

**PEN OPINION**

# How sustainable SMEs can incentivize economic development of Kosovo



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## How sustainable SMEs can incentivize economic development of Kosovo

New globalization and geopolitical trends are very much changing the way companies are developed and grow. Industry 4.0 technologies, introduction of new borders and raising protectionism, make hard for developing economies to both compete and be successful. However, for small economies, such as Kosovo, growth opportunities appear greater than risks.

With the entry into force of the Stabilization and Association Agreement (SAA) with the EU, Kosovar companies can help to shape the future of the country. To that end, in particular, small and medium enterprises are the best allies.

In Kosovo, SMEs account for more than 85% of firms. The trade and service sectors dominate the structure of the SMEs in Kosovo. On the other hand, the manufacturing, ICT and the agriculture sectors still remain quite underdeveloped. Kosovo's Growth rates of the past years, which varied from 2.7%-3.3%, are mainly attributed to the high level of remittances, public investments and continuous foreign assistance, partially reflecting the shift of many SMEs in the formal sector.

The SME sector, compared to large enterprises, has performed well in generating new jobs and offering employment opportunities, in particular, to youth and women. The latter is primarily due to the family-ownership pattern of the small and medium enterprises in Kosovo. However, the positive performance of SMEs in creating

new jobs has been hampered by many companies exiting the sector each year and/or declaring passive without officially terminating their activity.

According the 2016 EC Country Report for Kosovo, restricted access to finance, '...weak legal enforcement of contracts and business regulations, administrative barriers, unfair competition from the informal sector, an inefficient judiciary, and corruption' still are the main obstacles to SME development and growth in Kosovo. In addition, the European Investment Bank and the Economic Reform Plan of the Government have also noted the informal sector and shortages in access to finance as some of the barriers to development of SMEs in Kosovo. Moreover, according to the Government, inadequate and unreliable electricity supply, underdeveloped transport links and skill gap (lack of skilled labor force able to respond to market needs) are supplementary constrains that openly limit the competitiveness and sustainability of SMEs. The fact that most of the local SMEs are family-run type of enterprises with little professional supervision stops most of the SMEs from growing, formalizing and transforming themselves into exporting SMEs.

With many existing hurdles, long-term reforms are, nonetheless, required. However, the competition from regional and EU companies, huge unemployment rate among youth and recent graduates, trade deficit and continuous migration of qualified professionals, as well as a GDP growth reliant on remittances and foreign aid leave no space for the Government to solely focus on long-term reforms. The Kosovar Government should thus react rapidly and define what short-term policy interventions it ought to prioritize. Here are some suggestions.

## A. Improve Access to Finance and Incentivize the Level of Investments

One important recommendation, repeatedly highlighted, calls upon Kosovo to strengthen its economic viability mainly through prompt increase of the private sector investment and gradual ease of its dependency on remittances and foreign aid. Lack of viable financial incentives and affordable credit schemes are two main reasons that discourage investments. In general, most of the companies in Kosovo tend not to borrow and use own or family fund to support their business expansion.

A recent initiative of the Government to establish a Credit Guarantee Scheme is a welcoming policy. The Government should specifically support financing investments through grants, investment subsidies and tax incentives devised to assist development of new products or expansion of SMEs in European markets. In the midst of policy options that could incentivize SMEs to improve growth strategies and invest in new product development, encouraging low and stable interest rates is among the best policy solutions for Kosovo.

## B. Improve Labor Productivity and Close the Skills Gap

Kosovo's labor force remains poorly skilled, reflecting in low labor productivity in the country. A fast way to help the development of skills and close the skills gap is to prioritize vocational training and education in those sectors where Kosovo has a solid base of knowledge.

Investing more on education and skill development in ICT, specific services and agriculture is a must for Kosovo. Experiences from the main European capitals can serve as the basis to build

upon their models in addressing the skills gap and responding to new markets' needs. More innovative ideas to promote part-time jobs, especially among talented youth and recent graduates, are only some short-term priorities for the Government to contemplate. In addition, more funds to encourage business start-ups with innovative ideas, in particular, those which boost youth and women entrepreneurship will help Kosovo respond to the massive brain drain.

## C. Incentivize Exporting SMEs

The share of the exporting SMEs in Kosovo is less than 5%, echoing the negative trade balance of Kosovo. With the SAA into force, Kosovo SMEs have to be capable to enhance their competitiveness and integration into the EU markets. However, from the perspectives of SMEs, there are two general requirements that will distort their ability to integrate into EU markets and become more competitive. First, based on the experience of latecomer countries joining the EU, the SMEs should redirect their business towards market sectors on the basis of their specific competitive advantages and innovative value-added products and services. Secondly, the latter could be done only by investing or switching to services and products that cannot be produced at lower costs in European markets. Yet, the Government role in helping companies achieving this goal is pivotal.

To that aim, there are three ways how Government can help.

First, the Government can support SMEs in identifying new markets and developing policies that assist them in accessing those markets, including identifying consumer preferences and import agents.

Second, the Government should support exporting and potential-exporting SMEs to increase the quality of their services and products, and more importantly, help them participate in trade and business forums that can incentivize them to adjust the quality of their products and services.

As a third lesson, SMEs should also be supported to improve the rudimentary skills of their employees to cope with different markets and international companies. Of course, training schemes, linked to vocational public schooling, is one of the ways how the Government of Kosovo should act.