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RIT KOSOVO

Barriers to Small and Medium Enterprises in Kosovo

Honors Project

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30.05.207

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List of Acronyms

SME – Small and Medium Enterprises

OECD - The Organization for Economic Co-operation and Development

EU – European Union

TPP – Trans-Pacific Partnership Agreement

UNDP - United Nations Development Programme

HDI – Human Development Index

SAA – Stabilization and Association Agreement

CEFTA – The Central European Free Trade Agreement

NPL – Non-performing loans

CBK – Central Bank of Kosovo

Abstract

The aim of this research project is to identify the major barriers which restrict the growth of the SME sector in Kosovo. First, the impact of SMEs in a countries economy is established – which is then compared against two countries from different economic categories – the United Kingdom and Kosovo. Second, in accordance with primary and secondary data, the major barriers are identified and thoroughly discussed. Lastly, based on the findings, recommendations have been developed. The methods used to acquire data include: surveys, in-depth interviews and the use of secondary sources.

1. Section 1- Statement of the problems

This paper analyzes how the three major constraints impact the small and medium enterprise (SME) sector in Kosovo – namely corruption, unfair competition and access to finance. I use both primary and secondary data to conduct a quantitative and qualitative analysis (which will depend on some factors, mentioned in section 3. Methodology).

In order to understand the impact and relevance of SMEs, the paper will develop a comparison between the developed countries and the developing countries. Members of the Organization for Economic Co-operation and Development have achieved a stage of stability and prosperity – where part of this success can be attributed towards their dedication and promotion of the SME sector. On the other hand, the developing countries, such as Kosovo, have not been able to unlock their growth potentials through a strong SME sector. Henceforth, this paper aims at emphasizing the relevance of SMEs in Kosovo's developing economy.

According to the *Kosovo SME Promotion Programme* (KOSME) report, the existence of **corruption and political instability** in Kosovo was reported by approximately 50% of the firms (from a sample of 743 SMEs); hence, making these factors a major constraint towards SME development (2). Another major concern for the SME sector is the **unfair competition** emerging from the large informal economy present in Kosovo - which significantly distorts the market, harming those SME's which operate formally. Amongst other problems which have been stated in the KOSME report, are weak rule of law, macroeconomic uncertainty, crime, poor technological development, administrative procedures (bureaucracy), payment practice, exporting and even electricity; one which seems to be prevalent in many developing countries is **access to finance** – a limitation and restriction for SMEs wanting to access the capital necessary for growth. Other barriers, such as the tax burden, trade regulations, exports, access to utilities and more will be briefly discussed.

The paper will also specify two regression models, the first focusing on the barriers of SME growth and the second derives important information on access to finance. The models will not be run against any dataset; however, they will act as reference points and can be used by readers – who are willing to conduct empirical research on this topic. Lastly, in an attempt

to resolve the intensity of the barriers, I will propose certain recommendations that have the ability to bring change in the business climate.

2. Section 2 – Literature Review

This section aims at giving detailed information to the reader regarding the current status of SME’s in the developed and developing world. Understanding, the difference can be of great value towards establishing necessary policies which can possibly produce positive effects towards SME’s in Kosovo.

2.1 The SME Sector in a Global Economy.

The term “SME”, Small and Medium Enterprise, differs in its definition among countries. Various countries and organizations are responsible for defining their guidelines for categorizing SMEs. According to the guidelines set forth by the European Commission, “SMEs are categorized by three criteria: staff headcount, annual turnover or annual balance sheet total” (10). On the other hand, the World Bank Organization has its own criteria which differ from the ones set by the European Commission – these include: number of employees, sales and value of assets. Nonetheless, scholars have agreed that the EU Commission definition is more inclusive, in terms of turnover, compared to other definitions.

Table 1.0: The EU definition of Small and Medium Enterprises.

Enterprise Category	Headcount: annual work unit	Annual Turnover	Balance Sheet
Medium-sized	< 250	≤ 50 Million €	≤ 43 Million €
Small	< 50	≤ 10 Million €	≤ 10 Million €
Micro	< 10	≤ 2 Million €	≤ 2 Million €

Source: European Commission: User guide to the SME Definition, 2016

SME’s are seen as the power house of a country because of their large contribution towards economic development. However, the developed world, namely developed countries, incur different benefits as relative to developing countries. According to Krasniqi, the external macroeconomic environment, such as political stability, legal factors, economic, social, and technological environment, do affect all enterprises due to their uncontrollable

nature (60). These factors cannot be changed by internal decision-making and they differ from country-to-country. In the case of the developed countries we can observe a more stable environment which promotes growth; whereas, on the developing world the presence of corruption, informal economy, unemployment and other barriers do inhibit the growth of SME's.

2.2 The relevance of SME's in the developed countries.

The Organization for Economic Co-operation and Development (OECD) is an international economic organization with 35 member countries – which have achieved a stage of stable economic growth and employment, financial stability and high standards of living. Part of their economic success can be attribute towards the impact of SMEs in their economies. According to an OECD study, SMEs contribute largely towards the economy in the form of job creation, export, production and innovation (Local Strength, Global Reach, 4). In addition to their contribution to the economy, we have to recognize how these OECD countries have enabled the SME's to achieve positive growth rates. SME's have both strengths and weaknesses which have to be addressed properly by governmental authorities, in order to obtain the desired outcome. Globalization and rapid technological advancement enhance the relevance of SME's – by reducing the importance economies of scale – but they also promote global competition, which demands the SME's to grow; hence, there is an increasing need for capital / financing, higher productivity, adaptation to new technology and even enhanced internal managerial capabilities (SME's: Local Strength, Global Reach, 1). These factors can become a burden towards the SME's in the presence of a globalized, technology-driven market economy – we will later see how these factors negatively impact developing countries, where among many, political instability, the informal economy and poor access to finance prohibit the growth of SMEs.

However, the developed world, namely OECD countries, have adapted their policy-making accordingly, in order to benefit the SMEs. Considering the enhanced importance of SMEs, governments in the OECD countries have started promoting their growth by facilitating firm start-up and expansion and access to venture capital and other sources of financing. Recently, the United States of America (USA) withdrew from the Trans-Pacific Partnership (TPP) Agreement – which incorporated a chapter dedicated towards SMEs.

According to Sánchez, “the strong commitments of the TPP aimed at improving the environment for doing business overseas, and help small businesses export a larger quantity of ‘Made in America’ goods and services to Asia Pacific customers” (par. 3). This agreement included 12 different countries around the world: Australia, United States, Canada, Vietnam, Japan, Chile, Malaysia, Brunei, Mexico, Singapore, Peru and New Zealand. However, with the executive order of the new US president Mr. Trump put an end to this trade agreement – as the US backed away from it. The remaining 11 countries are still discussing alternatives, through which they can make the agreement work without the US.

Promoting international trade is only one of the activities of the OECD governments; other initiatives include reforms of fiscal practices, reducing administrative burden, providing management and skills training, improving information dissemination and increasing access to markets (SME’s: Local Strength, Global Reach, 6). However, these activities are only a fraction of what is being done to assist the development of SMEs in the developed world; thus, we must consider not only local government policies but also the regional, national and international level efforts.

The committee within the OECD which is responsible for the SME’s gathers twice a year to discuss the performance of SMEs and recommend possible policies which can positively impact the environment in which they operate. By using OECD indicators, which are derived from supply-side data provided by financial institutions (OECD Scoreboard, 20), the committee can assess and compare the growth of firms from different regions. Once the situation is assessed, the committee will pursue with policy recommendation in various areas such as financing and technology diffusion. In order to further examine the positive relationship between an OECD country and SME development, we will consider the case of United Kingdom – whose SME’s sector has shown outstanding performance over the last decade.

2.2.1 The case of the United Kingdom: Relevance of SMEs.

Statistics show that over the past 3 years, there have been record numbers of start-up businesses in the United Kingdom (UK). The UK is an official member of the OECD; therefore, we can safely assume that their economic, political and social environment does favor the rapid growth of SMEs. Nonetheless, an article written by James

McAllister does remind us of a lesser known notion, “that the country actually needs small businesses to sustain a healthy economy. SMEs are a large and integral part of the UK’s economy, with over 99% of all of Britain’s businesses classified as small or medium” (par. 2). Therefore, we can argue that policy-making which favors a stable environment for the SMEs will provide stable growth rates for the overall economy of a country. Returning to the UK case, the article further recognizes some factors which make SMEs important for the UK economy.

The first metric mentioned is **turnover**; SME’s overall contribute towards 47% of the entire UK private sector economy in 2014 – which amounts to £1.6 trillion. Second, is the ability of SME’s to contribute towards **job creation**. According to a study published by Department for Business, Skill and Innovation, “SME’s employ over 14 million people in the UK in 2013 – accounting for 60% of all private-sector employment, and a massive 81% of the overall workforce” (1). Lastly, SMEs are the main contributors towards the largest industries in the UK – retail and manufacturing. According to the Office of National Statistics, “every three out of twenty SME’s fall into one of the aforementioned industries, contributing over 46% of all revenues generated from each sector independently” (10)

None of these aforementioned benefits would have been possible without the existing environment in which the SME’s operate – largely impacted by the governmental policies. Governmental policies are an integral unit of the SME growth model – which was highlighted in a note published by the House of Commons in 2013. According to the writers, Ward and Rhodes, In 2011, the UK government released the long-term **Plan for Growth**, which was stated to be of “particular benefit” for SME’s. Policies included in the **Plan for Growth** are: minimize regulatory burdens, help SMEs access finance, reduce fixed costs for SMEs, make it easier for SMEs to access public sector procurement (ease at obtaining public contracts), encourage exporting SMEs, encourage innovation, help SMEs access apprenticeships (6 and 7). In addition, similar policies were re-mentioned in “*the Autumn Statement*” and “*GREAT Ambition*” programs of the UK government in 2013 and 2016, respectively – seeking to further improve the business climate for the SMEs.

When observing these factors, it becomes clear that there is a mutual relationship between growth of SMEs and the country’s overall development. That is why many of the recessions

which occur in the developed countries are outweighed by the favorable policies towards SME's.

2.3 The relevance of SME's in the developing world.

Developing nations for most of the history have been characterized as economies with low standards of living, underdeveloped industries and markets, high unemployment rates and low HDI (Human Development Index – life, expectancy, education and income). Considering these problems, developing countries have been dependent on Foreign Direct Investment (FDI) – as a source of growth. However, we will later see through the case of Kosovo that FDI and foreign aid are not a reliable source; thus, developing countries have to develop their own entrepreneurial capacities as a stable source of growth.

Global competition has impacted everyone, not only the developed (OECD) countries. However, as it was previously discussed, OECD countries have made it possible for their SME sector to adapt to global competition and seize the newly founded opportunities. On the other hand, SMEs in the developing world fight for survival. When referring to developing economies, we try to disregard cases such as China - due to their recent growth trends and their skewed impact towards the final result. Similar to the developing countries, SME's "are a fundamental part of the economic fabric in developing countries, and they play a crucial role in furthering growth, innovation and prosperity" (Report on Support to SMEs in Developing Countries..., 4). Yet, compared to the developing world where capital was widely available to the SME sector, in the developing world we see the complete opposite – where SME's are restricted in accessing the capital necessary for their growth. According to the *Report on Support to SMEs in Developing Countries*, such restrictions include lack of government assistance programs, poor access to finance with unfavorable lending conditions and a malfunctioning lending market – all which contribute towards the hostile environment present in the majority of the developing countries.

Access to capital is only one of the many barriers for the SMEs in developing economies; Other challenges which seem predominant in the developing world are the following: (1) Corruption, (2) Technological Capabilities, (3) Workforce Capabilities and (4) Unfair Competition

2.3.1. Corruption.

Corruption has become an increasing problem for businesses around the developing world. The term “*Corruption*” is commonly defined as “a personal gain of public officials through governmental policies” (Shleifer and Vishny, 2). Empirical evidence shows that corruption, as an obstacle, raises the operating costs and creates uncertainty; thus, negatively impacting investment and consequently growth (Asiedu and Freeman, 204-206) A study published by Kimuyu, utilized firm level data to reach the following conclusion that, “manufacturing firms that receive government contracts pay an average of 14.2 percent as bribery to persons that help with those contracts” (203). Furthermore, this study has highlighted that characteristics such as, firm size and location, indicate the degree of exposure towards corruption. Compared to large and micro firms; small and medium firms are the ones carrying the largest burden of a corrupt state – as larger firms have bargaining power, whereas micro-firms have the ability hide from the authorities, in the informal market.

2.3.2 Technological Capabilities.

In a world where technology is continuously advancing, firms both large and small have to change and adapt to technology, in order to increase efficiency and remain competitive. According to Batra and Tan, firms can acquire technological capabilities and attain higher efficiency levels in several ways: R&D Investments, Exporting, Foreign capital participation and experience in production (7). However, in the developing countries **R&D investments** are often restricted/ limited – work done on basic research is usually focused on modification of already existing products and processes. Second, **exporting** is a crucial tool in promoting technological advancement, since foreign buyers play a major role in providing local firms with the information necessary on product specifications through international contracts. The theory behind that statement is correct, yet, what we see in the developing world is an unstable export market, worsening terms of trade, and limited market access – which not only limits free trade but also prohibits the flow of technology in these countries (Dudovsky, 1). Third, **foreign capital participation**, commonly referred to as foreign direct investment, uses investments to move technology from a developed area towards a developing one. However, these investments tend to be questionable at times, considering the profit-maximizing nature of humans – especially in the developing countries. Lastly, **production expertise** implies that

all firms go through the initial development process of learning-by-doing; as these firms age and gain expertise towards a specific area. Still, the growth of SMEs under this assumption depends on the degree of technological advancement in the area in which they are operating; as it has been discussed technology travels and adapts slower in the developing countries as compared to the OECD countries. Therefore, production expertise does take longer in areas where technological capabilities are poor.

2.3.3 Workforce Capabilities.

Initially, we described developing countries as economies with low Human Development Indexes (HDI). Under the UNDP definition, “The Human Development Index (HDI) is a summary measure of average achievement in key dimensions of human development: a long and healthy life, being knowledgeable and have a decent standard of living” (Human Development Reports, par.2). The low HDI which persists in the developing world is a barrier for the SMEs. A firm’s efficiency does largely depend on the productivity of its labor, which in turn is positively correlated with human capital. Thus, in a country where educational attainment is low, in some cases even inexistent (African countries and South Asia), poor health persists and the training provided is limited, the labor force supplied in such circumstances will consist of primarily unskilled and unhealthy individuals – with low productivity. This also makes adapting, modifying and improving new technology difficult – hindering the growth of SMEs and the country, in general.

2.3.4 Unfair Competition as a result of the informal economy.

The informal economy which originates from a third world context, is full of terminological misunderstanding; different fields of economics (labor economics, macroeconomics, finance and more) derive different definitions on the informal economy. However, to keep it simple we are going to define the informal economy as “the activities which are carried out outside of the legal framework of the economy” (Gerxhani, 1).

The informal economy is closely related with the presence of corruption. According to Dutta, Kar and Roy, “there is sufficient empirical evidence to support the argument that a larger presence of corruption will lead to a larger informal sector” (16). The strong relationship between these two “barriers” is related to the excessive government regulations present in the developing countries, as a result of corruption. These excessive regulations

provide incentives for entrepreneurs to seek ways of avoiding additional costs and operate behind the legal framework. Johnson, Kaufmann, McMillan and Woodruff “argue that high taxes, official regulations, the inadequacy of institutional environment, and the predatory behavior by government officials seeking bribes from entrepreneurs operating officially are the main causes of the unofficial economy” (20). At first hand, informal activities seem like a perfectly reasonable decision undertaken by entrepreneurs to escape the corrupted state; however, if we support such statement than we fail to recognize that only micro-enterprises and small start-ups have the ability to hide behind the legal framework. In such a case, these micro-enterprises are operating at an advantage (charge lower prices on goods produced due to tax evasion) compared to other SME’s which operate under the formal economy – hence the term unfair competition.

The mere existence of such circumstances leads to a business environment which negatively impacts the economy of these developing countries. As stated by Shleifer and Vishny, corruption, the informal economy and unfair competition combined together can contribute to an uncompetitive environment, in which the market fails to allocate resources efficiently through the increasing cost of business and lowering productivity, which is harmful for the private sector growth, decreasing competitiveness of an economy in the international market (80). Additionally, investments, both local and international, are diverted from the economy resulting in an even slower rate of growth for the SMEs.

2.3.5. The case of Kosovo: Relevance of SMEs.

The goal of this paper is to identify the major barriers which prevent the growth of SMEs in Kosovo. In order to achieve this goal, we must first examine the current situation in Kosovo – economic, social and political status. Only after we have identified the major issues which are prominent in Kosovo, can we relate to the SME sector.

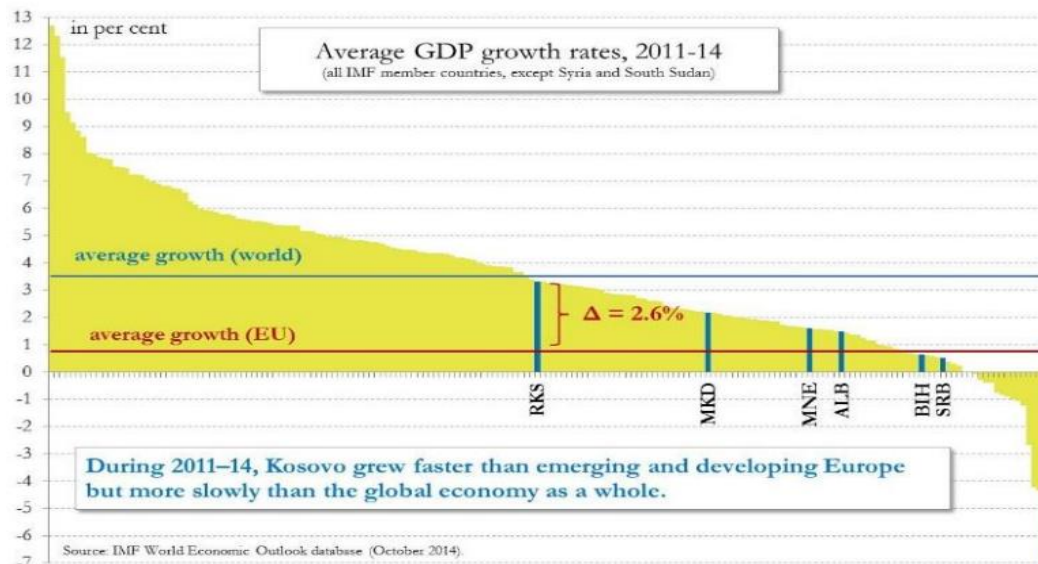
Kosovo is an independent country located in the Western Balkans; unlike its neighboring countries, Kosovo began its real transitioning process from the former-Yugoslavia, after the year 1999 – which marks the date when the war against Serbia came to an end. The war had a great impact towards the political and economic equilibrium in Kosovo. A large inflow of donations from international organization prevented the collapse of this newly found region. However, these contributions prioritized the formation of the political structure – which

previously was nonexistent. The strategic goal was to create a functioning governmental body, which would enable Kosovo to gradually stabilize and grow. The goal was ultimately achieved, however, at a fairly large cost to the business sector of Kosovo. It must be noted, that the inflow of donations did not target the overall business environment in Kosovo – which at that time required a large amount of support. The consequences of forgoing the business sector in Kosovo are haunting the state to this day.

The 21st century Kosovo has had significant political, economic and sectorial development, though, it is seen as one of the most underdeveloped countries in the region. With regards to its political developments, Kosovo is a potential candidate for the European Union (EU). Recent developments, including (i) the negotiation of *the Stabilisation and Association Agreement (SAA)*, (ii) *The Economic Reform Programme* in coordination with the EU Commission and (iii) the signing of *The Central European Free Trade Agreement (CEFTA)*, have had positive implications for Kosovo (Kosovo Snapshot, 2). Despite these positive developments, Kosovo has been prone to an increasing level of corruption since the end of the 1999 war. Furthermore, to worsen the situation the general elections in mid-2014 led to a protracted politico-constitutional crisis; after the coalition of the two largest political parties - the Democratic Party (PDK) and the Democratic League (LDK) (plus ethnic minority parties emerged) (Kosovo Snapshot, 2). Hence the presence of corruption, accompanied by the crisis has largely contributed towards migration pressures, antigovernmental protests and strikes in various sectors (health and education) – all of which have reflected widespread pessimism towards the prospects of this country.

Economic development similar to the political one has seen its ups and downs. Kosovo remains to be the country with a stable average growth rate of 2.6 % in the past decade. This stability has been quoted as being “Solid But Not Spectacular Growth” – as can be observed in the figure below.

Figure 1. Solid But Not Spectacular Growth, 2011–14



Every economist knows that, GDP is not the sole indicator of economic development – as it ignores the activity outside the realm of monetary exchange, regardless of well-being. If one were to dig deeper into the economy of Kosovo, they would observe the many flaws which exist. As an example, the business climate is unfavorable for stable development – because of unfair competition, low human capital and a constricted financial market. The financial sector itself has proven to be resilient (meaning maintain liquidity) over the years, however, its contributions towards improving the business climate has been negligible. The World Bank report on Kosovo states that “although nonperforming loans (NPLs) have increased moderately, they remain lower than in neighboring countries” (Kosovo Snapshot, 4) – meaning that the increasing risk in lending to business has prompted banks to go into a defensive strategy.

Understanding the current political, economic and social situation in Kosovo is of great importance, as it stretches our knowledge on the issue in hand and helps the audience understand the problems which will be discussed throughout the paper.

The lack of support for the SME’s in the - post-war period - and the absence of policies to improve the business climate in the 21st century Kosovo are undoubtedly halting the growth of SMEs. The Kosovo SME Promotional Programme states that SME’s are important, however, the Kosovo’s SME sector shows significant weaknesses. (1) These weaknesses are

directly related to the level of corruption, unfair competition, poor access to finance, lack of infrastructure and more. Accordingly, a research undertaken by the Riinvest Institute has successfully identified the obstacles which are present in Kosovo. These include: Corruption and poor rule of law, access to finance, access to electricity, unfair competition, taxes, regulations and organized crime. This paper makes use of existing finding about SME barriers and will identify three of the most substantial barriers and perform an in-depth analysis of each one.

3. Section 3 – Methodology

This section of the paper aims at providing an overview of how the research was conducted. The two research methods used were designed to study the political, economic and social aspects of the issue at hand, specifically the major obstacles for SMEs in Kosovo.

Primary research is defined as original research, “carried out to answer specific issues or questions. It can involve questionnaires, surveys or interviews with individuals or small groups” (Business dictionary, par.1). This particular research project employs interviews and surveys as means of conducting a quantitative and qualitative analysis - which can later be used to compare and relate with already existing secondary data. The interviewees which have participated in this research project include representatives of SMEs from various sectors, such as the wood processing, agriculture, construction, retail and service sector. The interviews were in-depth, face-to-face, discussions. Individuals were randomly selected to be interviewed in order to attempt to create a sample which corresponds to the entire population – meaning a sample representing the population. By following such a random sampling approach, I tried to minimize biases; though, we have to acknowledge the fact that a small qualitative sample size of 12 interviews is bound to lead to biases and errors. Hence, secondary data were also used to compare and contrast the findings from the interviews.

Furthermore, to enrichen the data set; a survey has conducted (the sample of the questionnaire can be seen in the appendix). Similar to the interviews, the survey follows a random sampling methodology in order to minimize errors. Nonetheless, the size of the sample (96 SMEs surveyed) may also be subject to biases in our analysis – if it were to be

isolated from secondary data. Thus, when referring to certain findings in my primary research; we must first consult credible findings and then make certain assumptions.

The paper will disclose two regression models that can be found in Appendix A-2. These econometric models can be used to estimate the impact of different variables, i.e. size of firm, number of loans attained in the past, number of years operating, on SME growth. The first model, uses the Ordinary Least Square method of analysis; whereas, the second model utilizes the Logistic Regression method. A detailed definition of each model can be found under Appendix A-2. However, this paper will not be running any regression analysis because of the small sample size and time.

Besides the primary sources, this research paper has also found use of secondary data – which are the main source of information. The sources of secondary data include: Riinvest Institute database of reports on SME's and its official website, OECD reports, World Bank reports and other credible sources derived from the RIT online library (Wally library).

4. Section 4 – Analysis of Results

The main purpose of this research project is to focus on Kosovo, as a developing country, and identify three major barriers which inhibit the growth of the SME sector in this country. In Section 3, we described the many techniques used to derive the necessary data; now, through the Analysis of Results section we will link our findings and see what their implications are.

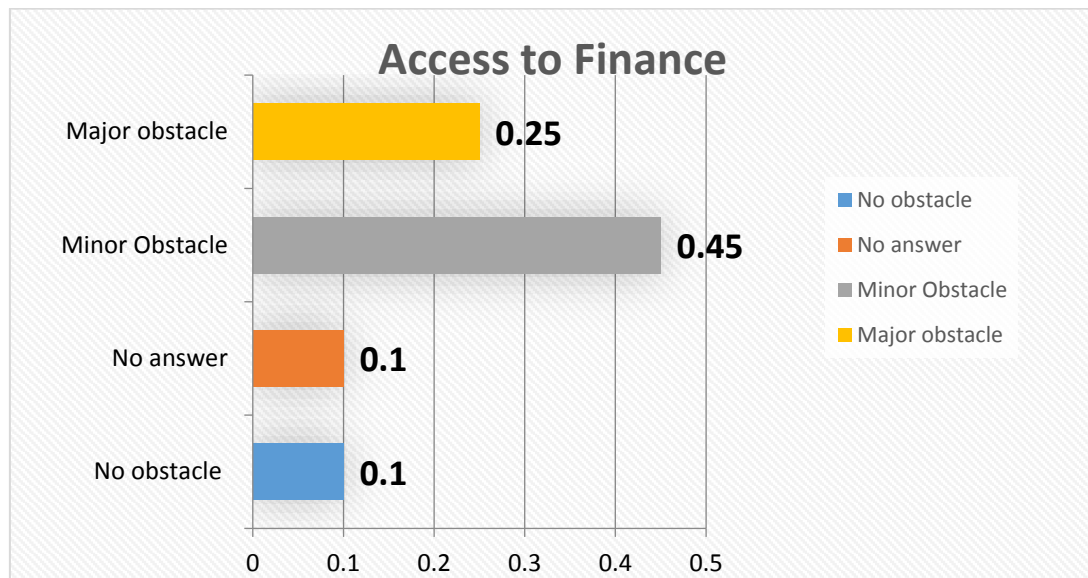
4.1. Qualitative Analysis

This section aims at analyzing data gathered through interviews in conjunction with secondary sources. The barriers which have been identified as being major obstacles for the growth of SMEs are Access to finance, Corruption and Unfair Competition – other obstacles will be discussed briefly at the end of section 4.1.

4.1.1. Access to finance

According to the Business Climate in Kosovo Report, “Financial barriers are perceived to be among the most pressing issues by the interviewed businesses” (34). Accordingly, results from the survey show that approximately 25% of the surveyed businesses indicated that access to finance is a major obstacle, while 45% believe that it's only a minor obstacle. This

data was obtained through the survey that I have conducted; thus, it will be compared to other sources – which have a larger sample size and are more precise.



The magnitude of the problem, namely access to finance, will depend on numerous factors – including, size of the firm, familiarity with financial system in Kosovo and history of the firm. Therefore, a prosperous SME is expected to have an easier time finding external financing relative to a small firm. To further the analysis, we will consider the access to finance barrier as a combination of two factors: **high costs of finance** and **limited access to finance**.

The first factor explains how high interest rates have made it too costly for firms to expand their business activity. In other words, high interest rates constrain firms from expanding and creating necessary jobs - which will lead to lower unemployment and ultimately low standards of living. According to Mustafa, “The reason why interest rates stand high in Kosovo is in part due to the fragile judiciary system, lack of competition in the banking sector, and cadastral problems (20). Other sources show similar results – ‘high cost of finance’ is perceived to be a serious barrier for the creation and development of Kosovan SMEs (Business Climate in Kosovo, 34). High cost to finance is ranked as the largest obstacle, whereas limited access to finance stands at the 10th position, compared to small market size (9th) and high customer tariffs (11th) (38).

The second issue, namely limited access to finance, has also been perceived as a barrier towards development. Limited access to finance describes the situation where a business applies for external financing (loan or grant) but gets rejected. The reason why many businesses get their applications rejected is related to their inability to provide sufficient documentation to the provider (i.e. bank, NGO...) and insufficient liquid-assets (collateral). These factors work against the development of the SME sector, as entrepreneurs struggle to find external financing to create new firms or expand already existing ones – in part because they are seen as high-risk enterprises. The 2012 Human Development Report has found that despite the credit growth in the financial market over the past years, the landscape of loans has remained relatively the same. Loans towards the service sector hold the majority of loans handed towards enterprises (71% of total loans), compared to 25% of total loans which were given towards the manufacturing service. The reason behind such an uneven distribution of loans in the market could be attributed towards the capital which is required to start a manufacturing business relative to a service-oriented business (UNDP, 59). However, for a business to experience growth over time, it needs to invest capital – absence of which could halt growth. Thus, many local enterprises – small and medium – have been investing their own accumulated capital to generate growth (2012 Human Development Report, 60).

According to Nichter and Goldmark, “policies favor large enterprises while small enterprises face problems and difficulties to their development as a consequence of lack of access to finance” (1460). In addition, through primary research, I identified a similar problem within the SME sector – as small firms had a higher probability of getting their loans rejected, as compared to medium firms. Interviewees (those that have obtained a loan in the past) have acknowledged that obtaining a loan becomes an easier task as you build a relationship with the financial institutions. Nonetheless, the price of obtaining the loan remains high (high costs of finance) – which discourages many SMEs from applying for a loan. The Business Climate Report has compiled a ranking table of the barriers based on an intensity scale.

Thus far, we have discussed only the demand side of the credit market – the demander being SMEs. However, the market does not function through demand forces only; therefore, we have to also consider the suppliers function, as it plays a crucial role in understanding the

severity of the barrier. The primary source of external financing for SMEs in Kosovo are banks, more specifically, bank loans. The issuance of bank loans depends on numerous variables – which will be discussed on Model 2 of Section 4.2.

The structure and efficiency of the banking sector is a vital component to our analysis. The current banking system in Kosovo is portrayed in the table below:

The commercial banks in Kosovo	Market Share	Capital Ownership	Entry in the Market
ProCredit Bank Kosovo	30.8 %	Foreign	2000
Raiffeisen Bank Kosovo	27.0 %	Foreign	2003
NLB Prishtina	15.6 %	Foreign	2008
TEB Bank	8.5 %	Foreign	2008
Economic Bank	6.0 %	Domestic	2001
Banka for Business	5.0 %	Domestic	2001
National Trade Bank - Kosovo Branch	5.4 %	Foreign	2007

*CBK Annual Report 2011 & the Kosovo Authority Competition Report (KAC) 2011

The table displays the current financial actors which are operating in the market. From the table, we can observe that Kosovo has a competitive credit/ financial market – bear in mind that we consider banks as normal business who compete with other banks for larger profits.

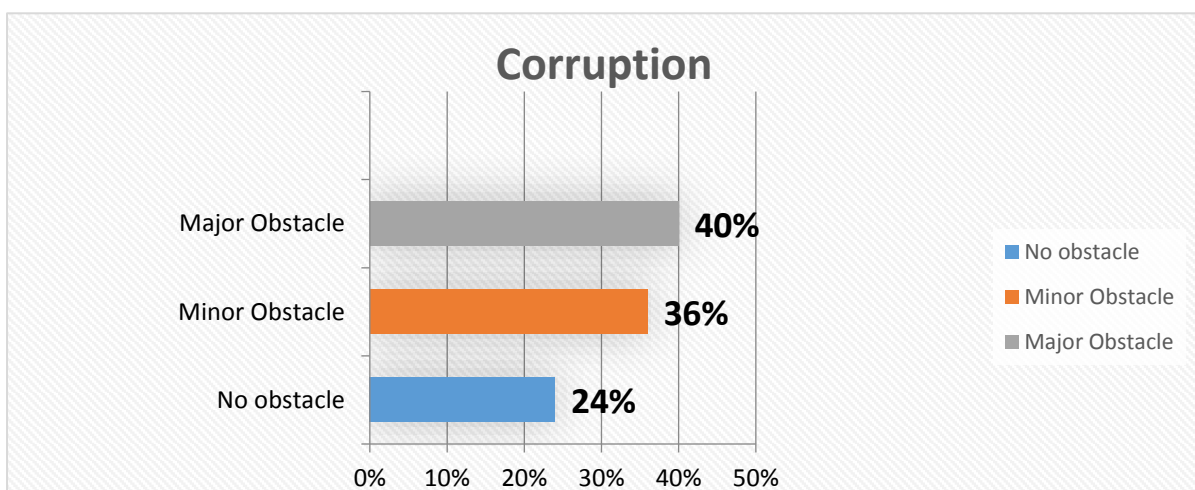
According to Zogjani and Kelmendi, “the fast-growing dynamics in the competitive banking market have forced banks to increase their competitiveness (369). In view of the structure of the banking sector, I interviewed representatives from a foreign bank operating in Kosovo and a domestic bank operating in Kosovo – refer to Appendix A-1 for a detailed overview of the capital structure of foreign and domestic banks in Kosovo. Both, the domestic and foreign capital bank, indicated that the increased competition in the capital

market has reduced their profitability and increased their operating costs. As a result, it has led to a lower performance of their product, namely loans – due to increased prices or interest rates.

As it was previously mentioned, in developing countries, capital markets tend to be inefficient with respect to small firms. A large body of studies (Stiglitz and Weiss) have stated that banks do not have complete information about the borrower, as such, uncertainty about the future behavior of the borrower with regards to loan repayment will result in information asymmetry (393). Information asymmetry is the main indicator of a tight credit market which we currently observe in Kosovo. The results from a working paper of Akins, Ng and Verdi, suggest that competition between informed investors has an important effect on how the information environment affects the cost of capital (35).

4.1.2. Corruption and political instability

In the literature review section, we have established the many ways corruption manifests itself in the developing countries – Kosovo is no exception. According to the data gathered from surveys and answers received by interviews, corruption is considered to be one of the most severe barriers over the last decade – with approximately 40% reporting it as a major obstacle.



These findings are supported by the existing studies; The Riinvest Institute report on the Business Climate in Kosovo states the following, “Corruption and unfair competition are ranked among the top five most severe barriers” (37) – unfair competition will be discussed in more detail in the next section (4.1.3.).

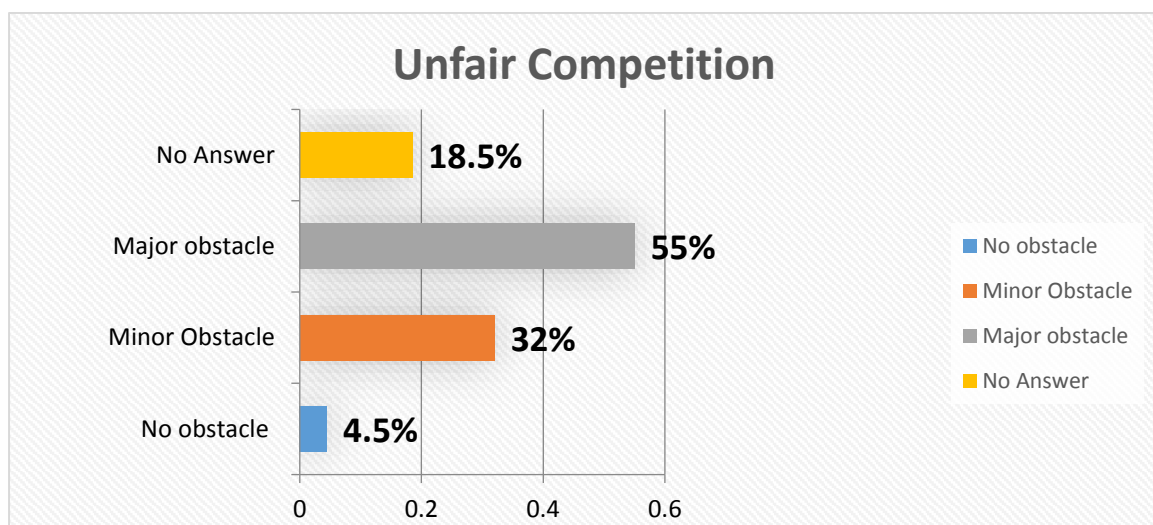
According to Dutta, Kar and Roy, “corruption is a barrier which is hard to measure, it is a phenomenon which distorts prices and raises transaction costs leading to inefficiency in the market” (4). Interviewees from different occupations perceived corruption differently; i.e. the wood processing industry perceived corruption as being administrative (permissible tax evasion by larger businesses, escape from regulations), lack of support and informal payments; Whereas other sectors (construction, retail and agriculture) primarily reported corruption as being systematic – meaning it has been embedded in our culture and prevails through all levels of society. According to the Assessment of Corruption in Kosovo Report, “The state continues to interfere in the business sector, while the business sector complains for corruption methods in place that they have to abide to have expedient results, such as informal payment for municipal official in order to receive municipal services” (Riinvest Institute, 26). In the same vein, the progress reports of the European Commission for the years 2014-2015, emphasizes that the challenges Kosovo faces in the field of anti-corruption are obstructing the business environment; these findings, of the progress reports, suggest that high levels of corruption exist also in sectors such as: Customs, Tax administration, Health and Education (European Commission, 40-41). At this rate of corruption, Kosovo faces multiple consequences which are reflected on its economy: (1) Corruption impairs economic development; (2) corruption undermines social and political stability while diminishing the governments legitimacy (3) corruption causes inefficiency in the market – meaning resources are diverted from the sectors which are in dire need of them and (4) the informal economy is a byproduct of corruption – which encourages and perpetuates illegal activities/ opportunities (Montesh, par.17).

Across different studies undertaken by the Riinvest Institute, we find that the business sector, that is SMEs, complain for corruption methods which exist in their respective sector. However, none of those studies mentions anything regarding efforts made by these businesses to address corruption. Therefore, in the interview, one of the questions I have asked representatives of SMEs was whether they have ever made any effort to tackle the issue of corruption – through any means (protests, complaints, trainings, press conference and more). The majority of interviewees responded in a similar way - the pattern which I have extracted from the answers is that individuals remain reactive towards the issue of corruption. Reactive individuals are the ones who always focus on the events, situations, behaviors and

actions they cannot control (the past) rather than the opportunities (the future). As a result, reactive actors (SMEs) complain on an issue (corruption), however, little effort is made to improve the current situation in Kosovo. These conclusions are indicative of the situation, however, a sample lower than 60 interviews is not a representative of the population and is bound to lead to errors.

4.1.3. Unfair Competition

The last component of the analysis is unfair competition – an issue which is closely related to corruption. The presence of corruption implies the existence of informality in the economy. According to article 44 of the Law on Internal Trade in Kosovo, “Unfair competition means activities of traders that contravene the good business practice in the market competition. In transactions of a commercial, industrial and agricultural nature all acts aiming at competition which are in conflict with best commercial practices are prohibited.” (12). The interviews and surveys were structured in a similar way as the previous barriers; In the questionnaire, there were four options presented to respondents from which they could choose, whether unfair competition is (1) Not an Obstacle, up to, (4) a Major Obstacle. According to the Riinvest Institute Report on SMEs, around 22 % did not believe that unfair competition is an obstacle, 7.6% perceived it as a minor obstacle, 10.2% saw it as a moderate obstacle and the rest (53.6%) reported it as a major obstacle (33). Relative to their findings, 8 out of 12 of the interviewees from my findings reported some form of unfair competition which represents a barrier for their organization.



*Survey findings – January, 2017

The SMEs from the wood processing industry continuously reported unfair competition as a byproduct of the informal economy. This is particularly true, considering that at present the majority of the processing of wood intended for the market takes place in the informal sector (FAO, 31). According to interviewee A, micro-businesses which operate under the informal economy are selling goods and services (G&S) at a price lower than what the market offers – as a result of tax evasion. Tax evasion seems to be the aspect which clasps the attention of many SMEs in Kosovo. According to Cowell, tax evasion is a crucial point of analysis, not only for its illegal features, but because of its economic implications (15). The first implication relates to public finance; the main source of financing government expenditures are taxes. Under an informal economy, the number of businesses (usually micro) which engage in tax evasion tends to be high. As the number of businesses, which do not report taxes, increases than the revenue the government receives starts to decline. In turn, government expenditure must be financed through borrowing/ debt – which increases price of borrowing in the private market and leads to a crowding out effect. The “crowding out effect” is a general term, often used in reference to the stifling of private spending in areas where government purchasing is high (Investopedia, par.1). Lack of investment, due to higher interest rates, is one of the consequences which results from distortion of prices (in this case interest rates). Another implication is that certain businesses engage in tax evasion in an attempt to improve their competitive position. According to Krasniqi, “the greater size of the informal sector constraints the growth of SMEs, as it increases the costs of doing business” (88). In other words, businesses which operate under the formal sector are put in a disadvantages spot, as they compete with businesses of the informal sector – who enjoy lower production costs due to tax evasion.

This distortion in prices, causes inefficiency in the market which creates a hostile business climate – where innovation, creation and growth are no longer the priorities of SMEs under the formal economy. Consequently, the *Business Climate in Kosovo Report* shows that “unfair competition as a phenomenon is very pronounced in the Kosovo market. The results reveal that ‘unfair competition’ has significantly constrained the growth and development of businesses in the last four years in Kosovo” (Riinvest Institute, 38). Among 12 of the interviewees, only one has been fighting unfair competition. According to representative B of the SME (retail firm), “we have been reporting any informal activity to

the proper agencies, in hopes that in the future unfair competition will decrease in magnitude”. Furthermore, interviewee B complained that the costs of hiring investigators, necessary for the process, were holding him back from investing in his own business. Market distortions are only one of the many consequences which prevail as a result of unfair competition. According to the World Bank Report, “politicians have a stake in the prevalent unfair competition through direct inclusion, for the purposes of pushing forward their personal interests held in various Kosovo businesses” (Kosovo Snapshot, 6). As a result, it is in the interest of politicians to have an incompetent *Competition Authority*, which is unable to efficiently implement its function. Last of all, interviewees that operate in construction have reported family, regional and political connections as being a source of unfair competition – as these individuals engage in nepotism and cronyism as means of gaining competitive advantage.

4.1.4. Other Barriers

The barriers discussed up until this point, are considered as the three largest obstacles which SMEs encounter in Kosovo. However, they are not the only ones; hence I believe that it is necessary to give a brief overview of the other barriers which do prevent SMEs from attaining proper growth rates. According to the interview data, firms from multiple sectors have identified the **quality of the labor force** as a problem. Interviewee C said, “There is a large body of individuals (students) who have a degree, however, lack the basic skills needed to do a job properly”. As a result, employers have a difficult time filtering the “skilled-workers” from the “unskilled-workers” during selection processes. The employers usually find themselves hiring certain “experts”, who require further training – meaning increased costs for the employers (Business Climate in Kosovo, 63).

Additionally, a company from the construction sector, has elaborated thoroughly on the **infrastructural barriers**, specifically transportation infrastructure, in one of the interviews. The projects which these types of companies underdo, depend on the transportation of raw material (concrete, sand, wood and more) to the workplace. However, this becomes a major problem when considering the narrow roads, traffic congestion and lack of parking. As a result, the large vehicles, which act as transporters of the material, run late and/or lead to road congestions – as they have nowhere to park. Therefore, the interviewee B has stated that, “the

issue of traffic congestion has to be addressed and the sooner, the better!”. Infrastructural barriers have also been identified by the Riinvest Institute research, “Infrastructural barriers are commonly perceived to be very minor obstacles to SMEs in Kosovo in the current period” (Business Climate in Kosovo, 48).

The aforementioned barriers are minor problems, reported by the interviewees, that SMEs encounter in Kosovo. Nonetheless, they are not the only ones we observe in Kosovo – as shown by a number of studies. Barriers such as small market size, street crime, theft, disorder, limited access to land, nonfunctioning court system, unfavorable labor laws, contract violations and inefficient administrations are encountered by SMEs in Kosovo. However, even the developed countries are subject to a number of barriers. Therefore, eliminating all obstacles remains to be a challenge for the world.

5. Section 5 – Discussion and Recommendation

SMEs are one of the most important mechanisms that stimulate economic growth; they “are the engines of economic growth through employment generation, contribution to GDP, technological innovations, and other aspects of economic and social development” (Krasniqi, 3). The newly-established empirical evidence on SME development, has caught the attention of policy makers across developed and developing countries. However, some countries have done a better job at addressing problems which prohibit the growth of SMEs. The case of the United Kingdom and Kosovo, was an illustration of the previous statement. On one hand, the UK has experienced economic growth by implementing certain policies that try to alleviate the pressure of SMEs. While, Kosovo’s economy has developed a hostile climate, full of restrictions, which have not helped SMEs grow - and most certainly not helped the countries development process. According to primary and secondary research data, I came to a conclusion that, among others, the major barriers that inhibit the growth of SMEs are access to finance, unfair competition and corruption. Therefore, after carefully reviewing empirical findings, I have drawn upon a number of recommendations – that have seen success in other countries.

5.1. The role of the Government in the private market

Empirical evidence clashes when it comes to identifying the role of the government in the private market. The neoliberals believe that the power of demand and supply (free market) can alone, without any intervention, stimulate economic growth; Firms will have to adapt to competition in order to survive, hence promoting a self-sustaining business environment. On the other hand, the majority of the advocates of the neoclassical counterrevolution theory have adjusted from a free-market approach towards a market-friendly approach. The market-friendly approach acknowledges that there are imperfections in the market of developing countries, thus the government plays a vital role in facilitating those operations which the market cannot carry out itself, through a non-selective, market-friendly manner. According to a OECD study, the role of government should be oriented towards ensuring a supportive business environment for SME growth (Small businesses, job creation and growth, 37). The government can intervene and provide the needed assistance by focusing on providing information, expertise and knowledge with regard to access to finance, access to foreign markets, creation of information markets and encouragement of skill development through subsidization of training services. The following recommendations are directed towards the Kosovo authorities.

5.1.1. Loan guarantee strategies

The financial market in Kosovo consists mainly of commercial or conventional banks. These banks, relative to venture capitalists, are less well-equipped to address the risk factor of credit issuance. Loan guarantee schemes serve as a mechanism to reduce the risk of loan issuance to, not only existing SMEs, but also start-ups. The general idea is that the state guarantees a certain percentage of the loan so that, in case of a default, the loss which the financial institution incurs will be minimized – which in turn reduces the risk inflated-interest rates and increases the probability of obtaining a loan (for SMEs). However, for such a scheme to be functional, the buyer will have to pay an additional premium to the state, so that the state can cover the expected losses. OECD countries, such as Hong Kong, the UK, Canada and France have seen great success in addressing the financial problems of SMEs by implementing loan guarantee strategies.

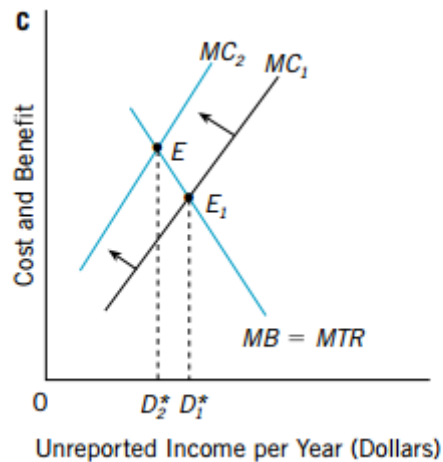
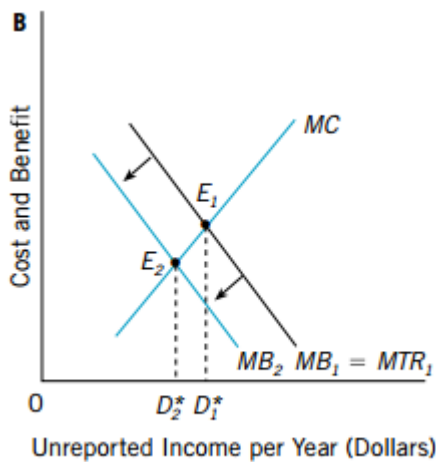
	France	Canada	United Kingdom
% of loan guaranteed	65	90	70-85
Interest rate premium	0.6	1.75	1.5

*OECD - Small businesses, job creation and growth: Facts, Obstacles and Best Practices

As it can be seen through the table, the higher the percentage of loan guaranteed, the higher the interest rate premium paid by the SMEs. According to the report on Small businesses, job creation and growth, the general lessons for loan guarantee schemes are that the criteria for success include: minimization of dead-weight loss, job creation, developing banking expertise and speed of decision-making (OECD, 4).

5.1.2. Decreasing Tax Evasion

Tax evasion is noncompliance with the tax laws by failing to pay taxes that are due (Hayman, 426). According to the results of the survey, over 45% of the respondents defined unfair competition as informal behaviors and tax evasion. In developing countries, tax evasion tends to be high because people engaged in such informal activities believe that corruption has led to a tax system which is not fair (Hayman, 427). The decisions of an individuals to engage tax evasion depend on the costs and benefits of noncompliance. Benefits are the amount of taxes not paid, which could be utilized for other purposes; whereas, the cost of tax evasion varies with the penalties and probability of being caught by authorities. Considering the fact, that taxes are the main source of revenues for any government, under any tax rate structure, addressing such an issue will benefit the government and SMEs (indirectly). Reducing tax evasion can be accomplished in two ways, which can be seen in the graphs below:



*excerpt from Public Finance – A Contemporary Application of Theory to Policy, Tenth Edition (Hayman, 428)

The first way of reducing tax evasion is by a decrease in its marginal benefit (MB) to taxpayers – which is illustrated by a downward shift of the MB curve. However, the shift in the marginal benefit curve will depend solely on the taxpayers – meaning it cannot be controlled by authorities. Such a shift can come as a result of an increase in moral pressures against tax evasion.

On the other hand, as shown by graph 2, an increase in the marginal cost (MC) of tax evasion will also reduce the unreported income per year (tax evasion). Compared to the first method, the marginal cost varies with the probability of being caught by authorities. As such, an increase in tax audits or an increase in the requirements of reporting income will shift the marginal cost of tax evasion upward – as a result, reducing the amount of unreported income. A decline in tax evasion would increase revenues collected by the government and decrease the level of unfair competition - which seems to prevail in the Kosovo private market.

5.1.3. Building state-owned information infrastructures.

The formation of an information economy is the first step that promotes a positive business climate. The information infrastructure is the most important precondition for the creation of an informed and innovative economy (Wipo, 23). Similar to the Innovation Center of Kosovo (ICK), such information infrastructure will be based on the state information system and will provide managers, employees and consultants with courses, training and consultancy services at subsidized rates. OECD countries, such as Japan, has successfully launched nine nationwide SME Universities. These universities offer, up-to 12 month,

courses to managers, consultants and other SME staff – who at the end of the course are certified by the Ministry of economy, trade and industry. A more realistic case for Kosovo, is that of the United Kingdom, who has offered its SMEs with consultancy services for 15 days at a subsidized rate of 50 percent. According to their analysis, after the 15-day long subsidy, SMEs were retaining the consultancy firms. These measures have significantly impacted the SMEs in Japan and the United Kingdom. I believe that there are multiple ways through which the government of Kosovo can improve the business climate in Kosovo.

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6. Section 6- Appendices

Appendix A-1 – Capital Structure of Banks

Relationship between Domestic and Foreign Capital in the Banking Sector in 2011 (%)

Banks	Procredit Bank	Raiffeisen Bank	NLB Bank	TEB Bank	Economic Bank	BpB Bank	BKT Bank	Market Share
Foreign	100.0	100.0	81.58	100	0.0	5.0	100.	90.2
Domestic	0.0	0.0	18.48	0.0	100.0	95.0	0.0	9.8

*CBK Annual Report 2011 & Kosovo Competition Authority (2011)

Appendix A-2 – Overview of Models

The following models have been obtained through secondary research; however, they were slightly modified to fit the purpose of the paper. The first model looks at the determinants of SME growth in Kosovo:

Model 1: Ordinary Least Squared Model

$$\text{SMEGROWTH} = \beta_0 + \beta_1 \text{SIZE} + \beta_2 \text{AGE} + \beta_3 \text{AGESQ} + \beta_4 \text{AGEFIRM} + \beta_5 \text{EDUCATION} + \beta_6 \text{GENDER} + \beta_7 \text{LOANS} + \beta_8 \text{UNFAIRCOMP} + \beta_9 \text{CORRUPTION} + \beta_{10} \text{TAXES} + \beta_{11} \text{FOREIGNOWN} + \beta_{12} \text{EXPORTS} + \epsilon_i$$

Through primary and secondary research, I was able to identify theoretical implications for each variable in the model. The variables are carefully defined in the appendix (Section X).

The variable SIZE is measured by number of people working for the firm. AGE and AGESQ account for the age of the entrepreneur running the business. I have included AGESQ as a measure for accounting the non-linearity in the outcome – further details will be discussed on the appendix. AGEFIRM denotes the age of the SME; EDUCATION and GENDER are the level of educational attainment of the owner and the gender of the owner, respectively; LOANS represent the number of loans received in the past X years (depending on the goals of the survey); UNFAIRCOMP denotes unfair competition in the market – elasticity of demand; CORRUPTION is measured by the perception individuals (SME owners) have towards the level of corruption; TAXES looks at the tax rate as an impeder of growth; FOREIGNOWN stands for foreign ownership and is the presence of foreign capital within the firm (Kastrati, 40); EXPORTS can be used as a continuous variable (percentage of sales which are being exported) or a dummy variable (does the firm export at all?);

STANDARDS include ISO, CMMI, BSI and more – usually ISO is commonly used as a standardization measurement; ϵ_i is the error term. This was a brief description of each variable; to understand how each variable is related to the topic, refer to Appendix A-2.

As suggested by numerous studies, this model follows the Ordinary Least Square Model (OLS) method of linear regression. The goal of OLS is to minimizing the sum of squared values of the differences between the estimated/ observed dataset and those which were predicted (in theory). The smaller the difference between the dataset observed and those predicted, the better the model fit.

According to Kastrati, “a firms’ individual characteristics, such as age of firm, owner characteristics (age, gender, educational attainment), legal status, foreign ownership and exports appear to be statistically significant” (45). This implies that each of the aforementioned variables has a significant impact towards the growth of the SME – i.e. Gender; A large body of studies have found that women tend to be at a disadvantage compared to men with regards to asset ownership and wealth – all of which restrict the capabilities of woman to finance their businesses (Kastrati, 7). Similarly, the higher the educational attainment of the owner, the higher the prospects a SME – as we expect a highly educated individual to have a better understanding of the market.

Furthermore, variables such as corruption, unfair competition and tax rates are expected to carry a negative sign – indicating that an high level of corruption, unfair competition and tax rates will negatively impact an SMEs growth. For e.g., in one of his studies, Krasniqi has found that, the tax burden and unfair competition constraint are statistically significant” (85). In his paper, Krasniqi defines unfair competition as the informal economy and level of corruption – which in our case we have separated into two dummy variables.

Lastly, the financial barrier is partially explained by the individual characterizes. Variables, such as AGE, GENDER, AGEFIRM, EDUCATION and SIZE determine the variable LOANS – which will be discussed under Model 2. Other variables, such as Foreign ownership, Exports and Standards have no statistical significance – in accordance with literature. Thus I will refrain from defining such variables in this paper.

The second model, highlights the determinants of the Access to finance barrier. It looks at what variables impact the probability of obtaining credit from financial institutions and government.

Model 2: Logistic Regression Model

$$(SMEBORROW/X) = \beta_0 + \beta_1 GENDER + \beta_2 AGEFIRM + \beta_3 EXPERIENCE + \beta_4 BUSINESSPLAN + \beta_5 SIZE + \beta_6 COLLATERAL + \beta_7 LEGALSTATUS + \epsilon_i$$

The dependent variable SMEBORROW/X, denotes the number of loans obtained by the business in the past X years (depending on survey structure); GENDER is the gender of the owner of the firm; AGEFIRM is the number of years that the firm has been operating; EXPERIENCE is related to the experience of the manager with business activity – includes past interactions with financial institutions; BUSINESSPLAN represents the strategy of the business for the upcoming years; EDUCATION represents the educational attainment of the owner/ manager; SIZE or Size of the company is measured by the number of employees; COLLATERAL is the value of the firm's assets as collateral; LEGALSTATUS categorizes businesses as Sole proprietorships, partnership, limited company, limited liability company, joint-stock and corporation; ϵ_i is the residual term or the error term. Similar to the first model, variable definition will be shown under Appendix A-2.

The ordinary least squared model is the simplest method of running a regression known to us. However, OLS accounts for outcomes which are continuous in nature; in the case of Model 2, secondary research suggests that the logistic regression method is a better fit for the model. Relative to OLS, the logistic regression method predicts an outcome (SMEBORROW/X) that is categorical (yes/no, true/false) from a set of independent variables which could be continuous and/ or categorical.

The independent variables represented by β_i in the equation are expressed in a categorical basis – in accordance with literature review. Additionally, the independent variables should be included in the survey as questions, in order to obtain accurate data on each variable – as shown in the table below:

Highest Education	1= university graduate, otherwise= 0
Previous business experience	1= Yes, 0= otherwise
Written Business Plan	1= Use 0 = otherwise
SME Size start-up (number of employees)	
SME size start-up number 1-3 workers	= 1, 0= otherwise
SME size start-up number 4-10 workers	= 1, 0= otherwise
SME size start-up number 11-17 workers	= 1, 0= otherwise
SME size start-up number 18-25 workers	= 1, 0= otherwise
SME size start-up number 26-above workers	= 1, 0= otherwise
Firm start ups financing option	1 = firm start up with bank loan (firm – bank relationship),0 = otherwise
Collateral required by bank, no problem	= 1, otherwise =0
Loan with interest –Riba-, no problem	= 1, otherwise =0

*Source: Financing of small and medium enterprises (SMEs): Determinants of bank loan applications

According to Abdesamed and Wahab, the individual characteristics of the firm and the owner-manager characteristics are the key to our understanding of the financing problems faced by SMEs in developing countries. Variables such as SIZE and AGE OF FIRM, are at 1% significance level and they do carry a positive impact on the ability to receive a loan (Mustafa, 45). This means that, larger and older/ more experienced firms have a higher tendency of obtaining a loan than others (start-ups).

On the other hand, empirical evidence suggests that there is no support on the impact of the variable gender on access to bank loans – even though theory argues otherwise. Another owner-manager characteristic in the model is EDUCATION, which is expected to carry a positive sign – as more educated managers will have a higher probability of obtaining a loan. However, the Riinvest Institute 2002 data set, suggests that education of the manager is another insignificant variable.

Two of the most discussed variables are COLLATERAL and BUSINESS PLAN. In numerous studies, the aforementioned variables have proven to have a significant impact in the ability of a firm to acquire a loan from a financial institution. Larger firms have shown higher probabilities of loan-application success than smaller firms (Abdesamed and Wahab, 725), which is largely due to the fact that larger firms have more collateral to offer to the bank, relative to small firms. Further, a business plan is a reflection of the firm’s strategic goals and it is used by banks as an assessment tool. In Kosovo, conventional banks have

reported that SMEs that do not have any formal planning process will run into problems when seeking external financing.

The models discussed, can be subject to change. Nonetheless, their purpose is to provide future researchers with the basics needed to start their own analysis. Model 1 and 2 can be applied to any country, as they have been derived from various studies – conducted in different developing countries.

Appendix B – Informed Consent Form

Informed Consent Form for Social Science Research

A.U.K/RIT

Title of Project: *Barriers to Small and Medium Enterprises in Kosovo*

Principal Investigator: Art Raifi, RIT Kosovo Student

Rrruga Bajram Kelmendi #31

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1. **Purpose of the Study:** The purpose of this research project is to identify the major obstacles which prohibit the growth of small and medium enterprises in Kosovo
2. **Procedures to be followed:** You will be asked to answer *11 questions* during this interview.
3. **Duration:** It will take *20-30 minutes* to complete the interview.
4. **Statement of Confidentiality:** Your participation in this research is confidential. The data will be used only for a research project as part of a course.
5. **Voluntary Participation:** Your decision to be in this research is voluntary. You can stop at any time. You do not have to answer any questions you do not want to answer.

You must be 18 years of age or older to take part in this research study. If you agree to take part in this research study and the information outlined above, please sign your name and indicate the date below.

You will be given a copy of this form for your records.

Participant Signature

Date

Person Obtaining Consent

Date

Appendix C – Interview Questions

1. How was the firm established? (private, public, privataized)?
2. How many people does this firm employ?
3. What are the sales trends in the last three years in this sector?
4. How much time do you spent dealing with officials in applying or interpreting regulations or laws that are applicable to your firm?
5. Which ministries and institutions (e.g. customs, TAK, etj.) do you cooperate with most, and how so? Do these ministries and institutions consult you when designing policies that interconnect with your sector?
6. Is any percentage of your firm owned by foreign investors?
7. Which are the THREE key external factors that hinder the development of the wood processing sector? (Infrastructure, energy, corruption, unfair competition, taxes, customs, etc.) How can these problems be solved and who is responsible in solving them?
8. What are the export trends in the last three years in this sector?
9. Did your business receive any loan from financial institutions in the past year?
10. How cooperative were the financial institutions and what is your opinion on the current procedures?
11. What would happen to your sales if prices increased by 10% above market prices? Assuming that competitors maintain their price?

Appendix D– Survey Questions

1. What is the sector you are operating in? (i.e. retail, manufacturing, construction....)

2. What gender is the owner of the firm?
 - a. Male
 - b. Female
3. What level of education has the owner acquired?
 - a. Less than a High school diploma
 - b. High school diploma
 - c. Bachelor's degree
 - d. Master's degree
 - e. Ph.D
 - f. Other: _____
4. What is the total number of employees in the company? (including the owner)
 - a. 1-9
 - b. 10 - 49
 - c. 50-249
 - d. 250+
5. What year was the company established? _____
6. Please identify the type of ownership?
 - a. Sole proprietorship
 - b. Partnership
 - c. Joint-stock company
 - d. Foreign company
 - e. Public company
 - f. Other
7. How was the company established?
 - a. Established privately
 - b. Established Publicly
 - c. Established publicly but was privatized later
 - d. No answer
8. What were total sales in the past year?
 - a. 0-25,000 €
 - b. 25,001-100,000 €
 - c. 100,001-200,000 €
 - d. 200,000 €+
 - e. No answer
9. Does the company have a business plan?
 - a. Yes
 - b. No
 - c. No answer

10. Identify each of the following factors based on t.....

Corruption Unfair Competition Tax rates Technology Access to finance Lack of information on the market Other: _____

No Obstacle	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Minor Obstacle	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Major Obstacle	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

11. What is your opinion on current tax rates?

- a. High
- b. Mediocre
- c. Low

12. Do you believe the current tax system is fair?

- a. Yes
- b. No

13. If not, what do you think is the problem with taxes in Kosovo?

14. How informed are you about the laws and regulations applicable to your firm?

- a. I am unaware of the laws and regulations
- b. I have some degree of information on the laws and regulations
- c. I am fully aware of the laws and regulations

15. How long do you wait for responses from the officials regarding leases?

- a. Less than a week
- b. One to two weeks
- c. More than two weeks

16. How long do you wait for responses from the officials regarding public services?

- a. Less than a week
- b. One to two weeks
- c. More than two weeks

17. How long do you wait for responses from the officials regarding info on laws and regulations?

- a. Less than a week
- b. One to two weeks
- c. More than two weeks

18. Have governmental institutions assisted your firm in the past?

- a. Yes

- b. No
 - c. No answer
19. If they did, what kind of assistance have you received in the past?
- a. Technical Assistance
 - b. Grant
 - c. Loan
 - d. Subsidized goods and services
 - e. Other: _____
20. How would you define unfair competition?
- a. Procedural Injustices
 - b. Tax evasion
 - c. Informal behavior (operating outside of laws and regulations)
 - d. Other: _____
21. Are you aware of any informal firms which prohibit your opportunities?
- a. Yes
 - b. No
 - c. No answer
22. If yes, please specify the impact of such ‘informal actors’ on your firms growth opportunities?

23. Has the company received a loan from a financial institution in the past?
- a. Yes
 - b. No
 - c. No answer
24. If yes, how often has the company acquired a loan?
- a. Once
 - b. Twice
 - c. More than two times
25. What did the loan amount to?
- a. 0 - 1,500 €
 - b. 1,501 - 5,000 €
 - c. 5,000 - 20,000 €
 - d. 20,000 - 50,000 €
 - e. 50,000 €+
26. Did you have a hard time understanding the procedures related with attaining the loan?
- a. Yes
 - b. No
27. Are you aware of any overseas opportunities for your firm?
- a. Yes
 - b. No
28. If yes, how did you become familiar with such opportunities?
- a. Governmental Institutions

- b. NGOs
- c. Partners
- d. Internet
- e. Family
- f. Other: _____