

The role of small and medium enterprises in economic development

The case of Kosovo

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Abstract

During the last fifteen years, significant SME sector was established in Kosovo. A greater dynamic regarding to the registration of new businesses can be encountered in the first three years of 1990's and in the postwar period that can be considered as reflection of the changing business environment in the respective periods. Private enterprises in Kosovo are established since 1989. But the intensity of registration of SMEs grew separately after 1990 and continued until 1995. At this time companies were mainly organized in the form of households, the crafts, commercial enterprises, small shops, restaurants and agricultural enterprises. The establishment of these enterprises has not been the result of enabling business environment, but it came from the need to create jobs to people whose jobs were terminated from the social enterprises. In Kosovo during the last decade, a valuable experience was achieved by increasing and development of private enterprises, small and medium enterprises. Despite the achieved success, private enterprises constantly complain about the difficulties that they encounter when developing their business activities but as an example in Kosovo's SME we do still face with higher interest rates when taking loans. Likewise, these private enterprises in the country are still not well enough stimulated due to application of overwhelmed laws. Therefore it is needed a new inventory of legislative developments, but also should be requested the evaluation for the implementation of new legislation. This paper aims to reflect the role of small and medium enterprises in the post war Kosovo in economic development, increase of employment and alleviate poverty, obstacles that they encounter during their establishment and development which affect barrier not to develop entrepreneurship development innovation skills, etc, also some advantages that they assist their functioning...

Keywords: Structure and size of small and medium enterprises, employment, economic growth, legal provisions, the informal economy, human resources, the issue of financing, taxes.

Introduction

Theme *'The role of small and medium enterprises in economic development - Kosovo'* attracted me because of the role and the truth of SME sector in our state economy. They are the main source of employment and poverty alleviation.

Market economy system, as known, relies on four pillars: private property, free price system, competition and entrepreneurial ability. Market economy is considered as the economy of free initiative and according to this free initiative is private property. The development of free enterprise combined with efforts to create an institutional market, with clear rules of the game for all, constitute a guarantee for the development of rapid and sustainable economic development.

It is recognized, theoretically and practically, that sustainable economic growth also improves the social and political stability and in terms of the transition period which is Kosovo currently situated guarantees reform system. Sustainable growth is achieved when in the country is created a safe environment and sustainable private sector (S. Dhamo, IFK,).

The aim of the paper is to analyze and present the role of SMEs in economic development of the country, as SMEs are the first to promote initiatives for the development and successful business, may be the main carrier of development of innovation, growth of the employment and development of integration processes of social and local character.

Overview of the SME sector in Kosovo

According to the dynamics, prevalence of SMEs in Kosovo can be seen in three phases: (Source BVM, M. Mustafa, E. Kutllovci, A. Gashi, B. Krasniqi, Prishtina 2006).

1. The first phase, from 1991 until 1993
2. The second phase, from 1994 to 2000
3. The third phase, from 2001.

In the last decade in Kosovo are achieved valuable experience with the establishment and development of private enterprises, small and medium enterprises. Although the establishment and development of these enterprises was held in a very convenient ground, facing with discriminatory obstacles and measures caused by serbian authorities, a large number of enterprises managed to survive, whilst the most important, is strengthening of private initiative and entrepreneurship in Kosovo. In Kosovo in 1991 we could count 5,610 private enterprises, while in 1994 this number increased to 16,371 of them. At the end of 2002, Kosovo had 54,412 registered businesses, of which 31. 220 were small and medium enterprises (IFK, Pristina 2006).

According to KBRA within the MTI, the number of SMEs registered in December of 2010 was greater than 100,000 that employed 216,799 workers or 79.59% of total employees in the private sector and 62.24% of total employees in Kosovo (Strategy SME, 2010).

Table 1: Enterprises registered in Kosovo by the number of workers.

Classification by size	Number of employees	Number of enterprises	Percentage in total
Micro	1-9	102,070	98.37
Small	10-49	1,406	1.35
Medium	50-249	221	0.22
Major	250 and more	58	0.6
Total		103,755	100.000

In total number of enterprises in Kosovo 98.37% are micro enterprises (0-9 employees), 1.35% are small enterprises (10-49 employees), 0.22% are middle enterprises (50-249) and only 0.06% are large enterprises (over 250 employees) (IFK: Prisons, 2010).

Size of SMEs in Kosovo is defined by the Law no. And Law No. 2005/02. 03/1031 supporting SMEs. Number of employees is the only criteria used for classification of enterprises by size in Kosovo. This represents the difference in EU countries, where except the number of employees, annual turnover is taken into consideration (SME Strategy, 2011). This law adds a new category of enterprises by size, such as the micro enterprise, but the criteria for classification of enterprises now only sets only one criteria, which is the number of workers and does not take into account the criteria of turnover (IFK, Pristina 2009).

Such a legal way of setting the criteria for classifying the size of enterprises in Kosovo inevitably will affect the quality of setting criteria for beneficiaries of governmental programs. These criteria equate as for an example a company that employs up to 9 workers in the manufacturing sector with an annual turnover and profit with a limited amount of commercial companies (fuel oil) which also has up to 9 workers, but with a turnover and profit tens of times higher. For sure, this kind of classification will not contribute the support to the companies in need and as the final result of the impact of the logic will be reflected in the dynamics of the country's economic development by reducing the index of entrepreneurship according to the possibilities and increase opportunities and increase entrepreneurship index as needed, ie by reducing the number of new enterprises creating enterprises with innovative orientations (IFK, Pristina 2009).

The criteria for classification of enterprises by size also the time factor should be taken into consideration (age of the enterprise) as a component which can suppress a permanent source of discrimination that brings the classification of enterprises. It is not the same and is not fair for enterprises to receive the same treatment, for example an enterprise of two years of existence which employs 18 workers and enterprise of ten years which employs the approximate number of employees (IFK, Pristina 2009).

In terms of the decomposition of sectors, SMEs are mainly concentrated in: retail trade (50%), transport, storage and distribution (14%), food products, beverages and tobacco (9%) and hotels and restaurants (9%). According index SME Policy 2009, the distribution sector has remained stable for some time (SME Strategy, April 2011).

*Table 2: Kosovo registered enterprises by number of employees-2010
(SME Strategy, 2011).*

Individual businesses clearly dominate with 90% ownership structure. The rest of the companies are general partnership (3.2%) and limited liability societies (5.8%).

Kind No.	Type of ownership	Number of enterprises	Percentage in total
1	Individual business	9329	90.00
2	General partnership	3,383	3.20
3	Limited partnership	90	0.08
4	Limited liability societies	6,170	5.80
5	Joint Stock Company	368	0.35
6	Foreign-owned enterprise	468	0.46
7	Social Enterprise	16	0.01
8	Public Enterprise	12	0.01
9	Agricultural cooperative	68	0.06
10	Othes – under jurisdiction of AKP	33	0.03
Total		103,755	100.000

(*)

According to the table we can conclude that the type of ownership represents disadvantages of SMEs in Kosovo, as it shows the reluctance of SME owners to join the financial and human capital in the most advanced forms of business.

SME contribution to GDP

Table 3: Annual Turnover by enterprise size and share of GDP, 2010.

Size of enterprise	Number of enterprises	Turnover (€)	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
Major	?	528.558.269.84	13.51
Total	16.363	2.222.485.094.15	56.81

(*)

Based on data from the Tax Administration in Kosovo (TAK), presented in Table (3), the total turnover of SMEs in 2010 in EUR was 1,693,926,734.31 or 43.30% GDP. Total turnover of all businesses was EUR 2,222,485,094.15 or 56.81% GDP.

Barriers to the development of SME

Small and medium private enterprises were the main generators of economic revival in post war Kosovo. They have their own specifications of development including the obstacles that they are facing with, but which differ from SMEs in countries with developed economies. Thus, for example SMEs in developing countries do not suffer so much from lack of laws, unfair competition, etc, actions which mostly has an impact on business activity of SMEs in Kosovo. It is noted that some obstacles have remained unchanged, but on the other hand have appeared many other obstacles (Institute Riinvest, 2001).

According to the panelists from SBA (Small Business Administration), among the obstacles that mostly will affect small business in the 21st century is the financing problem which is caused by rapid changes in the financial industry, then the need for more training at work that will increase the diversity of the workforce, and lack of adequate information on small business. In contrast, the problem of financing in Kosovo related to lack of proper financial infrastructure and inadequate data on small businesses.

The following will examine some of the most serious obstacles to business activity of SMEs in Kosovo.

1. The legal framework

Kosovo's legal system based on the Constitution is unique though is a set of legal acts which often are not in line and consistency with each other. Further, institutional mechanisms of law enforcement continue to be in the process of upgrading their functionality and efficiency, as these institutions continue to face numerous challenges. The functioning of law enforcement institutions and creating a predictable legal system are the catalyst to creating a favorable climate for private investment and economic growth. Foreign and domestic investors do require a clear legal and predictable environment. Therefore the rule of law by government is seen as key to the rapid integration in Europe and the attraction of foreign investments in Kosovo, as well as stimulation of SMEs (MEF, MTEF 2010-2013).

Hence, work should be done in order to create a conducive and competitive environment for SMEs. Fiscal reforms undertaken in 2009, should be completed with some additions in this area. All the difficulties that impede the effective development and establishment of SMEs should be eliminated, especially those related to access to

credit and capital markets, and inadequate and serious registry of business, licensing, reporting and other administrative requirements including conditions of employment (ie, the maximum reduction of administrative bureaucracy) and the elimination of difficulties to access private and public procurement cases (IFK, Pristina 2007).

Laws form an essential layer of the foundation for a healthy private sector. Without a transparent legal framework and administrative system to a judicial-legal, and other efforts to promote private sector development can not function as planned.

2. Approach to finance

Constantly is considered that the increase in the number of banks in the financial markets of Kosovo, will result in an increased level of competition, but this has not happened so far, because the recent interest rates for loans were increasing. As a result of this situation, especially approach to the loan and high interest rates continue to remain high-level barrier to business development activities in Kosovo. Higher interest rates necessarily result in higher costs for local companies, which as a result are less competitive in the domestic and external market.

Reducing interest rates would have the dual effects in the economy. Initially, the reduction of interest rates will cause the increase in the level of private investment, which would also result with new jobs. On the other hand, the reduction of interest rates will cause the increase of consumption by consumers, which will result in increasing the country's GDP and economic development in general.

Reducing interest rates in the Kosovo economy requires multi-dimensional approach, and in this aspect it is important:

- further increase of competition in the banking system
- Increased loans and financial opportunities
- higher efficiency of judicial system
- the cadastral registration and property rights

From the current situation in the financial system of Kosovo, when we consider the high level of profits that banks create, relatively low level of bad loans (under the regional average), we can conclude that there is sufficient space for reduction of interest rates at least up to measure the level of the region, which will affect us greatly in raising the level of investment and business development.

3. The presence of the informal sector

Informal economy impedes fair competition and increases costs relative to companies that operate in the formal sector. Informal labor contracts and systematic evasion of

social insurance contributions weaken the protection of workers and reduce their social benefits. Has a negative impact on the budget throughout the fiscal and social infrastructure due to decreasing revenues and landing right next to public services (SME's Strategy, 2011) According to "Government Program for the Prevention of Informal Economy in Kosovo for the year 2010-2012" "calculated measures of the informal economy ranges from 39% to 50% of GDP.

This condition is created due to a long period of economic operation in parallel and not structural. Its effects touch every aspect of socio-economic regulation in Kosovo. Therefore, fighting informal economy is an essential condition for progress and to ensure a continuous cycle of SME development and to social equality in the country. Implementation of the project to equip all businesses with fiscal cash expected to be fully implemented during the next three years (MEF, MTEF, Pristine 2011-2013).

Informality undermines trust between SMEs and financial institutions and weaken SMEs approach to the loan. It also discourages the foreign investment. It is desirable to analyze the implementation and drawing encouraging informal sector in terms of the formal economy and to eliminate factors that influence in discouraging SME to registered employees, turnover and profit to certain authorities (SME Strategy s, 2011).

4. Human resources in Kosovo

Presented real business conditions in Kosovo, within these, nearly 12 years of transition, most recently showing a slow trend of slow improvement, which affect the efficiency of the SME business, and are a result of permanent coordination between state institutions and small business representatives. Resulting with motivation to be an attachment to the Euro-Atlantic structures, intensively the changes began with legal and regulatory requirements in many areas that affect the advancement of the position of SMEs. Therefore, it should be affected with improving and raising the awareness of entrepreneurs for development of entrepreneurship culture and spirit that is in order to create an entrepreneurial society.

From this, a permanent need is imposed of finding most favorite forms of training and education of business providers through various forms of their training, that through the establishment of their business skills shall improve managerial and entrepreneurial potential of their successful adaptation against the unstable business environment. For this we must permanently enable young entrepreneurs to unlimited access to various business skills that exist in global business practice, education and their continued training through many forms applied in the economies of developed countries - lifelong learning (life-learning). In this regard it should be constantly promoted effective links between university centers and private business sector in order to co-decision between science and business (IFK, Pristina 2009).

Successful commercial application of skills, knowledge and technologies depends on the carrier's business, from their range of technological knowledge, the possibilities of realizing the transfer of knowledge and technology in small enterprises. This is done in order to change their traditional prejudices and subjective, and as a result of these prerequisites enables the business to strengthen technological capacity of SMEs with the only intense - successful coping with all the business challenges that are present in contemporary business.

Is also important a full adoption and application of a package of laws in Parliament that serve to eliminate barriers for doing business and improve indicators in doing business (plan to implement the vision and priorities of economic development of Kosovo, May2011).

List of laws:

- Law on Business Organizations
- Notary Law
- Law on Fire Protection
- Law on registration of rights in immovable property
- Law on Internal Trade
- Law on Cadastre
- Law on Accounting
- Financial Reporting and Auditing.

Some advantages for SMEs in Kosovo (Document of the World Bank, 2010)

- a) Kosovo's regulatory environment can be proud with some very significant forces that have helped in creating a private sector alive. In many business related fields, Kosovo has adopted modern legislation, often based on European principles and standards. This has been the legacy of the period after 1999, when the old Yugoslav laws have been deleted and replaced with new legislation, prepared by the United Nations Mission for the Interim Administration in Kosovo (UNMIK). Given that Kosovo is considered a potential candidate for membership in the EU legislation in areas covered by European legislation are designed, in most cases, in accordance with European requirements.
- b) Labour legislation is very flexible. Most transition economies have complex labor regulations, historical legacy from the socialist period, but Kosovo has benefited from open market policy established after 1999. Labor market rigidity in the sense of engagement and dismissal of workers is very small, smaller among all transition economies. Furthermore, the tax burden on work is among the

lowest in the region, because only a contribution applies Kosovo (small) pension in addition to personal income tax.

- c) Kosovar firms also benefit from tax and from low and simple customs regimes. Elsewhere, high taxes and complicated tax regulations often push firms towards informal sector. In Kosovo, the rate of value-added tax (VAT) is 16% which is among the lowest in Europe, until the rate of personal income tax ranges from 0 up to 10%. Customs rate profile contains only two levels, the standard of 10% customs and zero customs for some products. However, low taxes and relatively simple procedures do not form naturally a small informal sector, since there are many other factors that determine whether firms will decide to work informally. Low taxes also would not say that there is great respect. Invasion of taxes in Kosovo is dominant, despite the lower tax, and there is a need to strengthen tax administration to expand the tax base and to ensure the continued collection of taxes. Tax system, especially low tax corporate income is recognized as positive by investors surveyed. The tax system contains provisions such as transfer of losses and deferral of VAT, which apply to foreign and local investors. Despite these uniformed incentives, stimuli associated with certain investments, which are provided in most other countries in the region, not available in Kosovo, and this is perceived as a lack of investors surveyed, who certainly would prefer to had both.

Conclusion and recommendations

From the presented data we can conclude that SMEs are among the leading indicators for economic development of the country. SMEs employ a significant number of the country's population, which are also quite profitable in domestic revenues, profits Kosovo budget, GDP of the country etc. They have their own advantages because they operate and use local (national) assets as well as those human and material, in order to conduct their activities in Kosovo they have priority for use of a free labor, following the consequence of the large number the unemployment in the country etc.

Kosovo's development level and its claims to be integrated in the EU, a new amending law to support SMEs which would increase the number of criteria for defining the size of an enterprise, a criteria that will enable withdrawal of clear parallels between micro, small and medium enterprises, should occur as soon as possible and not to issue these formal but more substantive aspects of the accelerated development of the country, for the opening of new jobs and recudtion of poverty.

Deadline for the commencement of restitution of loans should be extended, and also maturity terms of bank loans should be extended, and more reasonable amateur policies should be implemented where bank loans should support the development of business and should not create obstacles to its development.

Banks and other credit institutions must apply the process of deregulation of their activity in order to help market the financial allocation of funds towards profitable projects, which may also compete in foreign markets.

At the state level, development of SME is defined also in the designing the strategy for SME development. But with a specific significance is the adoption of this strategy to monitor the operational measures encouraging the private sector.

Structure of SMEs by economic activity shows that macroeconomic policies should be supported between manufacturing and service quality, so as to supply domestic market by manufacturing and domestic service, which will be affected in improving the balance of exchange with the world and the balance of payments with the world.

The membership of the SME should be stimulated in business associations, because it consists an important factor for the development of SME activities in Kosovo. Through membership in various associations of many SMEs certain rights can be realized in terms of drawing of financial funds through donations to various governments and international financial institutions, in terms of training of personnel through joint training enterprise in the context economic sectors and branches, or through use of the information given at the branch or economic sector in the country and abroad.

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