PAVING THE WAY FOR A BETTER BUSINESS IN KOSOVO

WHAT ARE THE OBstacles TO THE BUSINESS GROWTH IN KOSOVO?

Prishtina, 2019
PAVING THE WAY FOR A BETTER BUSINESS IN KOSOVO

What are the obstacles to the business growth in Kosovo?
Content

EXECUTIVE SUMMARY ........................................................................................................................................... 7
1. INTRODUCTION AND JUSTIFICATION / RATIONALE ......................................................................................... 9
2. OBSTACLES OUTSIDE COMPANY ............................................................................................................................ 12
   2.1 Ten main obstacles to business activity in Kosovo ............................................................................................ 14
   2.1.1 Summary of obstacles to businesses: Economic environment ...................................................................... 17
   2.1.2 Summary of obstacles to administrative and regulatory requirements ......................................................... 20
   2.1.3 Summary of infrastructure obstacles and general conditions ........................................................................ 24
   2.2 Obstacles by sector ............................................................................................................................................... 27
   2.3 Obstacles by company size .................................................................................................................................. 29
   2.4 Obstacles by regions ........................................................................................................................................... 31
3. INTERNAL OBSTACLES ......................................................................................................................................... 33
   3.1 Internal factors by sectors ................................................................................................................................... 36
4. TENDENCIES OF COMPANIES ............................................................................................................................... 44
   4.1 Expectations of business for the development of investments in 2019 ................................................................. 44
   4.2 Informality ............................................................................................................................................................ 48
5. GENERAL BARRIERS AND CHALLENGES ............................................................................................................. 60
6. CONCLUSIONS AND RECOMMENDATIONS ........................................................................................................ 68
7. METHODOLOGY ....................................................................................................................................................... 68
8. REFERENCE .............................................................................................................................................................. 69
Honorable,

Kosova Chamber of Commerce has always been committed to strengthening the role of private sector in the function of a sustainable economic development. In order to ensure this, in addition to the service it provides, it regularly informs the business community about the economic development in the country and addresses the key issues to the relevant institutions.

Among main initiatives in the support of private sector is the identification of barriers that businesses face during their business activities in various fields and provision of recommendations in order to improve the environment of doing business.

After the research with various companies of private sector, Kosova Chamber of Commerce summarizes and analyzes the key barriers in the study “Opening the way to better business in Kosovo”. This research study, the fifth in a row since 2014, aims to identify the biggest obstacles that hinder the normal functioning of companies, irrespective if their nature is external such as economic environment, administrative requirements and infrastructure aspects, or internal that mainly relate to the managerial and operational aspects.

The growth and development of business is hindered by an unfavorable environment of doing business, therefore through such studies the Kosova Chamber of Commerce aims to give its contribution by opening the way to addressing the identified barriers.

I hope that all of us, including businesses, governmental institutions, donors and other relevant stakeholders will jointly help in the function of creating a better environment of doing business and strengthening the private sector as a pillar of the socio-economic development in the country.

Sincerely,

Berat Rukiqi
EXECUTIVE SUMMARY

Since the beginning of 2013 Kosova Chamber of Commerce (KCC) on regular quarterly basis publishes the study on the business climate and economic trends in the country. This study provides very useful information for decision makers at governmental level and provides an orientation for the entrepreneurs with their internal company policies.

Kosova Chamber of Commerce for the fifth consecutive year has conducted a research study in order to identify the greatest obstacles that are hindering the normal functioning of companies. These obstacles are of external and internal nature. The external obstacles are as follows:

- Economic environment,
- Administrative and regulatory requirements, and
- Aspects of infrastructural nature.

Internal obstacles relate to managerial and operational issues.

In 2018 the business community faced numerous problems. The top barriers for this year with similar percentage are "difficulties with access to finance" and high cost of electricity, namely 49.4% of companies for each barrier, followed by irregular supply with energy (46%) as the third top barrier for this year, thus reinstating the energy as the main problem the businesses are facing with.

In terms of economic barriers, in addition to difficulties with access to finance, businesses are facing with unfair competition from grey economy (43%) and consumers default in payment (26%). For the second consecutive year the unfair competition is one of the most emphasized barriers in this category.

The dimension of administrative barriers brings forth the difficulties that companies face as a result of a lack of appropriate legislation and non-harmonization of the laws with business needs. According to companies, this aspect has to a great extent resulted in the low level of their development, particularly in terms of improving the business environment and stimulating the growth of micro and small enterprises.
On the other hand, the barriers of infrastructural nature compose of a considerable number of general influential barriers that businesses have faced in the country. In addition to the cost of electricity (49%) and irregular and unstable supply with energy (46%), political instability (25%) presents the biggest barrier in this dimension, followed by crime, vandalism and theft (18%) which, as phenomena, have considerably increased in 2018.

In terms of internal difficulties, unlike the previous year where the lack of a business plan was the main problem, this year the respondent companies highlighted the undeveloped financial reporting (25%) and low profitability (24%).

The study is concluded with a number of conclusions and recommendations. The recommendations also contain the suggestions of companies and their proposals for overcoming the difficulties. According to them, the proper addressing of these barriers may help the creation of a suitable environment in which companies could operate better and would be helped overcome them, or face such barriers more easily.
1. INTRODUCTION AND JUSTIFICATION / RATIONALE

In spite of its numerous advantages, Kosovo remains relatively behind in economic and social terms and it is considered a potential source of social and political instability. The gross domestic product (GDP) is increasing slowly due to poor economic policies and political and governmental instability. Our country is suffering from high level of unemployment (particularly women and youth), poor education, high level of income inequality, gender discrimination, extremely underdeveloped infrastructure, and poor business climate. In order to overcome these developmental obstacles, Kosovo has to make comprehensive reforms of its economic, social and political system to ensure macroeconomic stability, economic growth, opening of markets and investments, improvement of business climate, strengthening of the rule of law, fight against crime and corruption and improvement of infrastructure and human capital.

During the year 2018 the economy of Kosovo faced various difficulties. In general, as also reported in the regular quarterly study of KCC, the confidence of businesses showed a declining trend in certain quarterlies. This is mainly due to political instability and lack of a clear platform for the support of Kosovo businesses, production sector in particular. Lack of cash in the country has had a great impact on purchasing power, thus resulting in low level of sales, mainly in trade sector.

According to Statistical Agency of Kosovo (SAK), in the third quarterly of 2018 a total of 2212 enterprises were registered, marking a decline of 16.1% compared with the second quarterly of 2018. A decline of 0.1% of registered enterprises is also observed if we compare it with the same quarterly of the previous year (Q3 2017). Even though the cause of such decline cannot be measured, one of the main factors worth highlighting are the unfavorable business climate and the impact of political agenda on doing of business in Kosovo.

Furthermore, according to SAK, the Gross Domestic Product in the third quarterly (Question) of year 2018 marked an actual increase for 3.4% compared to Q3 in 2017. The actual increase in GDP according to economic activities is as follows: financial and insurance activities 19.8%, construction 15.4%, business with immovable property 2.6%, hotels and restaurants 2.0%, agriculture, hunting, forestry 1.9%, transport and storage 1.7%, wholesale and retail trade 1.4%, public administration 1.1%.
Even in 2018 economic profile of Kosovo did not manage to change and reflect a different state compared with previous years. In the third quarterly of 2018, the level of unemployment was 30.7% compared with the same period in the previous year (Q3-2017) whereby the level of unemployment increased by 0.5%. (SAK, 2018). These unfavorable circumstances for employment and a cost of living which is increasingly unaffordable have also had impact on the level of poverty.

The remittances of compatriots living and working in diaspora have to some extent minimized the possibility of poverty deepening in the country. Even though the amount of remittances is high, they are mainly used for consumption and less for investments.

In Kosovo, in addition to high level of unemployment, political instability and level of poverty or low standard of living, high rate of corruption at all levels has been observed; business infrastructure has not been sufficiently built yet, the current education system does not promote self-employment as a career choice and business instability can be seen as one of the systematic causes of high level of failure of private sector.

Kosovo needs long-term, adaptable and readily implementable strategies according to the needs of the country. The employment generating strategies should focus on the improvement of internal and external competition, which would depend on factors such as improvement of human capital, namely investment in non-formal education, attraction of foreign investments, whereby safety of investments would be initially considered, further opening of economy to foreign trade, with special focus on the increase in export and competitive ability of our products.

Strengthening of private sector in Kosovo presents a challenge in itself since after the war. Nevertheless, the contribution of business community to building a country is undeniable. Understanding the barriers that businesses face with, the nature of such obstacles, their scope and impact are the fundamental condition to helping their development. Understanding the factors that hinder the business activity at a certain period of time is important and this is what the Kosova Chamber of Commerce has been doing until now with the business study on the obstacles of doing business. In addition, monitoring/supervision of environment for a certain time, at least annually, is important. Through time comparisons, the change in economic environment can be analyzed and as a result any type of
improvement or deterioration can be identified. Therefore, conducting this study on annual basis is what is aimed at, namely the fifth study of this type, which will be the best one.

This study shed lights on problems which are perceived by businesses. Unlike some ad-hoc studies related to this topic, not only the “bottlenecks” in the environments outside companies (e.g. infrastructure, international standards in trade and production, tax, approach to finance, etc.) but also problems within companies (such as quality of products/services, lack of distribution channels, lack of investments in staff within companies, lack of an adequate business plan, etc.) are monitored.

The data are divided by sector to which company belongs and by the company size. The report also covers the regional aspect/municipalities, in order to identify the obstacles based on the regional impacts.

KCC provides a progress report on the external and internal obstacles that companies face with in doing business. This information will help all economic agents – economic policies and the management itself – in order to implement measures to improve the business environment.

The results presented in this report are based on a broad business study. The Kosova Chamber of Commerce has developed a questionnaire and then it implemented the study. The study was conducted through personal interviews during the period from 3 to 21 December 2018. For the purpose of this study the Kosova Chamber of Commerce has interviewed 437 companies.

The study reflects the situation of companies during 2018. The report was prepared by Ms. Olivera Ceni Bardiqi – Department of Economic Analysis and Policies in the Kosova Chamber of Commerce.

The report begins with the external obstacles, as seen by the companies, followed by internal factors that threaten the business. The second main topic deals with planned investment and sales expectations for year 2019.

The results were analyzed by sector and size; in terms of size, micro from 1 – 2 employees, small 2 to 10, medium 10 to 50, and large over 50 employees.
2. OBSTACLES OUTSIDE COMPANY

In the report on doing business published by the World Bank for 2018 Kosovo dropped four places, which means the business environment has worsened.

The problems reported through years continue to be great obstacles to the business development. Even though businesses report high expectations for the improvement of the state of business, increase in number of employee and sustainable development, only a symbolic part of these expectations are met. This is mainly a result of the fact that a high percentage of businesses of Kosovo are micro and small and their possibility of increasing their investments and developing is limited after we analyze the factors that greatly hindered the development of enterprises in 2018. Nevertheless, the small businesses have a crucial role in developing countries and economies in transition, such as Kosovo. The developed countries usually apply such models of growth and development of businesses in that they adjust the business environment with the needs of the private sector mainly by strengthening the law and order in the country and by directly providing financial support to companies through subsidies.

Understanding the challenges of businesses is the main step toward orienting the improvement of the situation.

Based on this research, one of the main problems that Kosovo enterprises face with is access to external sources of financing. The lack of finances is recognized as one of the obstacles in growing the number of SMEs throughout the world, particularly in the developing economies. Our companies faces difficulties in the access to finance, especially in obtaining financial products (deposits and loans) and services (insurance and capital products) which have an unaffordable cost. Difficulties in providing the collateral, particularly for micro and small enterprises which constitute the largest number of surveyed companies, without a doubt influenced the results of this study. Inability to cover the collateral on one hand and the cost and inappropriateness of offered products rendered borrowing impractical, as a result of which businesses find it impossible to benefit from them.

Businesses declare that they face difficulties providing a collateral which is acceptable for lenders/banks. This is mainly due to the fact that businesses, particularly micro and small
enterprises, do not have enough assets to use as collateral or do not have ability and experience to manage and retain their assets for the needs of getting a loan.

In principle, enterprises need access to finance for several basic reasons: (a) for initial/start-up capital, (b) for circulating capital, and (c) for fixed capital. The limited possibility of access to these three types of capital may have affected and limited the growth of the vast majority of surveyed businesses. Consequently, access to finance has without a doubt remained one of the greatest obstacles for start-up/new businesses and to the growth of existing businesses.

Based on a study conducted by KCC in 2017, the commercial banks in Kosovo apply policies in order not to finance businesses younger than six months, thus excluding the possibility of young entrepreneurs to have access to finance. On the other hand, the micro financial institutions provide this possibility but the interest rates are very high and unaffordable for new businesses.

Furthermore, businesses highlight the high cost of bank transactions and loan rates being among other reasons, even though compared to previous years the loan rates have considerably decreased. On the other hand, the interest rate is mainly the base interest, level of risk for returning the loan and costs of administration. According to banks and micro financial institutions, in principle, the level of risk constitutes the biggest burden when determining the interest rate. However, the previous studies of KCC, which analyzed the level of non-performing loans declared by commercial banks and micro financial institutions in Kosovo, non-performing loans in the country are very low and they fluctuate between 1% and 3%. In general, high costs of transactions, interest rate, poor business plan, and lack of the ability to pay off the loan were some of the most influential factors that hindered the majority of businesses of Kosovo to have access to finances.

Regarding the studies conducted in this field, Alauddin and Chowdhury (2015) speak about non-availability of adequate and necessary loans for businesses, highly complex procedures for getting a loan, lack of infrastructural facilitations, problems with collateral and small working capital as obstacles to taking loans from financial institutions.

This finding clearly signalizes the lack of cash in the country and financial instability of our businesses.
## 2.1 Ten main obstacles to business activity in Kosovo

The research listed ten main obstacles, presented as follows:

<table>
<thead>
<tr>
<th>Obstacle</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Access to sources of financing</td>
<td>49.4%</td>
</tr>
<tr>
<td>Cost of electricity</td>
<td>49.4%</td>
</tr>
<tr>
<td>Reliability of energy</td>
<td>46.0%</td>
</tr>
<tr>
<td>Unfair competition from grey economy</td>
<td>43.0%</td>
</tr>
<tr>
<td>Consumers do not pay on time</td>
<td>25.5%</td>
</tr>
<tr>
<td>Insufficient demand</td>
<td>24.8%</td>
</tr>
<tr>
<td>Political instability</td>
<td>24.8%</td>
</tr>
<tr>
<td>Undeveloped financial reporting</td>
<td>24.6%</td>
</tr>
<tr>
<td>Very low profitability</td>
<td>23.9%</td>
</tr>
<tr>
<td>Corruption</td>
<td>22.3%</td>
</tr>
</tbody>
</table>

Furthermore, even in 2018, the high cost of electricity and irregular supply with electricity remain top barriers. The private sector in Kosovo will probably continue facing this problem until conditions and circumstances are created for the construction of the new power plant, a project which may face challenges in implementation. Nevertheless, the business community has a dose of optimism for the improvement of supply with electricity when this
power plant becomes operational, even though their concern is the possibility of increase in the price of energy.

Compared to 2017, businesses reported that the unfair competition from grey economy was the obstacle with the lowest percentage. While in the previous year around 61 per cent of enterprises ranked it as the main barrier, in 2018 this percentage has dropped to 43%. The relevant institutions in the country continued their fight against informality and corruption, which apparently had an impact on the perception of businesses that the level of these phenomena has dropped. Businesses list corruption as the tenth most important problem they are facing with.
### 2.1.1 Top ten obstacles (in percentage) through years (2014, 2015, 2016, 2017 and 2018)

<table>
<thead>
<tr>
<th>Obstacle</th>
<th>Year 2014</th>
<th>Year 2015</th>
<th>Year 2016</th>
<th>Year 2017</th>
<th>Year 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Access to sources of financing</td>
<td>42</td>
<td>38</td>
<td>49</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customs regulations, procedures, bureaucracy</td>
<td>21</td>
<td>37</td>
<td>24</td>
<td>16</td>
<td>9</td>
</tr>
<tr>
<td>Consumers do not pay on time</td>
<td>30</td>
<td>33</td>
<td>26</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Very low profitability</td>
<td>24</td>
<td>35</td>
<td>30</td>
<td>26</td>
<td>24</td>
</tr>
<tr>
<td>Tax system (e.g. rates, administration, procedures)</td>
<td>24</td>
<td>37</td>
<td>31</td>
<td>14</td>
<td>10</td>
</tr>
<tr>
<td>Quality of products/services often is not competitive</td>
<td>20</td>
<td>31</td>
<td>32</td>
<td>20</td>
<td>16</td>
</tr>
<tr>
<td>Undeveloped financial reporting</td>
<td>33</td>
<td>19</td>
<td>25</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corruption</td>
<td>35</td>
<td>24</td>
<td>34</td>
<td>29</td>
<td>22</td>
</tr>
<tr>
<td>Insufficient demand</td>
<td>24</td>
<td>31</td>
<td>34</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>Political instability</td>
<td>36</td>
<td>23</td>
<td>35</td>
<td>38</td>
<td>25</td>
</tr>
<tr>
<td>Unfair competition from grey economy</td>
<td>32</td>
<td>24</td>
<td>43</td>
<td>61</td>
<td>43</td>
</tr>
<tr>
<td>Cost of energy</td>
<td>57</td>
<td>33</td>
<td>51</td>
<td>51</td>
<td>49</td>
</tr>
</tbody>
</table>
2.1.1 Summary of obstacles to businesses: Economic environment

While in 2017, unfair competition from grey economy was the main obstacle under the category of barriers to economic environment, this year access to finances (49%) is presented as the main barrier. The third barrier under the economic environment is the lack of demand for around 35% of surveyed companies.

Businesses of Kosovo faced with lack of demand (35%) for their products/services. Seen from broader dimension, this can be explained by the high prices they are sold as final products in the market taking into consideration the barriers and difficulties that businesses face with and as a result final price is increased due to inability to face the competition, and due to decrease in purchasing power as a result of rise in cost of living in the country and high level of unemployment.

It is obvious that the main factor that limits the growth in developed economies is the level of demand and in developing economies the main limitation is the lack of production capacities. Considering that insufficient demand is the main cause of low growth this means that our country should stimulate the main instruments that boost the increase in demand. Stimulation of demand through the expansion of capacities will be essential for short-term and long-term growth. In developing economies, the effect of investment is undoubtedly positive, and increase in capacities will enable the increase in employment the development of company. Consequently, the increase in employment will increase the purchasing power and will abate the social burden.

Private investments will also not grow if the companies have unused capacities and have difficulties in managing the debts. In such circumstances, any incentive to increase the demand should be initiated from outside the private sector, for example, from the increase in public expenses or by cutting taxes, namely through fiscal policy.
Furthermore, the lack of qualified staff (16%) appears to be a problem in this category of barriers, though compared to the previous year, the situation appears much better with an improvement of situation by 16 percent. While around 13% of the companies participating in this study mentioned problems with liquidity.
As presented by above figures, compared to the last five years, the barriers of economic environment were smaller, except the difficulties in access to finances, which in the last year marked an increase by 11% compared with the previous year.
2.1.2 Summary of obstacles to administrative and regulatory requirements

The lack of adequate laws appears to be the main problem in terms of administrative and regulatory barriers. The business community of Kosovo often interpret the gap created by the lack of a suitable legislation as a lack of laws. In fact, what businesses interpret at this point is the discrepancy of laws that the Assembly of Kosovo adopts with the capacities of our companies as well as non-applicability of such laws.

Laws were often copied from EU countries and their implementation in practice was a challenge due to the low level of business development compared to the countries from which the model for drafting the laws was taken. According to the companies, some of the laws have often been major obstacle to their growth and development, mainly due to inability to meet the obligations that derive from them.

It is more than necessary to initiate the development of legal framework for the development and strengthening of businesses, creation (adoption) of special laws and bylaws that support the production sector in the country, swift introduction of changes to the existing normative documents in order to strengthen the legal framework for the development of businesses and presentation of changes in current normative documents that relate to overall processes, but which as a whole govern the spheres of economic activity in the country.

Furthermore, in addition to the lack of adequate laws, businesses have problems with the failure to execute contracts and lack of legal support in their execution. In general, businesses refer to contracts with suppliers, who often are at the mercy and will of the parties to execute and implement the agreement specified in the contract. Inefficiency of courts and dragging of cases have forced the companies not to consider courts for the settlement of their disputes. On the other hand, a low number of companies use arbitration for the settlement of dispute. It is worth mentioning that in the Kosova Chamber of Commerce the Court of Arbitration has been functional for several years and has settled disputes for national and international businesses.
Compared to 2017, the administrative barriers have marked a significant improvement. While in the previous year around 14% of companies declared that construction permits were the main barrier, in 2018 this percentage dropped to 6%.

Further, in the previous 11% of companies participating in the study considered the business registration as a barrier, while this year only 5 percent of companies listed it as one of the main barriers.
Improvement is also observed in terms of export and import licenses, whereby only 6% highlighted them as a problem, unlike 14% in 2017. According to companies, procedures for obtaining license for export/import have considerably improved, even though there is still room for improvement, according to small and medium enterprises in our country.
## Administrative barriers (in percentage) by years

<table>
<thead>
<tr>
<th>Category</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax system (e.g., rates, administration, procedures)</td>
<td>23.9</td>
<td>37.1</td>
<td>31.1</td>
<td>13.6</td>
<td>10.2</td>
</tr>
<tr>
<td>Business registration</td>
<td>27.3</td>
<td>10.8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customs regulations, procedures, bureaucracy</td>
<td>21.3</td>
<td>36.6</td>
<td>23.9</td>
<td>15.8</td>
<td>9.9</td>
</tr>
<tr>
<td>Lack of adequate laws</td>
<td>18.7</td>
<td>35.5</td>
<td>25.6</td>
<td>19.2</td>
<td>18.9</td>
</tr>
<tr>
<td>Legal environment (e.g., execution of contracts)</td>
<td>22.2</td>
<td>33</td>
<td>21.9</td>
<td>14.3</td>
<td>11.3</td>
</tr>
<tr>
<td>Import/export licenses</td>
<td>17.4</td>
<td>13.8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other administrative barriers or regulations</td>
<td>11.7</td>
<td>25.2</td>
<td>20.6</td>
<td>16.5</td>
<td>19.8</td>
</tr>
<tr>
<td>Protection of the intellectual property rights</td>
<td>17.5</td>
<td>16.3</td>
<td>15.6</td>
<td>14.6</td>
<td>13</td>
</tr>
<tr>
<td>Construction permit</td>
<td>19.6</td>
<td>11.7</td>
<td>16.4</td>
<td>14.3</td>
<td>11.9</td>
</tr>
<tr>
<td>Access to land</td>
<td>14.7</td>
<td>9.9</td>
<td>18</td>
<td>13.9</td>
<td>6</td>
</tr>
</tbody>
</table>

**Legend:**
- Year 2014
- Viti 2015
- Year 2016
- Year 2017
- Year 2018
2.1.3 Summary of infrastructure obstacles and general conditions

According to the findings, the category of infrastructural obstacles remains among the top 10 barriers. During 2018, the cost of electricity (49%) and unstable supply with energy (46%) were major barrier. Regardless of numerous addresses and public discussions related to this topic, the situation has only slightly improved. In fact, during the last quarterly of year 2018, very often voices were raised in the government of our country regarding the supply with electricity. Stability in the supply with electricity appears to be a difficult aim for each and every government since after the war. On the other hand, businesses were greatly damaged financially due to the lack of legal infrastructure in this area. Often businesses are required to pay for the connection to energy system, investments in energy transformers and ultimately such investments are transferred to the ownership of KEDS, thus creating a paradoxical situation. For several years there has not been any solution to this situation.

Furthermore, political instability and domination of political agenda was a problem for the functioning of approximately 25% of businesses participating in the study. In general, businesses had doubts on whether they should invest due to political instability. Same as reported in the previous years, when there is political instability in the country the business activity drops. Businesses highlighted a wide group of factors of political instability including corruption, instability of government, conflicts, religious and ethnic tensions, democratic accountability and bureaucracy.

Political instability is one of the conventional topics of modern theory of political economy. The modern theory of political economy provides that the political stability plays a significant role in the economic growth of a country. Hence, an unstable political system can seriously hinder the economic growth. Within the theoretical framework of the modern political economy, the government is considered ineffective if the objectives of politics change for a short period of time. That is why the coalition governments are under a serious threat and prone to political instability. Furthermore, the theory of modern political economy underlines that the political instability also affects the level of economic growth in the country since there is a correlation between the level of economic growth and the policies of government and the way the government applies such policies (Barro, 2013).

Consequently, the political instability creates economic inefficiency. One of the most important theoretical arguments behind this topic is that the political instability is not only a
serious obstacle to the economic growth but also the insecurity caused by such unstable political environment when rendering decisions on investments and consequently on the level of economic growth.

Furthermore, the high rate of corruption at local and central level was highlighted as obstacle by around 22% of companies. Corruption leads to the decrease in tax revenues, limits the ability of governments to ensure a sufficient level of public services for the development of private sector. The business community is aware that with this high rate of corruption everyone is in the losing position, not only businesses but also the citizens and the government.
The businesses of Kosovo to a large extent reported the rise in crime, vandalism and theft in the recent years. The level remains very disturbing and in the third quarterly of 2018 this phenomenon remains widely spread, regardless of the profile or size of companies. Nevertheless, businesses in the region of Prishtina reported this problem to a large extent.

<table>
<thead>
<tr>
<th>Barriers of infrastructural category (in percentage) by years</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cost of electricity</strong></td>
</tr>
<tr>
<td><strong>Reliability of electricity</strong></td>
</tr>
<tr>
<td><strong>Crime (e.g. theft, robbery, vandalism)</strong></td>
</tr>
<tr>
<td><strong>Other infrastructural barriers</strong></td>
</tr>
<tr>
<td><strong>Corruption</strong></td>
</tr>
<tr>
<td><strong>Political instability</strong></td>
</tr>
<tr>
<td><strong>Transport</strong></td>
</tr>
<tr>
<td><strong>Cost of water supply</strong></td>
</tr>
</tbody>
</table>
The barriers of infrastructural dimension have remained almost the same in the last four years, despite slight changes through years, either in terms of improvement or worsening of the situation. With the exception of electricity, other barriers in this department appear to have lower impact on the course of business. Even in 2018 the companies in Kosovo did not mention much the problem with water supply and transport.

2.2 Obstacles by sector

Every year the study of "Bottlenecks" analyzes barriers by sectors. In terms of internal factors of industry, the majority of companies in the trade sector reported low profitability being the biggest problem (40%), followed by the lack of underdeveloped financial reporting (38%). Further, around 35% of companies in the trade sector declared not to have a developed business plan. The business plan is an essential means for entrepreneurs who manage a business or who seek business partner, and it is also extremely important for applying for projects and funds from donors and state subsidies. Regardless of this, businesses complain about the high cost applied by consultants or other parties for designing a business plan, this being the reason why they lack such a document in their companies.

The production sector in the country is facing a great problem with the high cost of electricity (71%) and lack of regular supply with energy (65%).

Around 60% of companies participating in the study from the construction sector reported access to finances as a big problem. The construction sector is also facing with a high level of unfair competition from grey economy (59%). The process of fighting and reporting unfair competition is disappointing for businesses because the perceived and presented facts for many of the factors used to determine such process are subject to changes in the course of its detection and during the process of preparation for adjudication. Therefore, based on these allegations, this is the reason why businesses did not report it.

Crime and vandalism were reported to be a major problem for 25 percent of companies in the service sector, followed by default in payments by consumers (35%). Lack of cash in the country to a great extent had an impact on the increase in this percentage, compared to previous years. The high level of corruption (26%) was also highlighted by the service sector as a great obstacle to their development and functioning.

The retail trade sector, in addition to the high cost of energy and high interest rates, declared to have problems with financial statements (38%) which are not well developed and as a result they are often subject to fines by relevant institutions in the country.
Barriers by sectors (in percentage)

- Internal factors in industry
  - Quality of products/services often is not competitive
  - Very low profitability
  - No sufficient investments in staff training
  - No adequate business plan is developed
  - Undeveloped financial reporting
  - Lack of distribution channels

- Infrastructure and general conditions
  - Cost of water supply
  - Transport
  - Reliability of energy
  - Political instability
  - Other infrastructural barriers
  - Crime (e.g. theft, robbery, vandalism)
  - Cost of electricity
  - Corruption

- Economic environment
  - Access to sources of financing
  - Problems with liquidity
  - Use of company's funds for personal purposes
  - Other economic barriers
  - Insufficient demand
  - Unfair competition from grey economy
  - Lack of qualified staff
  - Consumers do not pay in time
  - Konsumatorët nuk paguajnë me kohë

- Administrative requirements and regulations
  - Business registration
  - Construction permits
  - Protection of intellectual property rights
  - Other administrative barriers or regulations
  - Export/import licenses
  - High cost to prove standards
  - Legal environment (e.g. execution of contracts)
  - Access to land
  - Adequate laws
  - Customs regulations, procedures, bureaucracy
  - Tax system (e.g. rates, administration, procedures)
2.3 Obstacles by company size

In terms of company size, the micro and small enterprises report a large number of barriers at country level. Concerning the internal factors, 43% of micro companies declared to have problems with profitability and stressed that they find it impossible to think about large investments. Furthermore, a large percentage of small enterprises reported the lack of a developed financial reporting (38%) according to standards, which causes them great difficulties to have access to finances, especially through commercial banks and micro financial institutions.

Regarding infrastructural barriers and general conditions, again the problems are more prominent in micro and small enterprises. Nevertheless, the large enterprises reported the cost of electricity (65%) as the biggest barrier. Political instability is a barrier for 36% of micro enterprises and 21% of medium enterprises participating in this study.

Difficulties with the access to finances were reported by 59% micro enterprises in terms of barriers of economic nature. Unfair competition from grey economy is a problem for 37% of large enterprises in the country. Large enterprises reported a high percentage of the lack of competent staff, 28% respectively, followed by micro enterprises with 27% and medium enterprises with 26%. Micro enterprises (27%) and large enterprises (28%) are facing delays in payments by the consumers.

The medium enterprises in Kosovo reported biggest problems being of administrative and regulatory nature. The lack of adequate laws constitutes a barrier for 19% of small and medium enterprises whereas execution of contracts is a barrier for 15% of large enterprises in Kosovo.

The high cost of implementing international standards is one of the most prominent barriers under this category. The biggest difficulties were reported by small and medium enterprises, each by 14%. According to enterprises in Kosovo, lack of consultancy in the field of standardization and certification and their high cost have dented the chances of companies to penetrate the foreign markets, where the compliance with qualitative systems and international standards is a basic requirement.
Barriers by company size (in percentage)

- Internal factors in industry
  - Quality of products/services often is not competitive
  - Very low profitability
  - No sufficient investments in staff training
  - No adequate business plan is developed
  - Undeveloped financial reporting
  - Lack of distribution channels

- Infrastructure and general conditions
  - Cost of water supply
  - Transport
  - Reliability of energy
  - Political instability
  - Other infrastructural barriers
  - Crime (e.g. theft, robbery, vandalism)
  - Cost of electricity
  - Corruption

- Economic environment
  - Access to sources of financing
  - Problems with liquidity
  - Use of company’s funds for personal purposes
  - Other economic barriers
  - Insufficient demand
  - Unfair competition from grey economy
  - Lack of qualified staff
  - Consumers do not pay in time
  - Konsumatorët nuk pagaujnë me kohë

- Administrative requirements and regulations
  - Business registration
  - Construction permits
  - Protection of intellectual property rights
  - Other administrative barriers or regulations
  - Export/import licenses
  - High cost to prove standards
  - Legal environment (e.g. execution of contracts)
  - Access to land
  - Adequate laws
  - Customs regulations, procedures, bureaucracy
  - Tax system (e.g. rates, administration, procedures)
2.4 Obstacles by regions

From the regional perspective, businesses in Ferizaj region have reported the highest percentage of barriers, almost in all analyzed categories. Nevertheless, barriers of economic environment are the most prominent, starting from the difficulties with access to finances for around 98% of the companies in Ferizaj region, followed by around 71% of companies of Gjakova region, who reported the same problem. 91% of companies in Ferizaj region are facing the lack of demand for their products/services, followed by 67% of businesses in Gjakova region.

Unfair competition from grey economy is a major barrier for 58% of the surveyed companies in Peja region. The businesses of this region to a great extent are facing delays in payments by the consumers (46%). Corruption (50%) is reported as the most prominent problem for businesses in Peja compared to all other regions.

Further, under the infrastructural barriers, the businesses of Prizren region reported difficulties with operating their businesses as a result of crime, vandalism and thefts (28%), followed by the businesses of Prishtina region (26%).

The areas/regions affected by crime are often places which, in addition to the risk, lack a number of facilities in doing business among others as well as lack of new businesses. In terms of income, crime may affect the attraction of potential clients and decrease the demand for products and services. Crime can also raise the cost of operation. In these circumstances the businesses are pushed to hire security personal in order to protect the goods or employees during and after the working hours. The additional costs of work can also result from the higher salaries for employees who should be compensated for the high level of risk the staff may be exposed at the workplace.

Businesses in Gjilan and Mitrovica region have reported smaller problems compared to other regions; nevertheless, barriers for these regions, among others, are the electricity and lack of competent staff.
Internal factors in industry
- Quality of products/services often is not competitive
- Very low profitability
- No sufficient investments in staff training
- No adequate business plan is developed
- Undeveloped financial reporting
- Lack of distribution channels

Infrastructure and general conditions
- Cost of water supply
- Transport
- Reliability of energy
- Political instability
- Other infrastructural barriers
- Crime (e.g. theft, robbery, vandalism)
- Cost of electricity
- Corruption

Economic environment
- Access to sources of financing
- Problems with liquidity
- Use of company's funds for personal purposes
- Other economic barriers
- Insufficient demand
- Unfair competition from grey economy
- Lack of qualified staff
- Consumers do not pay in time
- Konsumatorët nuk paguajnë me kohë

Administrative requirements and regulations
- Business registration
- Construction permits
- Protection of intellectual property rights
- Other administrative barriers or regulations
- Export/import licenses
- High cost to prove standards
- Legal environment (e.g. execution of contracts)
- Access to land
- Adequate laws
- Customs regulations, procedures, bureaucracy
- Tax system (e.g. rates, administration, procedures)
3. INTERNAL OBSTACLES

In chapter three the internal factors will be discussed. Regardless of the fact that businesses declare a low profit rate (24%), the biggest problem in 2018 in terms of internal barriers of a company is the underdeveloped financial reporting for around 25% of surveyed companies. According to companies, as a result of lack of knowledge and budget limitations to invest in additional staff in finance, the businesses were often fined by inspectors for improper reporting. In this respect, a large number of companies recommended the enhancement of cooperation with Tax Administration of Kosovo, taxpayer advisory unit respectively, by organizing informative sessions, trainings, seminars or workshops that would result in businesses acquiring knowledge in terms of financial reporting.

Further, in terms of these barriers around 18 percent of companies stated that they do not have a business plan.

Whereas around 16% of companies stated not having qualitative products that could compete with the products of the region and those of EU. In this respect, the majority of businesses were unanimous that as long as there is lack of implementation of quality systems and different international standards the situation cannot improve and our products cannot compete with the “aggressiveness” of the products from other countries.

Lack of distribution channels is a major barrier for around 14% of the companies.
Internal factors

- Lack of distribution channels: 13.8%
- Undeveloped financial reporting: 24.6%
- Very low profitability: 23.9%
- Quality of products/services often is not competitive: 15.9%
- No adequate business plan is developed: 17.9%
- No sufficient investments in staff training: 8.3%

Seen through years, the barriers of internal factors of industry were mainly subject to the improvement of situation. Nevertheless, this year the increase in percentage of companies that face difficulties in financial reporting signalizes the great need for their development and training in terms of finance management.
## Barriers of internal factors (in percentage) by years

<table>
<thead>
<tr>
<th>Factor</th>
<th>Year 2014</th>
<th>Viti 2015</th>
<th>Year 2016</th>
<th>Year 2017</th>
<th>Year 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of distribution channels</td>
<td>17.8</td>
<td>15.3</td>
<td>13.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Undeveloped financial reporting</td>
<td>32.9</td>
<td>19.1</td>
<td>24.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Very low profitability</td>
<td>23.8</td>
<td>35.3</td>
<td>29.8</td>
<td>26.2</td>
<td>23.9</td>
</tr>
<tr>
<td>Quality of products/services often is not competitive</td>
<td>19.6</td>
<td>31.1</td>
<td>31.8</td>
<td>19.6</td>
<td>15.9</td>
</tr>
<tr>
<td>No adequate business plan is developed</td>
<td>16.6</td>
<td>27.1</td>
<td>20.4</td>
<td>24.1</td>
<td>17.9</td>
</tr>
<tr>
<td>No sufficient investments in staff training</td>
<td>20.3</td>
<td>23.8</td>
<td>19.9</td>
<td>18.7</td>
<td>8.3</td>
</tr>
</tbody>
</table>
3.1 Internal factors by sectors

Low profitability appears to be a problem for most sectors, especially for the trade and manufacturing sectors. Businesses surveyed of the trade sector have reported problems as a result of underdeveloped financial reporting. On the other hand, about 30% of construction companies reported the lack of distribution channels as their major obstacle.
4. TENDENCIES OF COMPANIES

In the below chart was presented the estimation of the level of sales of companies participating in this research during year 2018. The highest percentage of Kosovo enterprises declared their sales being from 10 000 up to 50 000 Euros, 42% respectively. Further, only around 19% of surveyed companies declared sales over half a million Euros during 2018. From sectorial perspective, around half of construction companies declared their sales being over €500 000, followed by production sector (34%) and wholesale trade sector (29%).

The large enterprises reported the highest percentage of sales over €500 000 (78%), followed by medium enterprises (35%). Around 64% of micro enterprises reported their sales being from €10 000 to €50 000. In the context of regional scope, the enterprises of Mitrovica region reported the highest level of sales, followed by the enterprises of Prishtina region.
Year 2019 appears to be very promising for our businesses. Over 78% of surveyed enterprises expect rise in sales in 2019 thus giving a positive signal for increased business activity during the year.

Great expectations for the increase in business activity in the first half of 2019 were reported in the regular report of Kosova Chamber of Commerce on business climate in Kosovo. Nevertheless, despite positive expectations, not all enterprises had the chance to specify such expectations. The business activity in the country during 2018 had a decline, indicating a low level of business confidence, particularly in the first three quarterlies of 2018.
Sales expectations for year 2019 (in percentage)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Will increase</th>
<th>Will remain the same</th>
<th>Will decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>83.5%</td>
<td>12.8%</td>
<td>3.7%</td>
</tr>
<tr>
<td>Retail</td>
<td>81.0%</td>
<td>11.9%</td>
<td>7.1%</td>
</tr>
<tr>
<td>Wholesale</td>
<td>80.8%</td>
<td>17.3%</td>
<td>19.0%</td>
</tr>
<tr>
<td>Construction</td>
<td>70.6%</td>
<td>17.6%</td>
<td>11.8%</td>
</tr>
<tr>
<td>Services</td>
<td>68.2%</td>
<td>29.5%</td>
<td>2.3%</td>
</tr>
</tbody>
</table>

The importance of sales to the success of a company and the role of selling power in creating the company value provides support in terms of sales, as an important ability of a company (Blocker et al. 2012). Sale is an important component for generating the income of a company and creating a vital link between an enterprise and its clients, therefore the role of sales increased the benefits of effective management of selling power.

The production sector in the country has the highest expectations for the increase in sales in 2019, followed by trade sector. In addition, considering the fact that these two sectors constitute the largest contribution of Gross Domestic Product (GDP), their high expectations are a positive signal for business improvement in the country on one hand and improvement of wellbeing on the other. Increase in business activity and the increased business performance will likely result in the increase in number of employees and in the purchasing power and will have an impact on the decrease in the unemployment rate and poverty in our country. Nevertheless, it remains to be seen if the trend will be positive in the first half of the year, considering that it was reported that the investments by companies are expected in the first half of the year.

Businesses are intensifying the competition, but to what extent productivity can increase this cannot be confirmed without a special econometric model. The measurement of their capability is even more difficult considering the size of enterprises in Kosovo. For example,
Davis et al. (1993) indicate that while gross job creation and destruction rates are higher in smaller companies, there is no systematic link between the job creation and the size of the company. On the other hand, Biggs et al. (1998) in their analysis consider that the large companies were the dominant source of creation of new jobs in the production sector. Naturally, also in our country, regardless of the declaration of small and medium enterprises, it is expected that the large enterprises will have the biggest impact on employment.

Furthermore, approximately 90% of surveyed enterprises stated having acquired new consumers in the reporting year. Seen from the sectorial perspective, the service companies (92%) reported the greatest increase in the number of new consumers, followed by the production sector (90%) and retail trade (89%).

The largest number of new clients was reported by largest enterprises (94%), followed by the medium enterprises (93%). Nevertheless, micro enterprises (79%) reported to have acquired new clients during their operation.

The companies in Ferizaj region presented a large percentage of new clients acquired, followed by the companies in Prizren and Gjilan region.

### Have you acquired new clients during 2019?

- Yes: 88.5%
- No: 11.5%
Around 48% of surveyed companies in this student have acquired new clients in 2018, and the new clients constitute between 10% and 30% from the total number of their clients. Whereas only around 11% of enterprises reported that new clients constitute more than 30% of overall clients.

3/5 of surveyed companies increased their investments in 2018 compared to 2017. Year 2018 in spite of all difficulties appears to be favorable year for businesses in terms of investments.

The investment activities that are conducted by the companies are closely related with their investment policies and can be determined as a system for the management of optimal investment processes. Those policies can include the implementation of the process of operative planning of investments of companies and the development of investment projects that include the selection and execution of the best and most profitable investments by ensuring that economic interests of companies are met in terms of generation of income and increase in the financial performance of companies in general.
The investment policy is conditioned by the development strategy that is adopted by a company, depending on its approximation with the short term and long term objectives, financial capabilities and return of used/invested capital in actual terms, effectiveness of investment projects as well as financial and investment risks they may be exposed to.

### Development of business investments in 2018 compared to 2017

<table>
<thead>
<tr>
<th></th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increased</td>
<td>59.1%</td>
</tr>
<tr>
<td>Remained the same</td>
<td>37.4%</td>
</tr>
<tr>
<td>Decreased</td>
<td>3.5%</td>
</tr>
</tbody>
</table>

The businesses in Ferizaj region have made the largest investments compared to other regions (77%), followed by the businesses in Prizren region (76%) and Prishtina (65%). None of the surveyed companies of Peja and Ferizaj region declared to having lowered their investments in 2018.

The large companies again lead (91%) in terms of development of company investments in 2018 compared to the previous year, followed by the medium companies (72%). On the other hand, 11% of micro enterprises and 2% of small enterprises reported decline in investments. Again, the increase in investments by large companies is expected to have a great impact on the economic growth of the country.
The increase in company investments is essential in order to ensure stable economic growth, increase the employment, and reduce poverty in Kosovo.

In sectorial aspect, investments have mainly increased in the production sector (74%) and construction sector (71%). On the other hand, around 6% of service enterprises reported decline in investments in 2018 compared to the previous year.
4.1 Expectations of business for the development of investments in 2019

The lower part of this report refers to the planning of companies in Kosovo related to investments in 2019. Around 66 percent of business in Kosovo expect increase in ns compared to year 2018. The investment of private sector is the catalyst of economic growth because it increase the production capacity of the economy, lays the foundation for higher income and generates new jobs.

Expectations on the development of business investments in 2019 compared to 2018

The largest investments in 2019 are expected from the production sector (73.1%), followed by the retail trade (68.3%) and construction (64.7%). On the other hand, a very symbolic percentage of participating companies in the study expect decline in investments (3%). Furthermore, there are around 6 percent of enterprises in the construction sector that expect the investments to decrease in 2019. Regardless of the low percentage of the pessimism on decrease in investments, compared with the previous year, an increase in negative expectations is observed, which is between 4 and 6% - depending on the sector.
Expectations on the development of business investments in 2019 compared to 2018 by class size (in %)

<table>
<thead>
<tr>
<th>Class Size</th>
<th>Increase</th>
<th>Remain Unchanged</th>
<th>Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;2</td>
<td>8.2</td>
<td>59.2</td>
<td>32.7</td>
</tr>
<tr>
<td>2 to 10</td>
<td>1.6</td>
<td>21.7</td>
<td>76.7</td>
</tr>
<tr>
<td>10 to 49</td>
<td>1.0</td>
<td>31.0</td>
<td>68.0</td>
</tr>
<tr>
<td>50 and more</td>
<td>13.0</td>
<td>84.8</td>
<td>1.0</td>
</tr>
</tbody>
</table>

Just as in the previous years, this year micro enterprises are those that have lowest expectations about investments compared to other categories.

On the hand, none of the large companies expect decline in investments in 2019. Therefore, the expectations regarding investments in 2019 are very promising and will likely be an essential incentive for the economic growth of the country.

Under the presumption that these investments will take place this year, the increase in investments would provide incentive for greater and more sustainable economic growth and increase in productivity as a result of the investments made by companies (in terms of internal and external return); in a perfect situation where enterprises would operate properly, this would happen through the increase in the usage of capacities, development of skills for applying the technology, and other measures for the support of national development.

The growth of companies depends very much on the level of magnitude and productivity of investments made. The increase in investments requires the mobilization of from internal savings and external private investments of the company. This remains the greatest doubt on the ability of our companies to make such large investments, considering their financial limitations and human resources.
Furthermore, through this study, the companies were asked about the type of investments they plan to make during 2019. Our companies mainly planned to replace the old means/machineries and modernize the existing assets (37%) which presents a decline by 7 percent compared with the previous year. In addition, a large percentage of companies surveyed in this study (31%) plan to expand the production lines / existing services which indicates a decline for 12% compared with 2018. This year, the report on “bottlenecks” brings forth the minimum importance given to the pollution and safety at work (1%).

### Planned investments for 2019 will be of this type

<table>
<thead>
<tr>
<th>Planned investments</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Replacement of old equipment, modernization of existing assets</td>
<td>36.6%</td>
</tr>
<tr>
<td>Expansion of existing production/service lines</td>
<td>30.9%</td>
</tr>
<tr>
<td>Expansion of production/service capacities in new areas of production/services</td>
<td>16%</td>
</tr>
<tr>
<td>Projected investments for the modernization of production/services</td>
<td>8.6%</td>
</tr>
<tr>
<td>Control of air pollution, safety</td>
<td>1.3%</td>
</tr>
<tr>
<td>Others</td>
<td>6.5%</td>
</tr>
</tbody>
</table>

A small percentage of enterprises in Kosovo implement quality management systems. Only around 17% of enterprises participating in this study declared having implemented the standards EN ISO 9001. Nevertheless, the surveyed companies based on their ability/capability to implement standards are aware of the role that quality standards have on the increase in competition, minimization of costs, improvement of work process, enhancement of opportunities for penetration in foreign markets and improvement of companies’ reputation. A large part of companies think that the quality management systems would help them find new opportunities for exploring international markets.
This is the most accurate indicator about the great need that companies in Kosovo have for the support of standardization process. On the other hand, a very small number of companies declared that they do not see any interest in implementing such standards in the future, for several reasons: a) those companies that produce or export their products as a raw material and not as a final product are not required by the importing country to uphold such standards, b) lack of financial support and high cost that the implementation of such standards has is mentioned as one of the reasons for not implementing them, c) lack of consultant agencies at domestic level for the provision of such services, d) insufficient support of management team at the level of enterprise, e) lack of the readiness of professional staff to support the implementation of standards. Considering the high percentage of micro and small enterprises in Kosovo that mainly face various barriers, the biggest barrier being the lack of access to finances and lack of funds, the implementation of standards in Kosovo will continue to be a problem if there is no support by state mechanisms. Nevertheless, the high percentage of companies that confirm the role and importance of implementing the standards remains a promising signal for the future.
4.2 Informality

In 2017, the main barrier of businesses in Kosovo was the high level of informality. In order to identify the main factors that affected this percentage according to businesses, as part of its study of “bottlenecks” KCC included a special section dedicated to this topic.

There are various definitions of informality which could be categorized in two main groups, which are precisely defined by the International Labor Organization (ILO). The first category highlights the dualist and segmented nature of the labor market which defines “informality” in terms of the characteristics of enterprises and work conditions. The second category refers to the legal status of the economic activity. An economic activity is defined as “informal” if it is legal but it is not legally registered. The measurement of informality is an instrument that could be used to analyze the sources of the growth of GDP and relative sensitivity of informal sector in economic policies. This objective was highlighted in the System of National Accounts (SNA) of 1993, which provides that for the purpose of economic analysis and drafting of policies “it is particularly important for many developing countries to be able to make the distinction between formal sectors and informal sectors of economy” (UN et al., 1993, paragraph 4.159).

Typical activities of informal sector (unpaid work in a family business, work with random salaries, work at home, sales in the street) provide a sole opportunity for many poor people to meet their basic needs for survival. In countries without welfare during unemployment or other types of social benefits, the only alternative is the employment in the informal sector. Another form of informality is informal employment (as employment in informal production enterprises or as a self-employed qualified worker in small businesses) that sometimes can generate good salaries. These works may earn even more than regular employees who have a formal job. But for these good and qualified workers, employment in informal sector instead of formal employment often is the only alternative. (Chen et al, 2005, f. 47-49).

Nevertheless, many studies often found the correlation between the size of companies and informality. This is mainly due to several factors: a) Small enterprises may remain unidentified by authorities more easily than the large enterprises; b) governments with limited administrative sources are prone to focus on larger enterprises when collecting taxes or when implementing the labor legislation; c) Trade unions are prone to focus on large enterprises, which are more accessible, in order to ensure that their efforts have a maximum
effect; and d) small enterprises try to use more traditional methods of production. In fact, some of the studies emphasize that as long as non-registration of businesses is not correlated to any other action, it is not fair to count it as informality. In Kosovo, non-formal activity of enterprises has played a key role to defining the informality of enterprises. In this section, businesses were asked about many phenomena that are considered as determinants of informality.

Informality poses serious economic, social and political problems for an economy. A large informal economy hinders almost all efforts of governments to collect sufficient taxes, and to a great extent is detrimental to the efficient supply of public goods and services and consequently to the potential of economic growth.

Around 48 percent of companies participating in this study stated that regardless of the circumstances they manage to compete with informal enterprises.

In this respect, the financial cost of formal companies is increased. Nevertheless, according to de Soto (1989)\textsuperscript{ix}, costs to become a formal company are much higher and the companies were effectively excluded from the formal scope and were forced to remain under the optimal level.

Informality in Kosovo, even though not as high as in other countries in the region and in the economies in transition, still remains a source of concern for Kosovo policy makers, mainly because it reflects an unfavorable economic situation and lack of governmental mechanisms to fight and control it. Furthermore, for both sectors (private and public) it reflects less favorable working conditions, lower productivity for enterprises and especially low level of rule of law, which is one of the most prevalent obstacles in our country.

The study brings forth the lack of development and adequate growth of companies and high operating costs being one of the main reasons why companies decide to remain in informal sector.
Do you as a company compete with unregistered or informal companies?

The high level of unfair competition in the country has greatly damaged the business with regular business activity. Over 39 percent of companies participating in this study stated that the form of activity of competitors operating in the informal sector is a major obstacle. Only around 14 percent of them stated not being affected by the activity of informal competitors.

Do you think that practices of competitors in informal sector are main obstacle?

- Yes 47.7%
- No 25.9%
- Do not know 26.4%

<table>
<thead>
<tr>
<th>No obstacle</th>
<th>Moderate obstacle</th>
<th>Major obstacle</th>
<th>Does not apply</th>
</tr>
</thead>
<tbody>
<tr>
<td>13.9%</td>
<td>37.4%</td>
<td>39.2%</td>
<td>9.5%</td>
</tr>
</tbody>
</table>
There are only 36 percent of enterprises surveyed in this study that think that companies are registered formally when activating their business activity. Nevertheless, it is very difficult to accurately reflect the effect of non-registration of businesses at the beginning of their activity.

The measurement of informal economy in such cases is very difficult because a large part of informality under these conditions happens in agricultural sector, including agriculture of existence and unofficial sales of tradable goods. A large part, at least in terms of employment, comes from self-employed traders and sellers who live in similar conditions (Banerjee and Duflo 2011).

Approximately half of the companies in retail trade sector think that companies are not formally registered at the beginning of their activity, followed by service sector (21%). By measuring their perception, we can assume that these two sectors face difficulties of this nature to a higher extent than the other sectors.

Do you think that companies in Kosovo are formally registered once they commence their business activity?

- Yes: 41.8%
- No: 35.6%
- Do not know: 22.4%
In terms of identifying the period of informality of businesses, a large part of companies think that this happens only several months (43%), whereas 28 percent of companies think that companies operate without official registration up to one year. From the percentage of companies that think that businesses are not formally registered for up to one year, 53% of this percentage are retail trade companies, whereas 19% are production companies.

Furthermore, in aiming to measure informality in employment we sought the opinion of businesses if their competitors report all their employees. Of the total percentage of surveyed, approximately half of them think that companies do not report all employees. Only around 11% think that companies report the exact number of their employees. Seen from sectorial dimension, of the percentage of companies that think that competitors do not report their employees, 35% are retail companies where 27% are production companies.
Do you think your competitors report all their employees?

Only around 10% of companies think that the competitors regularly declare taxes and contributions to relevant institutions. On the other hand, around 47% of surveyed enterprises think that competitors do not regularly declare their taxes and contributions.
Furthermore, only 12% of enterprises participating in this study think that their competitors pay their taxes in a timely and regular manner. From sectorial perspective, around 33% of the retail trade companies stated that their competitors do not pay their taxes regularly, followed by the production sector (28%).

Of the percentage of companies that stated that their competitors do not regularly pay their taxes, 45% of them are small enterprises and 22% are medium enterprises.

**Do you think that your competitors regularly pay taxes?**

The main goal of each company is the maximization of profit. If companies face problems in this context, in such circumstances it is supposed that informality is to blame. Around 48% of companies stressed that high level of informality mainly results in low profit (48%), followed by high taxes (30%), low economic activity (9%) and low competitive ability of our enterprises (8%).

Formal and informal companies interact in the same market. The products offered in the informal sector are considered a perfect substitute of those offered in the formal sector. The informal producer sells at gross taxable price, which results from the function of inverse demand, from industry production respectively. Companies in formal sector pay taxes on goods; the collected tax income is used to finance the governmental activity, which is presumed to affect the productivity of formal sector. The companies in informal sector do not pay taxes, but they face an informal cost which does not relate to production process. For
example, they undertake costly activity in order to avoid being disclosed by the state authorities that fight informality, monitor the execution of contracts and prevent thefts and vandalism, since they are deprived of the majority of services that are provided in the formal sector. As a conclusion, informality has its costs for companies that belong to this sector.

What do you think affects the low participation of companies in formal sector?

According to companies, the tax system had an average impact on the level of informality (45%). For approximately 16% of companies the tax system had a large impact on the increase in informality.

Do you think that tax system had an impact on the level of informality?
With respect to the most prevalent form of informality, according to companies, their competitors mainly do not report their employees (55%), followed by failure to pay taxes and fees (25%) and suspicious channels through which the goods and services of competitors come (15%).

The failure of companies to report their employee reflects the reality that the conditions of employment in informal sector are different from those that are considered normal in the formal sector. This difference is in the form of the lack of employment contract or benefits, these being basic requirements for the employers to pay the respective taxes and social insurance on behalf of employees or for subjecting the employment to the labor legislation, applicable laws respectively. In this respect, the International Labor Organization considers that an enterprise is informal if none of its employees are registered in the relevant authorities for tax or social insurance purposes. This criterion is especially useful in countries where the registration of employees means the registration of enterprises in social insurance institutions (in our case pension trust).

Which of the below options do you think companies in Kosovo apply most?

- They do not report their employees: 55.1%
- They do not pay taxes and fees: 25.2%
- Their goods and services do not come through safe channels: 15.1%
- Others: 4.7%

92% of businesses in Ferizaj region think that domestic companies do not report their employees. The perception is different for businesses in Gjilan, whereby 61% of them think that businesses do not pay taxes.
For approximately 29 percent of surveyed enterprises in Mitrovica region, companies use illegal way to bring their product/service to the market, thus minimizing their business power and reducing competitive ability of formal businesses.

The perception of business community on the level of informality in Kosovo is very high. According to 33% of enterprises surveyed in this study, informality in our country is between 30% and 50%. The highest percentage of companies according to which the level of informality is 30-50% are small companies (40%).

For more than 9 percent of surveyed companies, informality is higher than 50% in the companies in Kosovo. Small and medium enterprises constitute the highest percentage.

18% of respondents from Gjilan region consider that informality is higher than 50% in this region, followed by Peja region where according to respondents informality is approximately 13%.
The majority of companies, over 57% of them, think that the government should fight informality in the country through its investments and mechanisms. On the other hand, a relatively large percentage (41%) of companies think that both government and private sector should jointly fight informality.

Approximately 80% of surveyed companies stated that informality should be fought either directly by the Ministry of Finance (44%) or through its subordinating agencies, namely Customs of Kosovo (20%) and Tax Administration of Kosovo (15%).

Small companies constitute the largest part of companies that think that informality should be fought by the Ministry of Finance (49%).

Around 20% of companies participating in the survey think that informality should be exclusively fought by the Ministry of Trade and Industry through its inspectors under its competence.
If informality should be fought by the government, please tell us which institution?

- Ministry of Finance: 44.3%
- Ministry of Trade and Industry: 19.6%
- Kosovo Customs: 20.3%
- Tax Administration of Kosovo: 15%
5. GENERAL BARRIERS AND CHALLENGES

In order to identify the problems which companies face and which were highlighted the most in 2018, the Kosova Chamber of Commerce mainly analyzed the impact that the lack of skilful labor force and the relationship between other factors that result in this situation have on companies. The skilful labor force is without a doubt the key to success for every company nowadays, especially for the production and trade sector. In fact, the lack of skilful labor force is one of the primary problems that the business community is facing.

Difficulties in the recruitment of staff are not a result of the lack of employees, but a result of the lack of their knowledge of the work process in the company. On the other hand, being in unfavorable financial circumstances, particularly in terms of their ability to invest in further training of employees, companies did not have a lot of opportunities to have an impact on the improvement of this situation. In order to effectively compete in national and international markets, producers have to continue finding ways to add value and to swiftly react to the changes in consumer demands, and in this process the skilful labor force is particularly helpful.

How difficult was the staff recruitment during 2018

<table>
<thead>
<tr>
<th>Difficulty</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very difficult</td>
<td>13.3%</td>
</tr>
<tr>
<td>Difficult</td>
<td>17.5%</td>
</tr>
<tr>
<td>Moderately difficult</td>
<td>39.8%</td>
</tr>
<tr>
<td>Easy</td>
<td>29.4%</td>
</tr>
</tbody>
</table>
According to 13 percent of surveyed companies, the recruitment of new staff during 2018 was very difficult. On the other hand, around 29% of them declared that the recruitment was easy and they managed to find adequate staff to meet the company needs.

Of the percentage of companies that reported having problems with finding new employees, the greatest difficulties were faced by the small enterprises (39%) followed by micro enterprises (32%).

Migration is a phenomenon that affects the creation and accumulation of human capital, particularly the migration of qualified labor force from poor to developed countries. Migration affects the process of creating the human capital mainly through “brain drain” which has a negative effect and depends on the “brain” part of the total migrants; in our country we can talk about the “optimal brain drain”, which is manifested when education is seen as “a passport” to emigration; hence, opportunity of emigration stimulates students from the country of origin to pursue academic studies. Therefore, brain drain may be considered as a strategy that pursues education and “exports” qualified workers in order to attract economic benefits. (Connell J, Kitainai, 1993)
In many reports migration appears with dual impact. While migration has a negative effect on the companies thus affecting the work process, migration is seen as an opportunity for companies when individuals return to the country of origin with new knowledge in certain fields, particularly in transformation of acquired knowledge.

Around 29 percent of companies said that they were affected by the emigration of employees from the country, thus causing great difficulties in adjusting the jobs and finding new employees.

39% of production companies included in this study stated that staff migration had a negative effect on them, followed by construction sector (35%) and wholesale trade sector (32%).

Seen from regional dimension, companies in Ferizaj region seems to have been mostly affected by the migration of employees (62%), followed by Mitrovica region (44%) and Gjakova region (33%).
The vast majority of companies participating in the study stated that they plan to increase the number of employees in 2019, thus giving clear signals about increased business activity and improved wellbeing in Kosovo. Increase in employment has a positive chain effect through which social stability and economic growth can be anticipated.

87% of construction companies included in this study stated that they will increase the number of employees in 2019, followed by production sector (83%) and wholesale trade sector (65%).

Most of surveyed enterprises have positive expectations for employment, with the exception of micro enterprises (35%) where expectations for increase in employment are lower than those of other categories of companies.

Seen from the dimension of company size, around 91% of large companies in Kosovo expect an increase in the number of employees in 2019, followed by medium companies (81%).

Furthermore, around 80% of enterprises in Mitrovica region expect to increase the number of employees. Unlike the previous year where Ferizaj region by a considerable margin had the highest expectations for employment, this year, though expectations are higher (60%) compared to other regions, a slight decline is observed in this respect.
Of the percentage of companies that stated that they will increase the number of employees, around 58% of them believe that this increase will be between 1 and 3 employees. Around 12 percent of companies expect that the number of employees will increase between 5-10 new employees.

If yes, how many employees will you hire?

Large companies of construction sector have high expectations about the increase in number of employees up to more than 10 new employees. On the other hand, around 78% of retail companies participating in this study expect to hire between 1 and 3 employees. Furthermore, around 20 percent of production enterprises expect to hire between 5 and 10 employees during year 2019.

What is the number of employees that will be hired during 2019 by sectors? (in %)
6. CONCLUSIONS AND RECOMMENDATIONS

1. **Advancement of partnership with commercial banks in Kosovo under the monitoring of Central Bank of Kosovo for enabling more flexible interest rates to the benefit of private sector** - A developed financial market such as the case of Kosovo can influence and promote long-term economic growth, an element that is related to the efficiency with which businesses use capital. In emerging economies, interest rates are very unstable and are closely related to the trade balance. Lack of cash in the country and on the other hand the inability of the private sector to access financing sources affects low business activity and low degree of economic activity. A favorable policy allowing flexible interest rates for manufacturing companies and especially for start-ups would create extremely favorable conditions.

2. **Strengthening of the rule of law** - The business community in Kosovo continues to report problems related to enforcement of the rule of law. This is mainly related to the inefficiency of the Kosovo judiciary system. Delays in court proceedings that take years to resolve have led businesses to lose confidence in the courts. Even when the decision turns in favor of businesses after such a long waiting period, there is no benefit due to the damage that such a delay has had by lowering the competitive ability, damaging the company's image and the most sensitive factor by reducing turnover for the company and consequently reducing their business activity. Kosovo Chamber of Commerce, in accordance with the business needs within its range of services, has an arbitrage tribunal whose purpose is to solve business problems and business disputes locally and in international level. The KCC believes that the legal crisis has more impact on enterprises than the economic crisis. A complete reorganization is needed to reform the current legislation under circumstances in Kosovo.

3. **Support for professional training and lifetime learning** - The KCC has consistently raised its voice to the need for harmonization of educational curricula in line with the needs of the private sector. Special emphasis is given by the KCC for dual education whereby the Government and the Parliament of the Republic of Kosovo are required to adopt a legal package that enables the implementation of the "Dual Education" system, according to the German-speaking countries model that must necessarily be
adapted with local specifications. The KCC survey in February 2019 on "Assessment of Export Potentials" clearly shows that enterprises that do not exploit the potential for export as one of the main barriers are reported to be the lack of skilled laborforce. Existing curricula in Kosovo are not even closely aligned with the current labor market needs, even less with the global trends projected for the future. For the implementation of the "Dual Education" system, besides the need for new curricula, new professional standards, a special budget is required, so the KCC recommends to the government that in the budget to be planned for the coming years, funding for implementation of the "Dual Education" system to be among the top priorities.

4. **Classification of the cost of electricity** - Building new generation capacities (New Kosovo Power Plant) using the natural resources Kosovo has (lignite reserves) is a necessity., but the global energy policy transformation implies an increase in public and private investment efficiency, renewable resources and complementarity with the countries of the region, within the framework of a regional energy market. In all these circumstances, when there is much uncertainty about the future of the energy sector in Kosovo, the private sector constantly pays unbearable costs associated with a lack of regular and stable electricity supply. This continues for 19 years.

Recommended:

a) Increase of the Energy Efficiency Fund, with the possibility of profitability for all businesses (MED);

b) Completion of the common energy market between Kosovo and Albania, funded by KfW (KOSTT and the government);

c) Increase of the fund for support of solar panel installations and other equipment that enable the generation of energy from renewable sources in manufacturing businesses (different ministries);

d) Subsidizing part of electricity bills for exported products (various ministries);

e) Financial support for start-ups and small business networks (MED, MIN and MTI);

f) Changing the tariff model by limiting cross-subsidization between different categories of customers, and increasing supply competition (ERO);

g) Handling of "capacity load" (maxigraph), based on regional practices and EU countries (ERO);

5. **Enhancement of cooperation with national institutions with Tax Administration of Kosovo (TAK) in particular**, on information on changes in legislation framework,
regulations and especially penalties for businesses. It is mentioned the lack of communication skills of TAK officials as a barrier to businesses, and this recommendation is addressed in increasing the professional capacities of TAK staff, especially tax officials and inspectors.

6. **Minimization of the political effect on the course of businesses** - In many reports published by KCC it is reported that in periods when the country has political instability, business performance in Kosovo decreases markedly. Consequently, the political effect appears to have a negative effect on businesses, so adequate measures should be taken that if it is not possible to completely avoid this effect, at least not to be at such a high level.

7. **Fight against informality** - The high level of informality in the country remains one of the major business challenges, and can even be categorized as a challenge for the decade of the independence for Kosovar entrepreneurs, especially those operating in the formal market and being regular taxpayers. The biggest damage is made to the manufacturing sector with the potential to increase exports, stressing that a transition to the formal economy is a condition for achieving decent work for all. Local private sector concerns are growing, and this is more pronounced by the growing informality in the north of the country. As reported in previous years, KCC raises concerns about the dysfunction of state mechanisms to maintain control of informality that has greatly affected the competitiveness and development of enterprise potentials. Informal employment this year is a growing hurdle that is severely damaging the competitiveness of the private sector.
7. METHODOLOGY

Obstacles to the growth of businesses in Kosovo were analyzed in this report through a survey with businesses conducted by the Kosova Chamber of Commerce. The survey used a questionnaire, which was developed and modified specifically for the economic situation in the country.

The questionnaire with specific questions was developed by the KCC staff, by the department for economic and political analysis, respectively. The questionnaire is composed of four parts:

The first part reviews some characteristics of a company. The second part is focused on the assessment of the economic position of a company regarding sales and investments. The third part contains questions related to the obstacles to the activity of companies. The obstacles were divided into three categories of external obstacles: economic environment, administrative and regulatory requirements, and infrastructure and overall conditions. In addition to the external factors, questions on internal obstacles were included. At the end of the questionnaire we added a separate section related to the barriers to business in broader scopes.

The character of the survey was both qualitative and quantitative. This means that the respondents were asked to give verbal qualitative answers but were also asked to give their recommendations in certain area. The answer options are for example: no obstacles / moderated obstacles / great obstacle / not applicable.

The size and structure of the sample meets the statistical criteria for obtain representative results. The data were collected from personal interviews. The staff of KCC visited the businesses between 3 and 21 December 2018. The visited businesses were selected from the database of the Tax Administration of Kosovo (TAK).

The research reflects the business situation for year 2018.
8. REFERENCE

1. Source: Statistical Agency of Kosovo, Q3 2018. [http://ask.rks-gov.net/media/4387/repertoristatistikor-mbi-nd%C3%ABrmarrjet-ekonomike-n%C3%AB-kosov%C3%AB-tm3-2018.pdf](http://ask.rks-gov.net/media/4387/repertoristatistikor-mbi-nd%C3%ABrmarrjet-ekonomike-n%C3%AB-kosov%C3%AB-tm3-2018.pdf)


