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**The Effect of Supportive Policies
on SME Development – Kosovo Case**

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Abstract: This paper examines the effect of government policies affecting the development of SMEs. SMEs are promoters of economic development, but being small, they are also very vulnerable to the unfavorable business environment thus they need to be supported. The paper will specifically address the impact of government subsidies and loans in supporting the development of the first SMEs in their turnover. Kosovo is a country in transition therefore it is expected that these effects will be interesting, as the opportunities of government institutions to help them are very poor either by the lack of means or by the wrong allocation of funds in sectors that have no influence in the economy. The analysis of the results was done using econometric models such as simple OLS regression and auto-correlation vector analysis VAR. There are many studies that have provided different opinions about the effects of these supporting policies on SME development. Hence, their findings and results from empirical analysis will draw useful conclusions and recommendations.

Keywords: SMEs; development; effects; subsidies; loans

Introduction

In order to promote the development of an entrepreneurial economy, it is necessary for the state to establish a system to support its development. This fact, in developed countries, has been clearly reflected since the 1980s. XX and also the results of this support are uncontested.

In this support system are locked state, private enterprises, voluntary organizations, non-governmental organizations, institutes and public agencies, which are organized and trained to provide various services and support to SMEs.

Entrepreneurship is the term that best suits and adapts to the free market economy, then the question arises, why should we propose that they should be helped, the implementation of the idea would be best done with a minimal intervention of other factors, especially the state?!

SMEs need a much more secure environment than financial capital, as it with the innovation and flexibility it characterizes as an enterprise generates revenue (without wanting to reduce the importance of financial support). The overall aim of SME support and entrepreneurship is to help those enterprises that have a good prospect in the future both in the production process and in the realization process, and on the other hand the entrepreneur's expenses somehow to be minimized.

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Support is provided through organized institutional networks such as: public, private, state and voluntary. It seems that transition countries fail in this dimension, exactly in finding the correct way of delegating the support resources to the private sector. A great deal of influence, so that this process does not reflect positively, is corruption, which is a very negative phenomenon that is expressed especially in post-war countries such as Kosovo, but also in transition countries in general.

In the last decades, by the classical support of SME development and entrepreneurship (through financial support, tax, customs, subsidies, etc.), it has gradually shifted to other forms of support through business incubators, science parks, business networks, business angels, risk funds, etc. Thus, Kosovo has also created various agencies that have the role of business angels or parks.

In Kosovo there are established eight economic zones distributed to municipalities in need of private sector support, but who have met the conditions set by law on the establishment of these areas.

A great support for private sector development in Kosovo has also been provided by international organizations such as USAID, EBRD, WB, UNDP, and many other non-governmental organizations that operate in Kosovo. However, the focus of this paper is to see the effect of policies supporting the development of SMEs seen in their circulation. The paper deals with empirical approaches trying to verify and validate the following hypotheses:

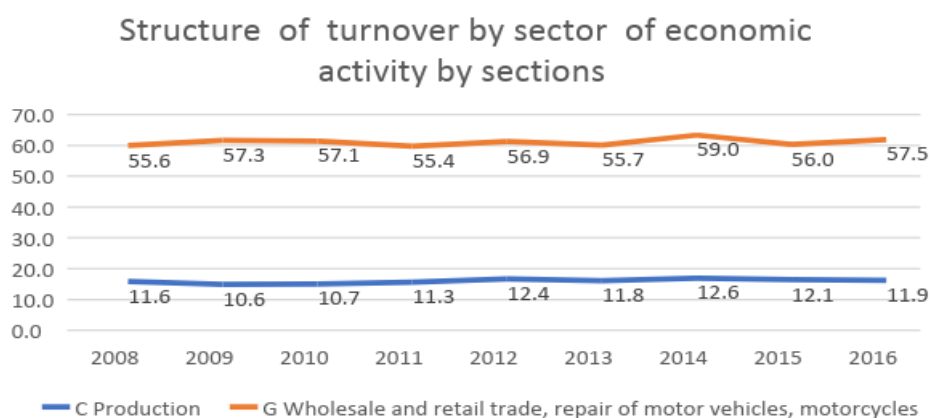
- H1 Subsidies granted by the government have positively impacted the turnover of SMEs;
- H2 SME loans have positively impacted the turnover of SMEs;
- H3 SMEs have a positive impact on employment growth.

Transition countries are in constant effort to build strong walls to secure sustainable economies. One of their forms of effort is the system of transferring funds to the beneficiary account which has provided projects contributing to increased production and employment, as well as the banking system that provides additional means with different financing costs to their needs.

Forms of Support to SME Development in Kosovo

SMEs, as in any other country, also in Kosovo carry a significant share of its economic development. They are really silent but have a great impact on economic development. But Kosovo continues to be the poorest country in Europe, and unfortunately, a major contribution to this situation is the poor functioning of the private sector, specifically the production sector. The share of production in the overall SME turnover in Kosovo is shown in the following graph:

Table 1



Statistics Agency of Kosovo, <http://askdata.rks-gov.net>

In fact, to know the economic development of any state, then we should look in production capability within the state, which in Kosovo is low, but recent developments, such as visa liberalization and improved relations with neighboring countries, will make Kosovo attractive for foreign investors.

As can be seen from the chart above, the share of trade in private sector companies turnover is very high, and this means that goods are being traded widely, and the more they are imported.

However, Kosovo is trying through various forms to support SME development. In this context, the government plays an important role through supportive forms such as grants and subsidies. On the other hand, the banking sector emerges as a very strong sector supporting the development of this sector.

The paper deals with the impact of these policies on the circulation of small and medium-sized enterprises.

The Government Support to SMEs

A very special form of SME support is that of state funding programs. These are generally forms of irreversible funding, such as subsidies and grants. The purpose of supporting state-owned SME development programs is to build a business environment, creating financial, administrative and technical facilities.

There are many papers that write about the government's impact on the private sector through various forms, and especially through the support of new initiatives and start-ups (Jahanshahi, 2008; Blackburn & Schaper, 2012) (Ligthelm & Cant, 2002), (Mbugua, Agnes & Ondabu) (Rafidah & Norfaridatul, 2014; Fred, Gregory & Mauric, 2016) (Giuseppe, Fabien & David) (Abonyi, 2005)

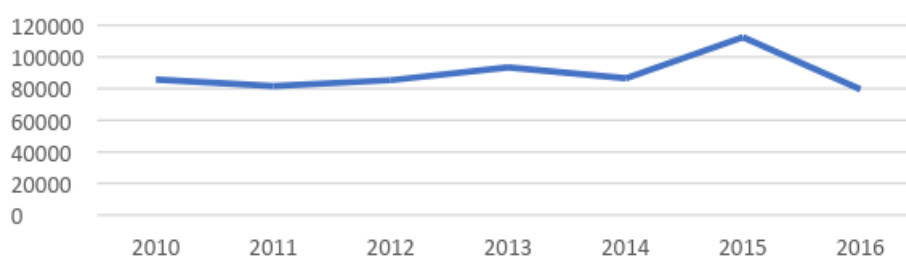
Subsidies

Subsidies are financial aid to unraveled enterprises and are a very useful tool for deficit recovery. Various works have looked at them from different aspects, as grants and subsidies are provided for many reasons, e.g., education, training, aspects of enterprise search and development, roads, tax-free facilities, interest in credit, promotion of products, creation of a glamorous environment for doing business, etc.. (Schumpeter, 1934; Birch, 1987; Weiss, 1981; Davidsson, 2006; Lopriore, 2010; Audretsch, 2002) This is not only interpreted if the policies concerned have succeeded, but whether it is necessary and reasonable to intervene with the government in creating business conditions (Fombasso & Cincerato)

Below we represent a graph of government subsidies distribution.

Table 2

Subsidies distributed from the Kosovo budget for the period 2010-2016



Source: Ministry of Finance of Kosovo, www.mf-ks.org

According to the data of above chart, these forms of support are taking proper account of the importance they have for the development of the private sector. According to the Kosovo Institute for Local Governance, for 2017, for all municipalities, the amount of funds allocated for the subsidy category is 2,576,299 euros, while in 2016 this amount was slightly lower, namely 8,447,811 euros.

Support from the Banking Sector

Kosovo as a country in transition deal with a lot of reforms especially in terms of loans. In developing countries loans seems to be expensive and with high criteria in the process of the fulfillment especially for small and medium enterprises. SMEs seemed to be unable to respond on time and on a regular basis to loans with high demand for loan cover documentation as well as high interest rates. High banking intermediation costs are typical for poor countries, first of all because of the high credit risk. There are several factors that characterize the developing countries because of high credit rating reasons, such as:

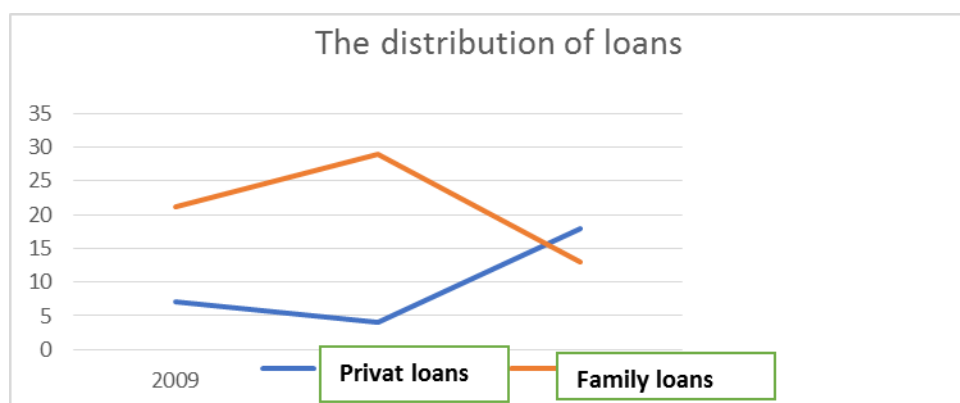
- the low level of savings in the respective countries, while the demand for loans is high and the trend is increasing;
- limited access to international financial resources to enable increased competition and lower credit prices;
- market structure (bank ownership, level of banking concentration, degree of competition, etc.);
- Lack of law enforcement in the case of compulsory collection of bad credit (the problem with the sale of mortgages - collateral);
- relatively high operating costs of banks;
- High level of informality that leads to wrong information on borrowing and increases the amount of bad credit (false financial report).¹

The total amount of loans allocated in total, at the end of 2017 reached the value of 2.41 billion euros, which meant an increase of 10.2% compared to the same period of the previous year, this is addressed to easing policies for borrowing from SMEs.² According to this report, SME loans in this period compared to the same period of time in the previous year increased by 31.9%. In fact, the data cannot show a real growth in the economy, as about 41% of SME loans are granted for non-investment loans, which didn't affect the capacity growth of enterprises. In Kosovo, the distribution of credits by the sectors has changed since 2011, where the focus of loans has shifted towards investment loans. Below we will see how the access to credit from the household sector to the enterprise has changed.

¹ Riinvest Institute: Banking system, assistance or barrier, 2015, p. 47.

² Central Bank of Kosovo, Quarterly Economy Report, TM4 2017, p. 14.

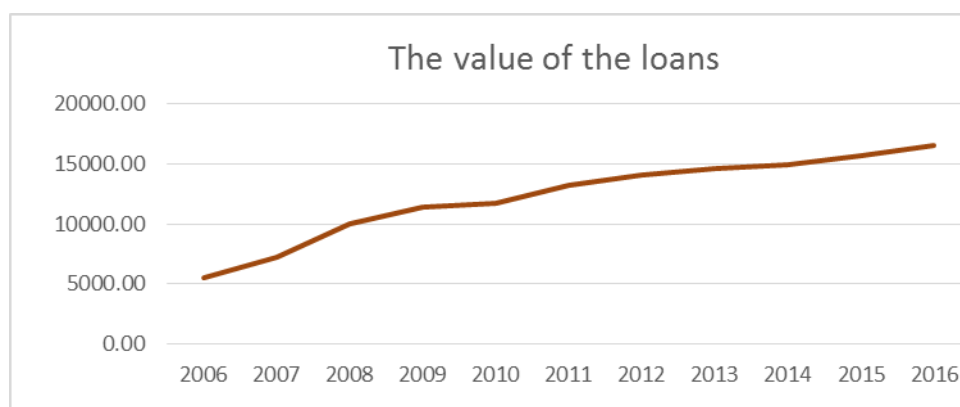
Table 3



Source: Riinvest Institute: Banking system, assistance or barrier, 2015

From the graph above we can see that household loans have had a high turnout in financing loan applications. There is a positive trend for private loans which imply that the banking sector is oriented towards loans of an investment character. This gives signals for improving the funding opportunities for additional funds. The interest rate has been a crucial factor which since 2010 has fallen below 10%. In the graph below we represent the trend of loans in total value.

Table 4



Source: Central Bank of Kosovo, www.bqk-ks.org

The situation seems very prosperous, given the growing trend of private loans, and thus the total value of loans is growing. On the other hand, the credit rate has been declining, this creates a more friendly and attractive environment for investment.

From this we understand that we are on the right path of economic prosperity, since as never before loans are being used by enterprises to increase their capacities or even to modify existing products, or even to improve their performance in market.

Research Methodology

To analyze the effect of these two forms of the support for SME that is seen in their circulation, a simple OLS model was used, and to measure the effect of SMEs on employment, vector autocorrelation was used.

OLS regression is one of the main techniques used to analyze data and forms the basis of many other techniques (for example ANOVA and generalized linear models). The utility of the technique can be extended extensively with the use of coding the variables dummy¹ to include grouped explanatory variables and data transformation methods.²

This econometric model represents an abstraction of reality. In the simple regression model, we have the dependent variables and an explanatory variable including the random error that implies all other factors that may affect the dependent variables but are not considered in the model.

So dependent variables = Constant + explanatory variables + random error

On the left-hand side of the equation is the dependent variable whereas on the right side of the equation appear:

$$Y_i = \beta_0 + \beta_1 X_1 + \mu_i$$

a) Constant;

b) Explanatory variables; and

c) Error term.

In econometric models the influence of variables is evaluated through;

T - statistics;

P - value (probability value); represents the exact level of significance: indicates the lowest level of significance in which we can reject the hypothesis zero.

The coefficient of determinant indicated by R² indicates how close are the observations with the regression line. The coefficient of determination takes the value:

1) $0 \leq R^2 \leq 1$;

2) Case R² = 1 all observations lie on the regression line (impossible);

3) Case R² = 0 no observation extends to the regression line;

4) Estimated coefficients should be presented and interpreted by paying attention to measuring units and explaining the economic and practical importance of the variables included in the model;

5) T-statistic or p-value, depending on group preference prefer to represent one or the other form.

To test the importance of the variables, we used the STATA software program.

In this model as a dependent variable is the turnover of SMEs, while independent variables are subventions, the value of issued credit for SMEs

¹Variable “dummy” Is an artificial variable created to represent an attribute with two or more distinct categories / levels, Smita Skrivaneek, Principal Statistician, MoreSteam.com LLC

²Graeme Hutcheson, Ordinary Least-Squares Regression, In (Moutinhoand & Hutcheson, 2011, pp. 224-228).

The abbreviations used in the model are

QI- SMEs turnover

sub- subventions

Cr- amount of issued credits to SMEs

The STATA program has produced data on which we build the econometric model in numeric form. The econometric model takes the following form:

$$\text{Turnover in SMEs} = \beta_0 + \beta_1 \text{sub} + \beta_2 \text{Cr}$$

The results lead to the model being significant and explains the growth of SMEs from the active supportive policies seen from the prism of data incorporated in the model.

The coefficients are significant and have a p - value lower than 0.05. Thus, to see the effect of these policies, OLS model was used which through STATA program has provided the following results:

Table 5

Source	SS	df	MS	Number of obs = 132		
-----+-----				F(2, 129) = 6.54		
Model	5.8156e+17	2	2.9078e+17	Prob > F = 0.0020		
Residual	5.7380e+18	129	4.4481e+16	R-squared = 0.0920		
-----+-----				Adj R-squared = 0.0779		
Total	6.3195e+18	131	4.8241e+16	Root MSE = 2.1e+08		

var1	Coef.	Std. Err.	t	P>|t|	[95% Conf. Interval]	
-----+-----						
var2	9050.374	4495.237	2.01	0.046	156.4373	17944.31
var3	146624.4	69469.02	2.11	0.037	9178.196	284070.5
_cons	3.08e+08	6.92e+07	4.45	0.000	1.71e+08	4.45e+08

STATA sources, author calculating

The p value in the whole model is less than 0.05, concretely, 0.0020 indicating significance between the variables used in the model.

The results show that subsidies as a supportive policy for SMEs have a positive impact and are important for SMEs turnover. That mean the H1 hypothesis is accepted. On the other hand, loans, as another form of SME support, have a positive impact, and are important in SMEs turnover. That mean the H2 hypothesis is accepted.

VAR model and results

The analysis of the relationship between the contribution of medium and small enterprises and employment in the case of the Republic of Kosovo during the relevant period 2006 Q1 - 2016Q4, also parks the second model of this paper.

Below are the variables that will be used in the model, and their abbreviations.

Variables

Rate of unemployment - **unemp**

SMEs turnover - **QI**

Subsides – **Sub**

In order to analyze the effects of turnover of medium and small enterprises in the unemployment rate in the case of Republic of Kosovo, the following equation was used that de facto structures the basic regression model

$$\ln unemp = \beta_0 + \beta_1 \ln QI + \beta_2 \ln sub$$

To research the long-term link between variables, the vector autoregression model or otherwise known as the VAR model was applied, whereby the VAR results of the model are shown in the following table.

Table 6

Variables	Coefficient	Standard error	Z-s values	P>|z|
$\Delta(\ln unemp)$				
L1. $\Delta(\ln unemp)$	-.4111752	.1261757	-3.26	0.001
L2. $\Delta(\ln unemp)$	-.4245771	.1342605	-3.16	0.002
L3. $\Delta(\ln unemp)$	.0185506	.1227922	0.15	0.880
L4. $\Delta(\ln unemp)$	-.2248628	.1054362	-2.13	0.033
L1. $\Delta(\ln QI)$	-.3303871	.1636188	-2.02	0.043
L2. $\Delta(\ln QI)$	.2698722	.1444849	1.87	0.062
L3. $\Delta(\ln QI)$	.2461553	.1333653	1.85	0.065
L4. $\Delta(\ln QI)$	-.3531247	.1294696	-2.73	0.006

Source: STATA result, VAR autocorrelation. Author calculating

Moreover, the results dictate that there is a negative and significant relation between the turnover of medium and small enterprises and the unemployment rate in the Republic of Kosovo, such result is based on the negative coefficient and significance value $p = 0.006$, and even in the fourth delay time. That mean the H3 hypotheses rejected.

Furthermore, the following table presents the results of the Lagrange-multiplier-LM autocorrelation results, where, as we can see, the value of p is not significant, whereby it implies accepting the zero hypothesis, meaning that the variables do not possess autocorrelation in time lags.

Table 6. Lagrange-multiplier test

Lag	chi2	Prob > chi2
1	68.4437	0.10089
2	34.7150	0.52965

Source: Author

H0: no autocorrelation at la

Furthermore, the following are the results of the Jarque-Ber and Skewness results, so that normal distribution can be seen, and as we can see from the results of these tests, we have a normal distribution of data.

Table 7. Jarque-Bera test

Variables	Jarque – Berra	Prob > chi2
ln unemp	2.262	0.32272
ln QI	0.710	0.70116
ln sub	1.994	0.36904

Source: Author

Table 8. Skewness test

Variables	Skewness	Prob > chi2
ln unemp	.55747	0.15004
ln QI	.00888	0.98170
ln sub	-.28179	0.46688
ln Kr	-1.1921	0.20208

Source: Author

In the following table are presented the results of the Granger Causality Test, which also illustrates the short-term effects of turnover, subsidies and credits at the employment rate in the Republic of Kosovo for the period 2006m1-2016m9.

Table 9. Granger causality test

Independent variable (equation)		ln unemp	ln QI	ln sub
Independent variables (time delays)	ln unemp		26.53 (0.000)	6.613 (0.158)
	ln QI	6.6792 (0.154)		34.023 (0.000)
	ln sub	.89441 (0.925)	10.355 (0.035)	
	ln Cr	20.097 (0.000)	25.344 (0.000)	14.479 (0.006)

Source: Author

Based on the results of the Granger test of causality, we can observe that there is a two-way correlation between the unemployment rate and the loans. There is also a two-way relationship between the turnover of small and medium enterprises and subsidies.

Conclusion and Recommendation

According to the data and the results from the two mentioned patterns, it is seen that these policies in the series of short time have positively impacted the growth of SME turnover, but in the long run there was not any impact on their turnover. This result finds explanation in the informal economy, enterprises do not report profit on one hand, but on the other hand, subsidies are an instrument that can easily be manipulated by a bad government. Their allocation is not done in those sectors where there is a greater profit, or where the criteria for profit are met, instead those who have corrupted the state officials for allocating subsidies. Also, subsidies in Kosovo are small values that do not motivate many citizens to engage in agricultural activities.

Loans seem to be in the middle of gold as they appear to be a good policy, but in Kosovo due to the insecurity and risk of return of loans, banks are reluctant to offer large loans for a long period. Thus, those at the expense of SMEs and the private sector in general, try to reduce their insecurity but also to increase profits as Kosovo is a bargaining market.

The government should pursue a broader policy by enabling citizens more financial support. Also, a strong recommendation comes here, the allocation of funds should be done in sectors where economic prosperity is seen but also the possibilities of expanding that sector to produce goods for export

The banking system now seems to be reflecting on the continuing market demand for reducing credit price. As we have done the research, we have already said that there is a positive trend in private loans and this is expected to affect the level of investment. Also, the amount of loans to SMEs is low compared to their need for funding, but with the establishment of the Kosovo Trust Fund for Credit Guarantee in 2016, thus the number of loans is increasing. In the short term, SME has increased employment. The strength of SMEs to be an engine for new jobs in Kosovo is limited. They need support for larger sums and fewer criteria, so for a more motivating conditions. Otherwise, SMEs in unfavorable conditions and circumstances cannot survive, they only arise and their life cycle is very short. Employment is an instrument through which state agencies manipulate figures to show their growth. In fact, there is an increase in informal scale which is one of the biggest limitations of such analysis in transition countries

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