for all kinds of organizations. Through it, organizations improve the performance and overall effectiveness of products, services and systems by enabling businesses to expand quickly and efficiently. Technological advancement in the modern era presents a great challenge for the SME sector. The role of information technology for the SME sector is being considered critical in relation to performance enhancement, competitive advantage and firm survival [25][26]. Given its importance, we conclude that technology is no longer something of a luxury, but a necessity for firms. However, the opportunity to adapt to technological developments is small, based on the fact that most of the SME sector in Kosovo consists of traditional and non-innovative enterprises. Despite the obstacles faced by these businesses, surprisingly, the technology sector is booming, contributing to economic growth in terms of employment of young men and women as well as increasing the level of exports. About 78% of firms in the technology sector export their services [27]. Based on these data, we notice that the domestic market has been left behind and overshadowed by the focus on exports, because they do not see it as a profitable market. This disconnect does not promote the local market and makes it impossible to capitalize on the benefits of technology. Consequently, skilled workforce, knowledge and financial means are main barriers for digital transformation of SME firms in Kosovo [28]. Also, in many literatures the positive relationship between IT capabilities and firm performance has been demonstrated [29]. IT capabilities are defined as the ability of the firm to use and mobilize IT resources along with other firm resources in order to improve the core performance mechanisms of the firm [30]. This section examined how IT capabilities affect the performance outcomes of SMEs in a dynamic environment.

## **2. Research methodology**

This paper seeks to investigate the internal environment factors affecting performance of Small and Medium Enterprises in Kosovo. The purpose of this study is to examine the internal environment toward the performance of SMEs, considering the importance level of sector for the economy of Kosovo. Registered SMEs in Kosovo Business Registration Agency operating in three local governments, namely: Pristina, Ferizaj, Gjilan as shown on the Ministry of Trade and Industry, represents our target population. They are categorized in manufacturing, service and agricultural SMEs. To achieve objectives of the study, it is employed a cross-sectional study which the collected information are analyzed from each subject at a specific point in time. Based on general scientific guidelines for sample size developed by Krejcie & Morgan (1970) as cited in [31], the recommended sample size for this study was 379.

### *2.1. Questionnaire and data collected*

In order to collect the data, it is developed a structured questionnaire mostly with yes/no and Likert Scale type of question. The questionnaire is composed in two sections. First section contains details of socio-demographic profile of the respondents. The second section of questionnaire contains the internal environment factors: managerial competencies and skills, access to finance and technological capabilities. Questionnaires were administered between

10th January 2020 and 10th March 2020 on SMEs from selected local governments through online survey using emails. Random sampling technique employed to determine the eligible owners/managers to be questioned.

## 2.2. Reliability and validity

Reliability in quantitative research in the process of measuring a phenomenon concerns with repeatability, stability, and consistency of the results over the time. Based on a minimum internal consistency coefficient [32][33], Cronbach Alpha Coefficient in the actual study is above .70 which shows that results are reliable. However, for a test to be reliable, it also needs to be valid [34].

Validity in quantitative research explains how well the collected data covers the actual area of investigation [35]. It is also meaning a “measure of what is intended to be measured” [36]. To improve our survey results, we used pre-testing method of Schindler & Cooper [37]. To validate the appropriateness of the questionnaire, pre-tests were performed with a group of relevant experts and as a result no major concerns were experienced or observed, thus paving the way for data to be collected as planned.

## 2.3. Data analysis

After taking the online results, data collected then imported to SPSS 25.0 version for analysis. The Demographic details are descriptive and are presented in tables and graphics. For continuous variables we used means (standard deviation), for categorical variables we used percentage. In order to find the significant factors relating the business performance its employed Chi-squared test of association. The majority of statistical tests were conducted A two-sided test its used employed at the significance level of 0.05 to conduct statistical tests. Considering that p-values in this study were reported to be less than 0.05, results are considered statistically significant.

## 3. Results and discussion

The presentation of results comprises in four parts. First, we summarize the socio-demographic profile of the respondents, showing the gender, job position and the level of education completed by owners/managers of relevant SMEs, and other company profile details. In the second part we present managerial competency and skills to further analyse the company practices in the context of operational activities. We also present results of challenges and impact in accessing finance in the context of business growth. The last part of results elaborates the impact of technological capabilities toward improving business performance of surveyed SMEs. Questionnaire was emailed to 379 SME owner/managers through online survey, resulting in 94 returns. The response rate was 24.8%.

Table 2. Socio-Demographic profile of the Respondent

Category	N	Percentage
<b>Gender</b>		
Male	71	75.53
Female	23	24.47
<b>Job Position</b>		
Owner	58	61.70
Manager	21	22.34
Both	11	11.70



Other	4	4.25
<b>Highest education completed</b>		
Diploma	34	36.17
Degree	41	43.61
Master	4	4.25
Doctorate	2	2.12
Other	13	13.82

Majority of the participants (owners/managers) were males, which shows the dominance of SME ownership by males. According to Riinvest Institute [38] over 80 percent of women are inactive in the labour market, while only ten percent of the country's active businesses are owned by women. Our findings show an increase rate of women in business activities mostly oriented towards services and trade, particularly beauty and hairdressing. The average age of the participants was found to be 32 year, thus, reflecting the average working population of Kosovo according to 2011 census which is 30,2 years. A well-trained labour force could be a comparative advantage and a key resource for economic growth [39].

More than a half (50%) of participants had tertiary educational preparation, while the rest had vocational or secondary education. Many authors and scholars have found a positive impact between education of SME owners and performance of SMEs [40][41][42][43]. However, owner/managers need to seek knowledge in relate with their businesses, on the contrary education may not assist performance [44]. But still, higher education preparation of owner/managers is considered to provide a significant performance advantage for SMEs.

Table 3. Background information of the participated SMEs

Category	N	Percentage
<b>Legal status of your business</b>		
Individual Business	31	32.97
General partnership	7	7.44
Limited liability company	53	56.38
Joint stock company	1	1.06
Foreign company	2	2.12
<b>Sector of your business</b>		
Agriculture	3	3.1
Services	67	71.27
Manufacturing	24	25.5
<b>How many people you employ?</b>		
Less than 10	79	85.1
11-49	11	11.7
50-249	2	2.12
Over 250	1	1.06
<b>How long has your enterprise been in this business?</b>		
Less than 3 years	32	34.04
3-5 years	40	42.55
5-10 years	7	7.44

10-15 years	10	10.63
Over 15 years	5	5.31
<b>Business performance in the past year in comparison to the previous year</b>		
Improved	47	50.00
Worsened	36	38.29
Unchanged	11	11.70
<b>Running an SME over the past year in comparison to the previous year</b>		
More difficult	67	81.27
Easier	0	0.00
Unchanged	27	18.73

All of the surveyed SMEs are registered business with a legal status. Given the fact that mostly of SME owners perform many roles our majority of the participants were both manager and owner. Regarding the legal status, recently in Kosovo it is seem more appropriate for SME owner/managers to choose the legal form of Limited Liability Company (56%), while the Individual Business form was option for about 1/3 of participants. However, Kosovo still continue to have large informal sector which is estimated at around 30% of GDP [45], and as a result creates unfair competition and weakens labor rights. Although, informal SMEs can be a significant source of job creation, it is considered that the formalization of SMEs is often associated with better performance [46]

With a low level of industry as a developing country, Kosovo as the most important sector have services and industry, a fact that was emphasized in the survey results. The structural stretch of surveyed SMEs was mostly service-oriented (71%) and manufacturing oriented (25%), while agricultural stands at 3%. More than two-third of surveyed SMEs employ 1-10 people, which is in line with the Kosovo Government [47] definition criteria for MSMEs.

The majority of surveyed SMEs are in business for less than five years, indicating that Kosovo SMEs remain in the embryonic phase, which is 3-5 years since start-up, lacking growth. An empirical study conducted in 956 Croatian food industry businesses found a negative impact between firm age and business performance, stating that their accumulated knowledge in all crucial aspects of the business become overcome with their inertia, inflexibility and osseous by accumulated rules, routines and organizational structure [48]. Respondents were asked to indicate whether their SME performance is improved, worsened or unchanged in the past year in comparison to the previous year. As Table 2 summarize, 50% of participants indicated that their performance has improved, whilst more than 80% of them stated that running an SME was more difficult in the past year in comparison to the previous year.

### *3.1. Managerial competencies and skills*

Regarding the experience of owner/managers in the relevant type of business, majority of them indicate that they have relevant experience (63%), while more than a half (30%) of them lack prior experience in managing SME.

Table 4. Summary of accessing managerial skills of the participated SMEs



Category	Yes	No
<b>Owner/management having the necessary experience and training</b>		
Does management/owner have prior experience in managing this type of business?	61	33
Does management/owner have prior experience in small business management?	65	29
Does management/owner have formal training in business management?	31	69
Does management/owner have formal training in financial management and planning?	29	71
Does management/owner have formal training in marketing?	37	63
Does management/owner have formal training in bookkeeping and accounting?	29	71
<b>Management/owner having the necessary skills to undertake the following</b>		
Prepare financial statements	27	73
Prepare trading budgets	26	74
Prepare cash flow forecasts	27	73
Analyze financial statements	25	75
Do you outsource any of the business functions?	69	31
<b>If yes to outsourcing, then which of the following functions is outsourced?</b>		
Accounting	73	27
Human Resources	4	96
IT	38	62
Marketing	12	88

More than two-third of SME owner/managers are not engaged in formal training regarding business management activities and marketing, showing more difficultness level in running their businesses. The lack of training in business functions of SME owner/managers through empirical studies it's proved to have a negative impact in the business performance and growth [49]. In Kosovo, a majority of SME owners lack financial and planning skills which indicates directly on the performance indicators like effectiveness and goal achievement, firm growth, employment growth in long-term periods. As it stated above, most of the participants were found to have lack of skills in analyzing and preparing financial statements and cash flow forecasts. This situation is driven by the lack of training in relevant fields of SME owner/managers and low monthly fees of accountants' firms. Influenced by the current situation, more than 70% of surveyed SME owner/managers are forced to take services from external sources. The survey response reflects that majority (76%) of the SMEs outsource business functions, with accountancy and IT services being the most outsourced functions.

### 3.2. Access to finance

In Kosovo, access to SME finance remains a major obstacle to the survival and growth of this sector. This is confirmed by two-thirds (74%) of the surveyed owners / managers, emphasizing that access to finance is a great challenge to grow their business. With the increasing need for investment and development which was driven by the formalization of the micro-enterprise sector in particular which represents 97% of the entire private sector, created the continuing

need for external financing (41%), mostly on loans, relatives and other sources of financing. Banks in Kosovo have restricted access to finance for the micro-enterprise sector through requirements for high collateral, business turnover and age, indicating difficulties (55%) in accessing external finance for surveyed businesses. The sector of new micro-enterprises has more difficulties in accessing finance, which as a result of lack of skills in the field of business planning, financial record keeping, growth management and low awareness have created a barrier to borrow with lower collateral requirements. This indicates a blockade of more than 93% of the total enterprises in private sector by banks in Kosovo, challenging the microfinance sector with limited funding sources to meet the growing demand of micro-enterprises.

Table 5. Summary of accessing finance of the participated SMEs

Category	N	Percentage
<b>Access to finance is a major challenge that affects the growth of my business</b>		
Strongly disagree	7	7.44
Disagree	16	17.02
Agree	26	27.65
Strongly agree	45	47.87
<b>What financing methods you use to finance your business?</b>		
Existing cash	56	59.57
Bank loans	21	22.34
Relatives	13	13.82
Other	4	4.25
<b>Does your business experience difficulties in accessing external finance?</b>		
Yes	52	55.32
No	42	44.68

### 3.3. Technological capabilities

The majority of respondent's state that they are interested and willing to invest in the technology of their firms. More than 90% of respondents point out that technology helps them improve performance. As awareness grows, they have realized that investments in technology contribute to increased performance and competition against other firms especially against the informal sector which has the main advantage of price. However, most respondents noted the difficulties they face during the digital transformation of their firms. The main barriers that challenged the surveyed businesses were more of a financial nature and lack of expertise and knowledge in the field of IT. Based on this approach, we note that the surveyed enterprises want to embrace the integration of technology but have not yet developed any concrete strategy or action plan on how to do it.

## 4. Conclusions, Limitations and Recommendations for Further Studies

The contribution of this research can be seen in two contexts, practical and scientific, with a dynamic approach which covers only the impact of internal factors as a whole, and their impact on the performance of SMEs.

The impact of factors such as managerial skills and competencies requires a further and detailed study especially for the micro enterprise sector in the terms of growth and development, considering their significant impact on performance of the SMEs, which is found to be also related to other factors such as access to finance and technological skills.

The factors examined in the study were grouped into three groups - managerial skills and competencies, access to finance and technological capabilities.

This study confirms that all internal factors - managerial skills and competencies, access to finance and technological capabilities, depending on a period, have a significant impact on the performance of SMEs.

Lack of training and experience in relevant important business activities was a negative indicator of business performance, making it difficult to run a business.

Access to finance is considered a major challenge for businesses, especially for micro-enterprises which in the absence of skills in the field of business planning, financial record keeping, and growth management created barriers to respond to the requirements and procedures of financial institutions.

Based on results, the majority of respondents considered technological capabilities as the main indicator for improving performance. Struggling to meet their customer expectations, they see technology as their savior. However, the lack of IT skills and expertise, the lack of concrete action plan and strategy, and the associated costs limited the utilization of its technological capabilities.

The study has its own limitations. The first is poor response rate of the selected SME (24.8%), which could be due to time factor to complete the survey, and by the inadequacy of respondents to complete an online survey. The second limitation in this study was that the survey was conducted only in three regions of Kosovo and does not represent the sample of all Kosovo SMEs. Another limitation of this study is that performance appraisal is only analyzed within the framework of internal factors, excluding product innovation, organizational features of autonomy, market roles, and type/importance of goals. Examining the impact of these factors would strengthen the research results.

However, performance measurement can be completed by adding the influence of external factors in Kosovo SME sector, a study which would be necessary in future academic research.

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