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## **Small and Medium Enterprises: Importance for the Kosovo Economy**

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**Abstract.** This study aims to broaden the understanding of the importance of SMEs (Small and Medium Enterprises) for the economy of Kosovo, especially in terms of economic development, labor market and innovation. The study was conducted through analysis of documentary sources such as relevant reports of national and international institutions as well as relevant scientific papers. The scientific contribution of this study is theoretical and aims to help researchers of the field for an expanded understanding of SMEs over national economies. This study provides a concise framework of important elements on the economic impact of SMEs on Kosovo's economy. Examination of available data has shown that the SME sector plays a crucial role for the Kosovo economy. The key role of SMEs was emphasized in terms of overall value generated and the labor market while innovation remains a challenge to be addressed by stakeholders.

**Keywords.** SMEs, economic development, labor market, innovation

### **I. Introduction**

Small and medium-sized entities are the most vital and important sector in a country's economy. They are the backbone of an economy and a key factor for growth and employment. SMEs provide and generate employment opportunities, especially in times of recession; they are a major source of modernization, innovation and entrepreneurial spirit; they create links between individuals' innovative efforts and competitiveness and play a very important role in the future development of businesses. In short, dynamic and healthy market economies are totally reliant on small and medium-sized entities. The economy which is depended on remittances, public investment and consumption activities also remains a general challenge for the economy of Kosovo. This structure of economy it's followed by challenges of the private sector which also have hindered the contribution of the business community to economic growth.

The main problem that prompted this study is the scarcity and clarity of the impact of SMEs on the economy of Kosovo, which makes it difficult to further expand studies on the importance of SMEs. This study addresses three key issues. Firstly, it is the aim of this paper to give a brief exposition of some arguments in favour of and against the economic importance of the small business sector to the Kosovo economy. Secondly, it examines the overall role of SMEs in Kosovo's economy. Thirdly, it deals with the role of the SME sector in employment,

and it analyses their role toward innovations. The subject of this paper is Kosovo SME sector, economic development, employment and innovation.

### 1.1. Literature review

**Classification of SMEs:** To better analyse the role of SMEs we must first define them. An enterprise is defined as any legal, independent, organized entity of persons, property, obligation and economic activities oriented on realization of profit. (Khatuna & Jinoria, 2014). Classification of enterprises are categorized based on different factors and criteria's, such as location, size, age, structure, organization, number of employees, sales volume, worth of assets, ownership through innovation and technology (Rahman, 2001). The most used criterion to distinguish between large and small businesses is the number of employees (Hatten, 2011). According to Bolton Report 1971, two main approaches are suggested to the business entity definition: quantitative and qualitative approach, (Carter & Jones-Evans, 2006). Nations, policymakers, academics, statistical agencies, and international institutions mainly apply quantitative criteria when defining SMEs. European Commission in 2003 determine the number of employees as main criterion to define an enterprise, however in 2005 this institution added two more financial criteria: annual turnover and annual balance sheet (European Commission: 2003, 2005).

**Importance of SMEs for economy, employment and innovation:** SMEs are widely considered as the backbone for most economies. In general, the role of SME-s in industrialized and developed nations has increased continuously over the past decades. Small and medium enterprises have been the subject of discussion for many relevant international actors and under the attention of academics (Dragnić D., 2009, 39). 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 (Dragnic, 2014, p. 122).

Small and medium sized are widespread around the world and represent more than 90% of the total enterprises in almost every nation (World Bank, 2020). According to Annual Report on European SMEs, there are more than 25 million SMEs which accounts 99.8% of total enterprises in EU-28, and employ around 100 million people or (66%) of total employment in EU-28, and generate slightly less than three-fifth of the value added in the non-financial business sector. Despite the fact that they provide economic growth, generate employment, impacts innovation process, bring new ideas and other benefits, there is a fact that SMEs play a major role particularly in developing countries (World Bank, 2020).

However, Kosovo lags behind the region relatively economically and socially and is considered a potential source of social and political instability (KEC, 2019, p.9). Slow GDP growth due to weak economic policies and political instability has resulted in high levels of unemployment and informal economy (1/3 of GDP according to EC, 2019, p.47), poor education, weak business climate and infrastructure.

Nowadays the word innovation is synonymous with the word digitalization. The way business is developed today is very different from the way it has been. Innovations are changing economies, markets, and rediscovering relationships between organizations and suppliers, consumers, thus becoming a critical mechanism for increasing innovation and job creation (EC, 2019, 4). Digital transformation is a major challenge for SMEs, especially those traditional and non-innovative such as those in Kosovo who are facing the risk of digital transformation losing the ability to compete (KCHC, 2019, 7).

## 2. Methodology

The methodological approach of this paper is based on secondary data analysis and examination of documentary sources, such as reports from national and international relevant institutions, and other research publications in the area of SMEs. This study has analytical character and aims to review the previous studies by various actors which serves to the theoretical part of the study. The research purpose is also to give an overview of the SME role related to economic growth, challenges and constraints toward employment opportunities and innovation. The researcher first examines and interprets concepts and data for the relevance of SMEs toward economy in general. Secondly the author discusses and analyzes the relevance of SMEs toward labor market and innovation generally, to try to realize the ultimate goal of our study, and draw conclusions based on result analysis.

## 3. Results and discussions

### 3.1. The SMEs' significance for the Kosovo economy

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. (OECD, 2019)

**Table 1.** Classification of SMEs in Republic of Kosovo

	<b>EU definition</b>	<b>Kosovo definition</b>
Micro	< 10 employees, turnover or balance sheet total ≤ EUR 2 m	< 10 employees
Small	< 50 employees, turnover or balance sheet total ≤ EUR 10 m	< 50 employees
Medium	< 250 employees, turnover or balance sheet total ≤ EUR 43 m	< 250 employees

Source: Republic of Kosovo (2014 [23]), Law No. 04/L-220 on Foreign Investment, <https://mti.rksgov.net/desk/inc/media/1916AE1F-48E8-451D-A328-CA350EC4D7D2.pdf>;

Despite facing a high number of challenges and barriers, SMEs are expected to be the largest contributors to the economy and employment opportunities. A private sector which is dominated by SMEs and is considered as a pillar of economic growth, is also considered to be suffering from a state of stagnation and has failed to grow relative to its potential (Dobranja, 2019).

**Table 2.** Business demography indicators

<b>Enterprise size</b>	<b>Enterprise</b>		<b>Value added</b>	
	<b>Number</b>	<b>Share</b>	<b>Million E</b>	<b>Share</b>
Micro	34,611	93,1%	39,9	13,2%
Small	2,182	5,9%	61,5	20,3%
Medium	322	1,0%	144,4	47,5%
<b>Total SMEs</b>	<b>37115</b>	<b>100,0%</b>	<b>303,3</b>	<b>100,0%</b>

Source: EC (2019) SBA Factsheet. Country Report. p.3

Although, SMEs play a special role in the private sector, composing about 99.9% of all firms (KAS, 2020). With more than 93% of total business stock, is composed by micro-enterprises which is the largest sector in non-financial business economy (European Commission, 2019, p.3), while small and medium sized enterprise comprise 5.9% and 0.1% respectively. Kosovo SMEs generate 81,0% of total value added for the private sector with medium enterprises as largest contributor with 47% of total value added (European Commission, 2019, p.3). However, the value added created by micro-enterprise remains low compared to its peers in region, meanwhile, it has the largest share of SME exports of all the WBT economies, at 97.3%, with the dominant share coming from micro enterprises 54.9% (OECD, 2019, p.655). Given the fact that micro-enterprises dominate, and while their contribution remains small, stakeholders should be committed to creating favorable conditions for micro-enterprises to grow by creating a stability that enables future growth of value added, employment and exports.

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 (MTI, 2019). Almost half of businesses in Kosovo (45.4%) belong to the trade and retail sector, the other services sector represents about 15% of enterprises, while manufacturing represents about 14% of enterprises in the business sector according to Kosovo Agency of Statistics.

Most enterprises in the trade and retail sector are mainly focused on food, beverages and retail. While most of the companies in service industry mainly operate in catering services, which is considered that the majority of businesses in the construction are involved in the construction of residential buildings. Despite the potential of the sectors that these enterprises are operating, they are mainly focused on consumption activities, which impacts directly to the growth of trade deficit, giving the fact that sectors with potential for employment growth and exports like manufacturing and information and communication technology continue to be underdeveloped and below potential levels.

This poor performance is attributed to the impact of internal and external barriers. From an internal perspective, the SME sector is characterized by traditional and non-innovative enterprises which often suffer from a lack of skills related to business activities, access to finance, innovation and technological skills, etc. Whereas, the external barriers that limit the development of SMEs and the utilization of its potential have to do with corruption, informality and unfair competition as well as the limited market and weak business climate, pandemic situation, political instability. Consequently, the continuous improvement of the business environment has not been sufficient for SMEs to increase the importance of this sector further.

### **3.2. The SMEs' contribution to job market and innovation**

The SME sector also plays an important role in the labor market in Kosovo. Although not enough to reduce the unemployment rate which is currently at the level of 24.5%. This situation is also reflected by the education system which is not responding sufficiently to labor market needs.

**Table 3.** Employment in SME sector

<b>Enterprise size</b>	<b>Numer of employee</b>	<b>Share</b>
Micro	62,450	34,9%
Small	40,727	22,8%
Medium	33,075	18,5%
<b>Total</b>	<b>136,252</b>	<b>76,2%</b>

Source: EC (2019) SBA Factsheet. Country Report. p.3



Kosovo is considered a state of micro-enterprises based on the fact that about 99% of enterprises employ 1-9 workers, or about 76% of total business sector employment in Kosovo (EC, 2019, p.3), and around 55% of total employment in Kosovo (KAS, 2020). While the small and medium sized proportion (employing 10-249 workers) is only 1% (EC, 2019, p. 51). This is reflected in the fact that about 80% of enterprises have individual ownership according to the Open Data Platform, which in most cases have a characteristic of self-employment rather than their growth as an integral part.

The SME sector is considered a promising sector in terms of employment growth, however, based on the fact that the existing enterprises are small and do not continue to grow their staff and business, it remains unclear whether the SME sector will generate in the future the necessary employment to ensure higher growth and impact in terms of the labor market and overall economic development. SME sector have been subject of a major criticism, concerning the working conditions and the treatment of labor force (Dita Dobranja, 2019).

Based on our above states that most of the firms in Kosovo are traditional and non-innovative, Kosovo is still in its initial phases of innovation development. However, some steps are taken by the institutions with the establishment of the Ministry for Innovation and Entrepreneurship (MIE) in 2017 which has underpinned the institutional framework for streamlining innovation in policy making. Kosovo has made some progress with launching the programme for direct financial support for innovative businesses, start-ups and NGOs, however a limited number of entities supported it will not help overall improvement in the innovation and entrepreneurship without ant long term strategy (EC, 2019, p.28) Widespread informality leads to unfair competition, hindering access to finance and the ability of registered businesses to grow and innovate (EC, 2019, p.7)

The ICT sector is expected to take the lead in the innovation road of Kosovo. It is the one of few sectors with positive trade balance, 78% of already existing companies export their services (ECIKS, 2019) and has started to play an increasing role in Kosovo's economic growth.

Despite this situation, international community especially European Commission is helping out with financial measures to support expansion of ICT infrastructure network, innovation and entrepreneurship centers, improve quality of vocational and education training and other educational reforms to help overall environment for social development (EC, 2019, p.29). According to Kosovo Chamber of Commerce, management/owners of SMEs are aware and are working in the direction of digital transformation to improve their business performance. However, skilled workforce, knowledge and financial resources are main obstacle to digitally transform their businesses.

#### **4. Conclusions**

SME sector plays an important role in the economic development and employment of Kosovo, while innovation activity of SMEs remains challenging and its necessary to take strategic and concrete actions by relevant actors to unlock the potential in the most important and promising sector of the economy.

Kosovo's SMEs lack long-term objectives, innovation development, low product range, trade and services orientation, inadequate resource management, low level of product diversification, access to finance, informal economy.

Utilizing and expanding the potential of sectors such as manufacturing and information and technology would help the overall contribution of SME toward stable economic development, generate employment, and increase innovation activity toward healthy export rates.

The SME development agenda must be considered with urgent and concrete priority by local and international institutions to overcome the challenges of unemployment, high trade deficit, consumption in terms of development and increasing their role in the overall economy of the country. Kosovo's medium-term outlook is estimated to be positive and growing. However, Kosovo needs to further engage in creating a sustainable political and fiscal environment and create a better business climate that enables productive investment and SMEs performance enhancement.

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