



The Role of SMEs and their Impact on Economic Growth – Kosovo Case

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Abstract:

Small and Medium Enterprise (SME) has different definitions by different countries. According to the European Union (EU), businesses are divided in micro businesses (1-9 workers), small businesses (10-49 workers), and medium businesses (50-249). SME has direct impact on technology changes, it brings a healthy competition, opening new jobs and a rich offer of products in local markets. SMEs are characterised by flexibility, direct relationship at work, job/employment opportunities, managing by person, limited capital, innovations. Economic grow is related to SME growth in which there are stimulating competition, new product and service and other advanced services necessary for market survival.

The general categories of businesses most entrepreneurs start are: retail, manufacturing and service. Additional categories of small businesses are: construction, hospitality, communication, finance and real estate.

The economy changes constantly, providing opportunities for new businesses. The demand for services is booming, and 97% of service firms are small, with fewer than 100 employees.

Entrepreneurship is dynamic process of creating incremental wealth; it is the process of initiating a business venture, organizing the necessary recourses and assuming the associated risk and rewards. An entrepreneur is someone who engages in entrepreneurship.

Kosova as a new country knows the importance role of SMEs in the economy development. More than 90% of enterprises are small and medium business. Since 1999, the economy of Kosovo has been largely driven by international assistance and remittances. The role of the private sector, particularly SMEs has been relatively weak. However, Kosovo is still in the transition phase where entrepreneurship and small business creation are expected to play a key role on the road to a

modern free market economy and economic growth. Ministry of Trade and Industry (MTI) and Agency for SME Support (SMESA) are the responsible institutions for the formulation of SME Development strategy. The strategy for SMEs within a period of five years (2012 to 2016) entered into force on 1 January 2012. Also, there is a project funded by European Union (EU) in order to assist SMEs, with four main components: 1. improving the Business Climate; 2. Setting, Public-Private Dialogue and Donor Coordination; 3. Improving SMEs competition in Kosovo; and 4. Public Information Campaign.

Key words: SME, Economic growth, entrepreneurship, strategy, investment.

Defining small and medium enterprises (SME)

Small and Medium Enterprises (SME) have different definitions by different countries. According to the European Union (EU), businesses are divided into micro businesses (1-9 employees), small businesses (10-49 employees) and medium-sized businesses (50-249). (Mustafa et al. 2006, 21)

The full definition of small business used by the US Small Business Administration (SBA) is detailed and complex, including 37 different benchmarks that define 1151 industries and 13 sub-industries across the US. In general, a small business is considered to be 'one that is independently owned and operated and which is not dominant in its field of operation.'¹

One of the definitions of small business is given by the 'Committee for Economic Development', under which two or more of the following characteristics must be met: (Steinhoff 1988, 6-7)

1. The management of the firm is independent and usually managers are also the owners.
2. Capital is owned by an individual or a small group.

¹ www.sba.gov.

3. The region is mostly small extended, while the employees and owners are from the same region, but the market does not mean to be local.

4. Relative size of firm in the industry frames must be small when compared with the company's largest region.

Other criteria might be considered, such as the following:

- Business must be independent,
- Business should not be dominant in the region, in which it operates,
- Number of employees,
- Revenue from the sale.

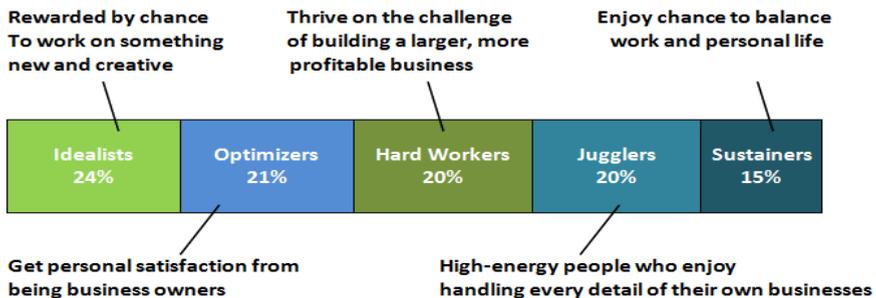
Referring to Peter Drucker, businesses are simply defined as organizations that create value for the customer. "If businesses do not create value for the customer, that means if they do not meet the unmet needs of the client, then they will stop existing."

In principle, there are two types of businesses: the first, which constitutes the highest number of businesses in the world, function to draw profit. Second businesses, called non-profit, state that their main object is to provide goods and services to society, without purpose of profit extraction.

The Role of Small and Medium Enterprises (SME)

SME-s are the result of entrepreneurship. Entrepreneur is anyone who opens, owns and runs the business. Entrepreneurship is a dynamic process of growing wealth creation. So entrepreneurship is the process of initiating a business venture, organizing the necessary resources and assuming the risks and rewards associated. (Kuratko and Hodgetts 1998, 30) Also, an entrepreneur is someone who engages in entrepreneurship. An entrepreneur recognizes a viable idea for a business product or service and carries it out by finding and assembling the necessary resources – money,

people, machinery, location – to undertake the business venture. Entrepreneurs also assume the financial and legal risks of the business and receive the business's profits. Successful entrepreneurs have different motivations, and they measure rewards in different ways. One study classified small businesses owners in five different categories, as is illustrated bellow. (Daft, Kendrick, Vershinina 2010, 201)



Some people are *idealists*, who like the idea of working on something that is new, creative or personally meaningful. *Optimizers* are rewarded by the personal satisfaction of being business owners. Entrepreneurs in the *sustainer* category like the chance to balance work and personal life and often don't want the business to grow too large, while hard workers enjoy putting in the long hours and dedication to build a larger, more profitable business. The *juggler* category includes entrepreneurs who like the chance a small business gives them to handle everything by themselves. These high-energy people thrive on the pressure of paying bills, meeting deadlines and making payroll.²

Business contributes to the productivity of any country in different ways. Small firms stimulate change in the business sector, a process known as "creative destruction". This term has been used by Joseph Schumpeter, to describe the process of

² Study conducted by Yankelovich Partners, reported in Mark Henricks, 'Type-Cast' Entrepreneur (March 2000): 14-16.

competitive success and business failure. Small firms entered the market in order to compete existing higher firms. New businesses with technology update destroy large businesses with older technology. The creation of these small firms is mostly the result of new technological inventions. Therefore, SMEs have a direct impact on technology changes in the behavior of healthy competition, opening new jobs and offering rich products in local markets. SME is characterized as flexible, direct relationship to job, job opportunities, managed by one person, limited capital, innovation, etc.

Economic growth is associated with the growth of SMEs that stimulate competition, offering new products and services and other advanced services. General categories of businesses entrepreneurs start are: retail, manufacturing and service, whereas other categories of small businesses are: construction, hospitals, communication, finances and real estate.

Today's economy is fertile soil for entrepreneurs. The economy changes constantly, providing opportunities for new businesses. The demand for services is booming, and 97% of service firms are small, with fewer than 100 employees. (Daft, Kendrick, Vershinina 2010, 206)

Finally, globalization is another trend that is changing the role of SMEs. While large firms certainly have been the main beneficiaries of trade among countries, small businesses are learning how to participate in this growing activity. One way that small firms can be involved is becoming part of the supply chain to large firms. While large firms crossed international borders, they enhance their human and physical resources and increase the demand for additional contributions for small businesses. Alternatively, small firms can be linked with other small businesses in the global market.

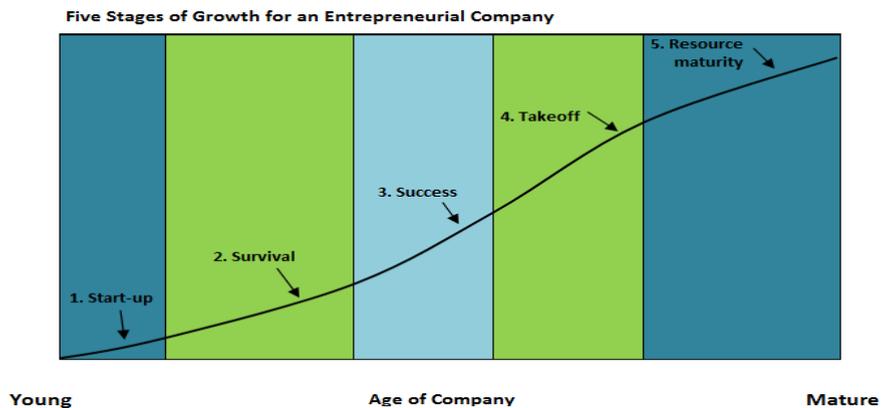
Stages of growth of an entrepreneurial company

Entrepreneurial businesses go through distinct stages of growth, with each stage requiring different management skills. The five stages are illustrated below: (Daft, Kendrick, Vershinina 2010, 225)

1. *Start-up* – in this stage, the main problems are producing the product or service and obtaining customers. Several key issues facing managers are: can we get enough customers? Will we survive? Do we have enough money?
2. *Survival* – at this stage, the business demonstrates that it is a workable business entity. It produces a product or service and has sufficient customers. Concerns here involve finances – generating sufficient cash flow to run the business and making sure that revenues exceed expenses. The organization will grow in size and profitability during this period.
3. *Success* – At this point, the company is solidly based and profitable. Systems and procedures are in place to allow the owner to slow down if desired. The owner can stay involved or consider turning the business over to professional managers.
4. *Takeoff* – Here the key problem is how to grow rapidly and finance that growth. The owner must learn to delegate, and the company must find sufficient capital to invest in major growth. This period is pivotal in an entrepreneurial company's life. Properly managed, the company can become a big business. However, another problem for companies at this stage is how to maintain the advantages of 'smallness' as the company grows.
5. *Recourse maturity* – At this stage, the company's substantial financial gains may come at the cost of losing its advantages of small size, including flexibility and the entrepreneurial spirit. A company at this stage

has the staff and financial resources to begin acting like a mature company with detailed planning and control systems.

SOURCE: based on Neil C. Churchill and Virginia L. Lewis, 'The five Stages of Small Business Growth', *Harvard Business Review* (May-June 1993): 30-50.



Impact of SME's in Economic Growth – Kosovo Case

Republic of Kosovo as a new state knows the role and importance of SMEs in the economic development and growth. More than 90% of enterprises are small and medium. Since 1999, Kosovo's economy has been driven mainly by international aid and remittances. The role of the private sector, in particular SMEs, has been relatively weak. However, Kosovo is still in a transitional phase, where entrepreneurship and small business's creation is expected to play a key role in the path to a modern economy with free market place and economic growth.

Kosovo has a payment misbalance, where imports dominate exports. This shows that SMEs in Kosovo are mostly not competitive at the international level. Currently, there is an unfavourable environment for business, and in the absence of the creative entrepreneurial culture, Kosovo has a lack of innovative firms that Western economies are major

contributors to job creation. In Kosovo, over 50% of all SMEs operating in the commercial sector are characterized by small investments and are not productive.³

The following table shows the registered businesses in Kosovo during 2010.

Registered Businesses in Kosovo by Employee's number - 2010

Size	Employers number	Enterprise numbers	Percentages (%)
Micro	1 - 9	102,070	98.37
Small	10 – 49	1,406	1.35
Medium	50 – 249	221	0.22
Large (big)	250 - <	58	0.06
Total		103,755	100.00

Source: ARBK; Kosovo Business Registration Agency

Out of a total of 103,755 enterprises: 102,070 (or 98.37%) are micro-enterprises; 1406 (1:35%) are small, 221 (0.22%) are medium and only 58 (12:06%) classified as large. Prevalence of micro-enterprises has implications for Kosovo SMEs Strategy. In terms of sector breakdown, SMEs are concentrated mainly in: retail trade (50%), transport, storage and distribution (14%), food products, beverages and tobacco (9%), hotels and restaurants (9%). According to the SME Policy Index 2009, the distribution sector has remained stable over time.

The impact of SMEs in Kosovo is quite large. Based on data from the Tax Administration of Kosovo (TAK), presented in the table below, the total turnover of SMEs in 2010 was EUR 1,693,926,734.31 or 43.30% of GDP. In 2011, the total turnover of all businesses was € 2,222,485,094.15 (56.81% of GDP).

³ Source: World Bank, 2010

Size	Enterprise number	Annual 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
Large (big)	58	528,558,359.84	13.51
Total	16.421	2.222,485,094.15	56.81

Source: SME Annual report – 2011.

Based on the World Bank report (WB), there are used 9 *Doing Business indicators*⁴ to measure certain areas of a country's business environment. According to the report "Doing Business 2011", prepared and published by the World Bank in November 2010, Kosovo ranks last in the region of Central and Eastern Europe to start business and enforcing contracts. Of the total 183 seats, Kosovo in general terms of doing business ranks as 113th.

Kosovo World Bank "Doing Business Rankings" (2010 vs. 2011)						
Note: (1) ranking is out of total 183 countries; (2) higher percentile is the aim						
#	Area	2010 Rank	percentile out of total	2011 Rank	percentile out of total	Change in rank from 2010 to 2011
0	Overall Doing Business	113	38%	119	35%	-6
1	starting a business	164	10%	163	11%	1
2	Dealing with construction permits	176	4%	173	5%	3
3	Registering Property	68	63%	65	64%	3
4	Getting credit	43	77%	32	83%	11
5	Protecting Investors	172	6%	173	5%	-1
6	Paying taxes	50	73%	41	78%	9
7	Trading across borders	132	28%	130	29%	2
8	Enforcing Contracts	157	14%	155	15%	2
9	Closing a business	28	85%	31	83%	-3

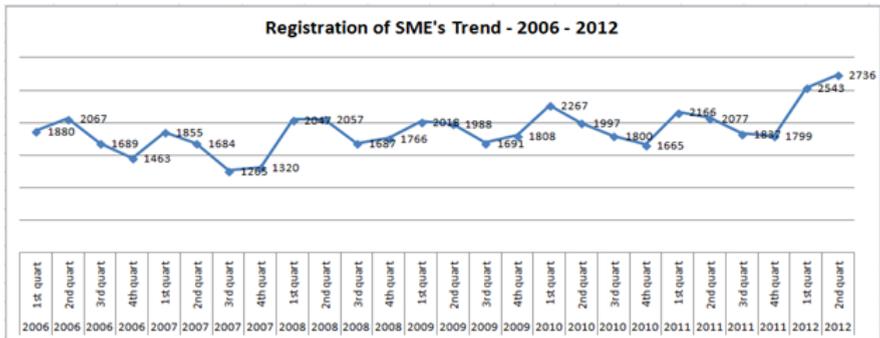
Source: www.doingbusiness.org

According to the European Commission (EC) Progress Report for Kosovo 2010, there are identified three main barriers faced by businesses in Kosovo. The *first barrier* is related to the unreliable supply of electricity and water, which are especially serious for manufacturing SMEs. The *second barrier*, as one of the main barriers to rapid development of SMEs is the limited

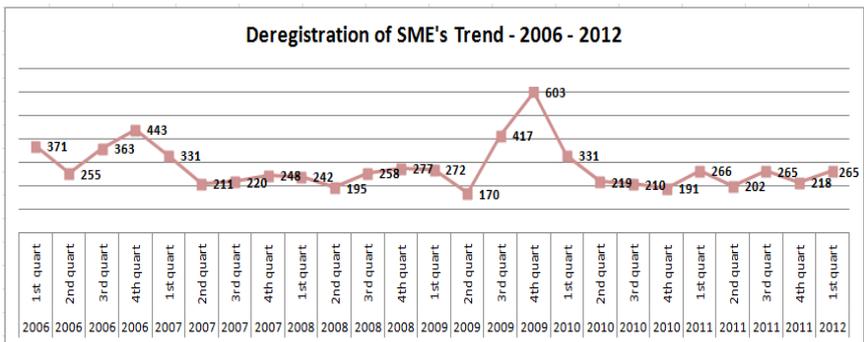
⁴ Source: World Bank Report: 9 Doing Business Indicator.

access to finance. The *third barrier* is insufficient rule of law, which affects all citizens.

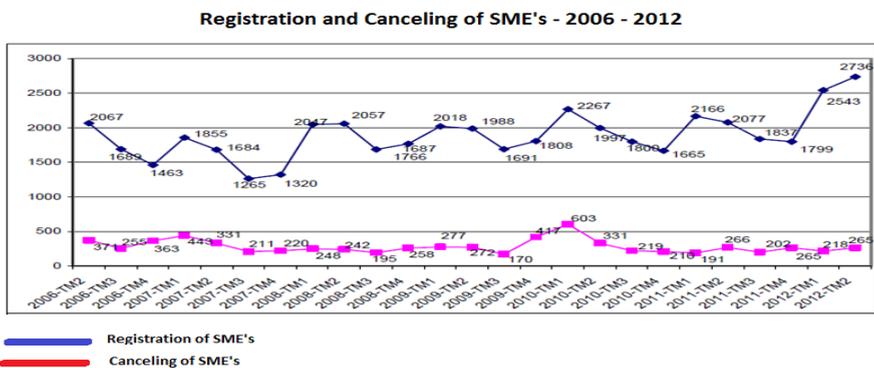
In general, the Government on Kosovo has accepted that in order to remove barriers to business investment and job development, more efforts are needed at all levels of government activity. Simplification of administration procedures is a key to the promotion and development of the SMEs sector. In the framework of these efforts there are a numbers of key achievements which came as a result of some improvement of the business environment for SMEs in Kosovo as: a major tax reform, streamlining the collection of VAT through cash registers (POS), legal and administrative improvements matters (SME can register through pilot Municipal Business Center). Actually, the Ministry of Trade and Industry (MTI) and SME’s Support Agency (SMEs) is responsible for the preparation of SME development strategy. SME strategy is designed for a period of five years from 2012-2016 and entered into force on 1st of January 2012.



Source: *Statistical Repertoire of Enterprises in Kosovo (Q2 - 2012)*



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During the second quarter of 2012 (Q2 2012) there are recorded a total of 2736 new companies, while in the previous quarter (Q1 2012) there have been 2543 of them (see tables above). There is a difference of 193 enterprises between the quarters, or expressed in percentages we have increased new enterprises to 7.6 %. Also, there are 31.7% of new businesses compared to the same quarter of the previous year (Q2 2011).

During this period, the most favourite economic activities are: 842 trade enterprises (30.8%), processing industry 302 (11.0%), hotels and restaurants with 301 (11.0%), real estate and leasing with 264 (9.6%), construction with 255 (9.3%), other social and personal 240 (8.8%), agriculture, hunting and forestry with 235 (8.6%), transport, storage and

communication with 199 (7.3%), while the other activities participate in very small scale.

Since 2005, the Government has adopted a number of important strategies related to economic growth. Of these strategies, we have specifically to examine Employment Strategy, Energy Strategy, Strategy for the Development of Education Up, Government Programme and the Action Plan for the Prevention of Informal Economy.

The development of SMEs is mentioned in the Strategy for the Development of the Private Sector as one of its components, where the preparations of the Strategy for SMEs are consulted.

The structure of Kosovo economic strategy by SMEs includes:⁵

1. Strengthening the Legislative and Regulatory Framework for Establishing enhancement and development of SMEs
2. Improving SME Access to Finance
3. Promotion and Development of Culture of Entrepreneurship
4. Strengthening domestic and international competitiveness of SMEs
5. Improved dialogue between the private sector and the public and civil society.
6. Strengthening SME's Support Institutions.
7. Improving the position of women entrepreneurs, youth, minorities and other specific groups and entrepreneurs in disadvantaged areas.

After approval of SME's strategy and Implementation Plan (IP) of Strategy, the SME Agency will take the lead to implement them. The SME Agency, under the guidance and supervision of MTI will act as a driving force to coordinate and stimulate SME policies and their implementation efforts. Other

⁵ Ministry of Trade and Industry, SME Development Strategy, July 2011

key agencies such as: the Investment Promotion Agency of Kosovo (IPAK), Agency for Registration of Businesses in Kosovo (ABR) and the Agency for Standardisation will contribute to the development of IP activities for relevant objectives within the Agency for SMEs.

In addition, there is a project founded by the European Union (EU), in order to assist SMEs. The project has four main components: 1. improving the business climate, 2. Establishment of public-private dialogue and Donor Coordination 3. Improving the competitiveness of the SME's in Kosovo, and 4. Public information campaigns.

Conclusions:

- Implementing strategy will have a direct impact on SME development in Kosovo and they will become globally competitive. This will also fulfil the vision and mission of the development strategy.
- Improving the business environment and entrepreneurship's culture by aiming to create rapid growth of sustainable SME's
- Reconciliation of Kosovo SMEs policies and support programs with those of EU policies and programs. This will have affect the SMEs development in the national market and prepare them for the global market too.
- By establishing conditions for the business and investment climate, as a key factor for Kosovo to promote foreign investment and economic growth. Therefore, the Government, through the application of special tax and customs incentives to international companies, will increase foreign investment promotion.
- A better governance or management, transparency, security and legislation, are crucial factors in attracting investment.

- Effective collection of taxes and customs fee will affect directly the economic growth and development and will increase the welfare as well.

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