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ECONOMIC POTENTIALS IN THE NORTH OF KOSOVO

2015



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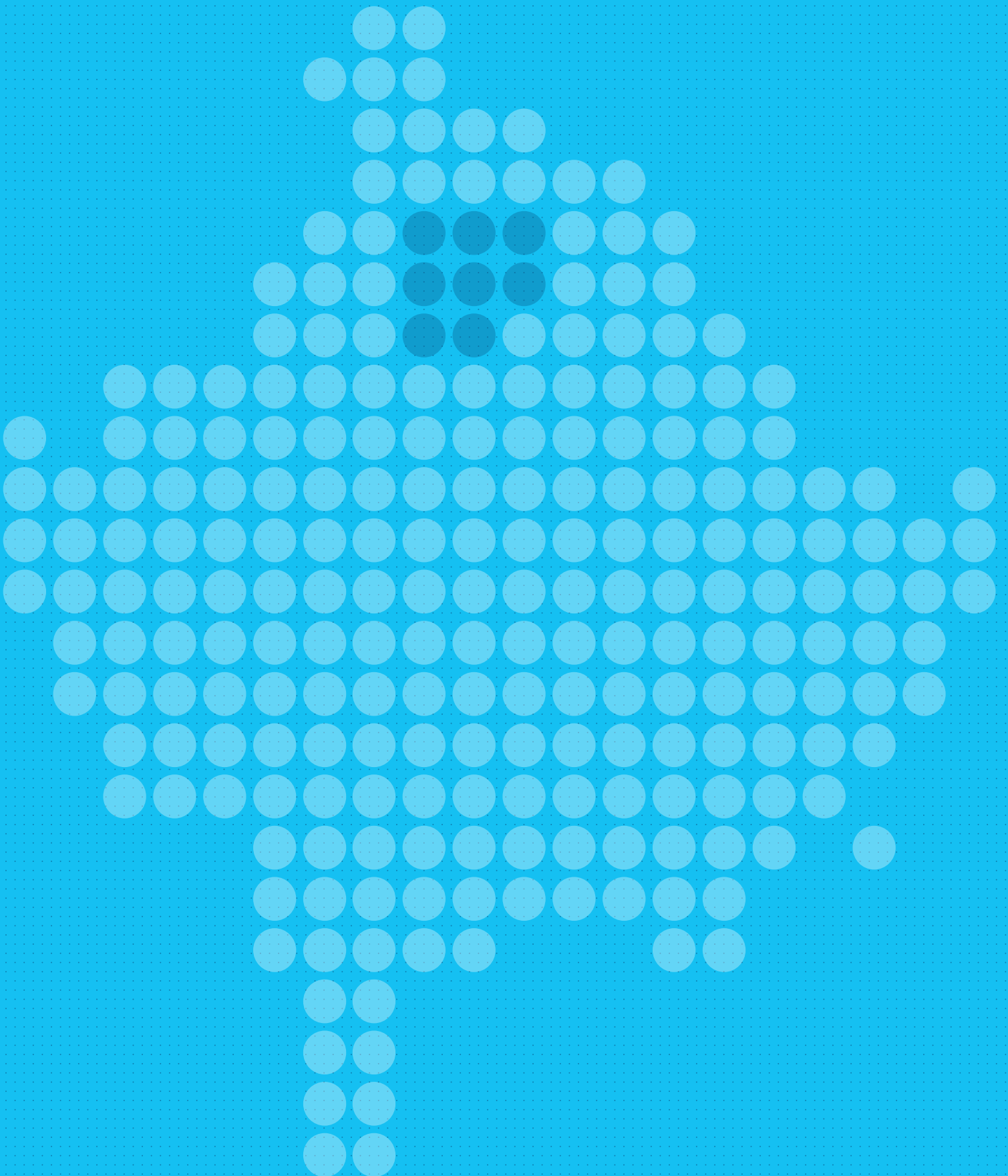
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LIST OF ACRONYMS

BRAK	→	Business Registration Agency of Kosovo
ECMI	→	European Center for Minority Issues
EU	→	European Union
EULEX	→	European Union Rule of Law Mission in Kosovo
FDI	→	Foreign Direct Investment
GDP	→	Gross Domestic Product
IMF	→	International Monetary Fund
KAS	→	Kosovo Agency of Statistics
MSME	→	Micro Small Medium Enterprises
NGO	→	Non-governmental organizations
RDA	→	Region Development Agency
REC	→	Regional Environmental Centre in Kosovo
SME	→	Small and Medium Enterprises
TAK	→	Tax Administration of Kosovo
UNDP	→	United Nations Development Programme
USAID	→	United States Agency for International Development
VAT	→	Value Added Tax



INTRODUCTION

Participation of all ethnic communities in Kosovo's market economy is crucial for sustainable economic development and improvement of the welfare of all citizens. Both economic growth and private sector development are fostered by using all existing potentials that a country has to offer. Since 1999, government institutions together with the international community have marked a significant progress in ensuring political representation of all ethnic communities in Kosovo. However, very little has been done in strengthening the involvement of different ethnic community owned businesses. In this line, the same trend has been seen on the research side. Most of the studies up till now have mainly focused on the business climate and potentials of Kosovo-Albanian businesses. In this way a clear picture of the needs and potential of Kosovo Albanian business has been established. As an example is the Riinvest Institute study on Business Climate in Kosovo (2014) where a survey with 1000 businesses was conducted and potentials and barriers of businesses were analysed. Meanwhile, very little research has focused on depicting and analysing the overall businesses environment, barriers, needs and channels for developments in the four northern municipalities of Kosovo (collectively referred to as the North throughout this study), that are predominantly owned by members of Kosovo-Serbian community.¹

As a result of an unclear picture of business environment in the North, Riinvest Institute together with the Regional Environmental Centre in Kosovo (REC) decided that a thorough assessment of the businesses operating in this part of Kosovo should be conducted. With the support of the European Union Office in Kosovo, a survey with 129 businesses in the North has been administered. The report aims at: (i) providing a detailed description of the business profile of the North; (ii) performance, sales trends and forecast; (iii) opportunities and challenges faced by the businesses; and (iv) inter-business cooperation. By covering all these points, actual business activities and potentials of the North of Kosovo will be depicted. The conclusions and recommendations drawn from this study will help policymakers, donors, civil society organizations and business community itself to understand the development potentials and needs of the private sector in the North of Kosovo.

According to the survey and research results, the following are the main findings:

- ▶ The economic structure of the North is made up almost entirely of small businesses which are mainly family owned and that generate less than €10,000 per year. However, there are also a small number of manufacturing and construction companies whose revenues are higher than €100,000. Sector wise, small wholesale and retail businesses make up most of the market (47 percent), while the rest is composed of other sectors, respectively, manufacturing (15 percent), other service activities (14 percent) and accommodation and food services sector (12 percent).
- ▶ The vast majority of sales of the North businesses, 90 percent, are done locally, around 6 percent are sold in other parts of Kosovo and less than 3 percent of sales are done in Serbia. The main buyers (62 percent) are Kosovo-Serbian households. The average net profit rate for all businesses is 19.4 percent; however, this result varies significantly with some businesses having net profit rates higher than 40 percent. During 2014, almost 47 percent of businesses have experienced a drop in sales by 28 percent on average and 20 percent have experienced sales increase by 20 percent on average. The outlook for 2015 is more optimistic since 31 percent of businesses expect an increase in their sales. Around 31 percent believe that their sales to the Kosovo-Albanian community will increase, 11 percent believe the opposite and 58 percent think that the sales will remain the same.
- ▶ Tax morale among northern businesses, measured on a scale from 0 (never justifiable to avoid reporting taxes) to 10 (always justifiable to avoid reporting taxes), stands at 2.4. Nevertheless, it turns out that 45 percent of sales are never reported for tax purposes.
- ▶ Regarding registration, out of 129 businesses interviewed 75 percent turn out to be registered; with around 31 percent being registered in both the Serbian and Kosovo registry, about 51 percent in the Serbian registry, and 18 percent in the Kosovo registry. Meanwhile, roughly 25 percent are not registered at all.
- ▶ The public services provided by the Kosovo government to the businesses in the North, are rated as "very poor" or "poor" by 69 percent of the businesses. Regarding municipal services, 43 percent of respondents rate them as "very poor" or "poor".

¹ Four northern municipalities include: North Mitrovica/ë, Zvečan/Zveçan, Leposavić/q and Zubin Potok.

- ▶ As to cooperation with other businesses, almost 36 percent of the businesses state that they cooperate informally with other businesses in the North. Around 54 percent of businesses report that they have a high level of cooperation with Kosovo-Albanian owned companies and that cooperation is done informally as well. Hardly any business participates in fairs organized in Kosovo, or is a member of any business association or chamber (i.e. only 14 percent of businesses are members of associations).
- ▶ As per the labour force in the northern municipalities, 66 percent of the workforce is male and only 17 percent has completed university level education. The majority of businesses perceive their labour force to be very good, while only 20 percent think the same for the labour force in the North in general.
- ▶ An important part of this report is the analysis of barriers to doing businesses in the North. The interviewed businesses in the survey were asked to evaluate the severity of 16 potential barriers to business development. The findings show that, as anticipated from sales figures, the top ranked barrier to doing business is market-related due to a small market size. The second highest ranked barrier is an institutional barrier which businesses experience as a result of lack of subsidies. The third highest ranked barrier is unstable supply of electricity. Another highly ranked barrier, 4th, is the political instability. High tax rates and customs tariffs rank relatively high in barriers list, with an intensity score of 52 out of 100, where 100 represents an outright barrier. Poor roads rank as 6th in the list of barriers with 21 percent of respondents believing that poor roads pose a major barrier to business. Some of the very low ranked obstacles are lack of security (with an intensity score of 38), informality and tax evasion (with a score of 36), corruption (with a score of 35), inefficient courts (with a score of 33), and extortion (with a score of 20).

The rest of this report is organized as follows. Section 1 gives an overview of the overall socio-economic situation in Kosovo and in the North specifically. Section 2 provides a general review of the research methodology used to examine the topic of economic potentials in the North of Kosovo. Section 3 presents, discusses, and analyses the findings of the survey on the performance of businesses, barriers to doing business, and on relations between businesses and institutions. The last section concludes and provides recommendations on major findings.

1. SOCIO-ECONOMIC CONSIDERATIONS

This section will present background information on the socio-economic conditions of Kosovo, with a special focus on the four northern municipalities. This section will inform the reader about the main social and economic characteristics of Kosovo. A separate section is dedicated to describing and analysing the social and economic characteristics of four northern municipalities of Kosovo which are North Mitrovica/ë, Zvečan/Zveçan, Leposavić/q and Zubin Potok. Subsection 1.1 presents a political background of the four northern municipalities by first describing the geographic area and the number of inhabitants living in the four municipalities. The subsection continues by explaining how the Serbian Government has maintained its presence in the region until 2011 when the negotiations between the Kosovo and Serbian Government initiated so that the North of Kosovo is integrated. The second part of this subsection describes the result from negotiations in more detail. Subsection 1.2 provides a picture of the economic situation prevailing in Kosovo in general. The subsection provides detailed information on the unemployment figures, growth rate trend and the forecast for the future, private consumption, export, trade balance, current account deficit, balance of payments, remittances received by households, and at last it presents a short description of private sector development in Kosovo. Subsection 1.3 presents the economic situation in the four northern municipalities of Kosovo. This subsection describes the businesses environment and the structure of the businesses in the four northern municipalities and their limited involvement in the country's overall market. In addition, it provides information on private sector development and investment, on assistance received from international donors and governmental agencies, and on unemployment which is a very serious matter. This subsection ends by describing the serious need to integrate Kosovo-Serbian owned businesses in the Kosovo market so that they benefit from a large market size.

1.1 POLITICAL BACKGROUND

Northern part of Kosovo comprises four municipalities, those being North Mitrovica/ë, Zvečan/Zveçan, Leposavić/q and Zubin Potok; it covers an area of 1,539 square kilometres and inhab-

its around 40,000 citizens² primarily consisting of ethnic Serb population with a minor representation of ethnic Albanians, Bosnians and Roma communities.³ Throughout the years, the Serbian Government tried to preserve presence in the North by providing political guidance and governing the local administration through its parallel structures. The Government of Serbia has provided large amounts of funding mainly through infrastructure development projects and workplaces. The provision of salaries and pensions as well as education and health care has been financed by the Belgrade administration.⁴ Law enforcement has been minimal in the northern municipalities, giving way to widespread tax evasion and smuggling. Up to now, integration of the North has been insignificant and the extent of mobility and communication among the four municipalities and the rest of Kosovo has remained limited.

To initiate cooperation and integration of the northern part of Kosovo, the Kosovo and Serbian governments have engaged in a dialogue since March 2011 which is mediated by the European Union (EU). The initial technical talks have resulted in some practical solutions on issues such as trade relations, representation in regional conferences, reciprocal diploma recognition and have touched base on matters of free movement of persons, personal documents and civil registry. The talks on topics of high importance – telecommunications and energy have not produced anything concrete yet. The greatest accomplishment signifies the establishment of two border posts that is controlled by both sides. Still, a lot of issues concerning border regime and customs controls remain unresolved.⁵

The high-level political talks initiated in October 2012 and a series of agreements have been reached since then. On 19th of April 2013 Kosovo and Serbia agreed on working jointly on the implementation of the Ahtisaari Plan throughout Kosovo territory

2 Kosovo Agency of Statistics, "Kosovo Population 2013", 2013

3 USAID, "Assessment of Economic Conditions and Possible Development Projects in Northern Kosovo", 2006

4 Balkan Policy Research Group, "Setting Kosovo Free: Remaining Challenges", Europe Report N°21810, 2012

5 Balkan Policy Research Group, "Serbia and Kosovo: The Path to Normalization", Europe Report N°223, 2013

which has become known as the 'First agreement of principles governing the normalization of relations'. This agreement has resulted in some serious changes on the ground and most importantly has opened the way for the organization of the first local as well as parliamentary elections in the whole Kosovo territory. Indeed, the citizens in the North went out to vote in the local elections held on 3rd of November 2013 and the result was an overall turnout of above 25 percent. The previous municipal assemblies and the mayors of the municipalities were dismissed and on 11th of January 2014, new assembly and municipal bodies in the four northern municipalities (North Mitrovica/ë, Zvečan/Zveçan, Leposavić/q and Zubin Potok) were formally instituted.⁶

Another issue accorded in the 19th of April 2013 Brussels Agreement, signed between the governments of Serbia and Kosovo, is the establishment of the "Community of Serb Municipalities". The elected representatives of the four municipalities have the duty to institute this Community, essentially an association of municipalities with Serb majority in Kosovo, which holds no legislative authority. Yet, its assembly has overview authority on subjects of education, health, economic development, urban and rural planning in line with the European Charter of Local Self-Government and Kosovo law. In addition to the four northern municipalities, the Community includes the south municipalities: Štrpce/Shtërpce, Klokot/Kllokot, Gračanica/Graçanicë, Novo Brdo/Novobërdë, Ranilug/Ranillug and Parteš/Partesh.⁷

The transformation of northern structures into self-governing institutions that are accepted under Kosovo's jurisdiction creates a more suitable situation for both sides, ensuring that the northern municipalities handle issues of community concern and that do not interfere with Kosovo's country-wide politics and territorial integrity. Moreover, continuation of the dialogue and active commitment to implement the Brussels Agreement and all other standing agreements is indispensable in order to come closer to achieving normalization of relations between Serbia and Kosovo. Progress in this matter remains vital for proceeding on the European future of both countries.⁸

1.2 ECONOMIC BACKGROUND IN KOSOVO

The economic state of Kosovo is characterized by continuous impediments and struggles. A high rate of unemployment, for instance, prevails for years now. As stated by the Kosovo Labour Force Survey the unemployment rate stands at 30 percent

in 2013 and around 69 percent of unemployed labour classify as long-term unemployed. Roughly 1.2 million of the total population makes up the working age group (15–64 years), of which nearly 41 percent represent the active labour force. From this percentage of active labour only 70 percent are actually employed. The youth unemployment rate (15–24 years) is worrying with almost 56 percent, as such constituting the highest rate among all age groups. Meanwhile, labour participation rate of the workforce remains very low at around 41 percent which, among others, signals few employment opportunities.⁹ Moreover, there is a high rate of unskilled workers among the unemployed labour, namely about 57 percent. A great number of workplaces in the private sector offer jobs for low-level skilled workers, which surely does not contribute towards the alleviation of this high percentage of unskilled workers.¹⁰ On the other hand, businesses in need of high-level skilled labour are also not satisfied with university graduates' knowledge and skills, claiming that the acquired skills do not meet market needs.¹¹ This brings out the inevitability of additional active labour market policies and vocational trainings as well as the importance of drafting curricula that match current market trends and demands.

Even though Kosovo experiences yearly slight economic growth since 2001 significant sources of sustainable growth are lacking. The growth rate in 2013 is estimated at 2.5 percent,¹² attributed mainly to significant private consumption and slight progress in net exports. Private consumption has strengthened mostly by higher remittances and the progress in net exports is linked to diminished imports rather than improved exports.¹³ In spite of the positive growth, factors such as weak rule of law, poor infrastructure, unfavourable business environment, widespread informal economy, labour market challenges and lack in international competitiveness all hinder a more substantial progress. According to the International Monetary Fund (IMF), Kosovo's Gross Domestic Product (GDP) reaches €5.15 billion in nominal value in 2013 and its GDP per capita €2,794.¹⁴ With this figure Kosovo ranks lowest in the region. The highest GDP per capita is marked in Montenegro with €5,783 and the second highest in Serbia with €5,171.¹⁵

The country continues to experience high current account deficit in its balance of payments mainly since its imports remain extensively higher than its exports. During 2013, Kosovo's cur-

⁶ European Commission, "Kosovo Progress Report", 2014

⁷ European Commission, "Kosovo Progress Report", 2014

⁸ Balkan Policy Research Group, "Serbia and Kosovo: The Path to Normalisation", Europe Report N°223, 2013

⁹ Kosovo Agency of Statistics, "Kosovo Labour Force Survey 2013", 2014

¹⁰ UNDP, "Human Development Report 2012", 2012

¹¹ Riinvest Institute, "Business Climate in Kosovo", 2014

¹² IMF "Republic of Kosovo - Fifth review under the stand-by arrangement", 2013

¹³ European Commission, "Kosovo Progress Report", 2014

¹⁴ IMF "Republic of Kosovo - Fifth review under the stand-by arrangement", 2013

¹⁵ World Bank "Data Bank", 2014

rent account deficit, affected by the negative trade balance, amounts to 6.4 percent of GDP.¹⁶ The trade deficit is €2.1 billion in the same year.¹⁷ Kosovo's total trade as a percentage of GDP is about 66 percent in 2013, showing a decline in openness to trade from 2012, when it stood at about 70 percent. EU and neighbouring countries constitute the most important trading partners with shares of around 44 percent and around 28 percent of total trade, respectively.¹⁸ Expressed in percentage of GDP the trade deficit is about 32 percent in 2013, 2.5 percentage points less than in the previous year. However, exports show a 0.4 percent decrease and imports a 1.2 percent increase in the first half of 2014, worsening the trade deficit by 1.4 percent.¹⁹

Despite the fact that remittances contribute towards narrowing of the country's current account deficit, they also remain an essential source of income to Kosovan citizens. Around 22 percent of households accept payments and transfers from abroad-living family members. This figure follows the positive trend that has lasted for years now. In 2013, remittances reach €632 million and represent 11 percent of GDP. This number is considerably higher than in the previous year when it was €457 million.²⁰ As is made evident by these figures, remittances stand as one of the main positive contributors to the balance of payments and more specifically private consumption in Kosovo.

Kosovo's private sector keeps on displaying a weak performance and remains far from reaching its full potential. According to the Tax Administration of Kosovo (TAK) 105,000 businesses are registered with the Business Registration Agency of Kosovo (BRAK); however, only 68,309 represent active businesses (as of September 2014). Newly registered businesses in 2013 follow the slow trend of registration with only 9,421 establishments, indicating a decline by almost 2 percent. Whereas the number of businesses closing down in 2013 reaches 1,508 as such showing an increase of around 28 percent from the preceding year.²¹ The low number of new business establishments more often than not is unable to perform in this business environment and closes down short after set up. According to Riinvest Institute's report on Business Climate, roughly 92 percent of businesses represent micro-enterprises, with 1-9 employees and typically family owned.²² During 2013, the private sector as a percentage of GDP persists at approximately

70 percent.²³ Kosovo businesses are indeed suffering from the market conditions greatly. Figures emerging from a 2013 Riinvest Institute survey show that an average of 54 percent of businesses experience decreased sales, that is a roughly 34 percent decrease. Whereas, only around 21 percent of businesses declare sales increase by nearly 22 percent (and 25 percent declare no changes).²⁴ Overall, the private sector continues to be underdeveloped, fragmented, with low domestic production rate and incapable of attaining valuable economies of scale. Due to weak law enforcement, informality is widespread, hampering fair competition and overall business environment.²⁵

1.3 ECONOMIC CONDITION IN THE NORTH

Businesses in the North take a minor role in Kosovo's economy due to their limited involvement in the country's overall market. Formerly a prosperous business environment with various natural resources industries and high employment rates in the related sectors; now the mining and related industry generates insignificant output and employs a small number of labour. Large private sector investment is missing in the region and noteworthy assistance comes mainly from international donors and governmental agencies. The economic state in the four municipalities is problematic, since they are mostly dependent on Serbian institutions; face low income and high unemployment rates; experience political instability and are prone to informal market economy.

Unemployment is a serious matter of concern in Kosovo and even worse so in the North. From the approximate total population of 40,000 it is estimated that almost 65 percent signify the working age population (15-64 years) and only nearly 37 percent are active in the labour force. Roughly 35 percent of this labour force is unemployed, meanwhile the rest are actually employed.²⁶ A great part of the active labour force consists of temporary non-permanent workers, who are usually inclined to work on a short term basis and more often than not find themselves without jobs, as such experiencing high economic insecurity. A considerable number of citizens, especially the young generation, do not speak Albanian and many citizens lack the right skills, mostly due to the limited education and training opportunities in the area. The inability to communicate and integrate and the limitations of capacities make it much

16 Central Bank of the Republic of Kosovo, "Macroeconomic Developments Report", 2014

17 Riinvest Institute, "Business Climate in Kosovo", 2014

18 World Bank, "Trade (% of GDP)", 2014

19 Central Bank of the Republic of Kosovo, "Macroeconomic Developments Report", 2014 and European Commission, "Kosovo Progress Report", 2014

20 Kosovo Agency of Statistics, "Study on Remittance in Kosovo", 2013

21 Central Bank of the Republic of Kosovo, "Macroeconomic Developments Report", 2014

22 Riinvest Institute, "Business Climate in Kosovo", 2014

23 European Commission, "Kosovo Progress Report", 2014

24 Riinvest Institute, "Performance, Barriers and Trust of Businesses in Kosovo", 2013

25 Ibid.

26 Kosovo Agency of Statistics, "Kosovo Population 2013", 2013 and Aktiv, "An inquiry into the economic situation of north Kosovo businesses", 2013

more difficult to access employment opportunities and acquire a steady job. According to the survey on Socio-economic conditions in the North conducted by the European Center for Minority Issues (ECMI), around 47 percent of labour in Leposavić/q, around 62 percent in North Mitrovica/ë, about 49 percent in Zubin Potok and about 56 percent in Zvečan/Zveçan state that they are employed in a workplace not related to their field of study. The public sector is very much pursued owing to its security and level of income with approximately 41 percent employed in this particular sector and roughly 59 percent in the private sector.²⁷

The economic structure of the North is made up almost entirely of Micro Small Medium Enterprises (MSMEs). Moreover, according to the Riinvest Institute report "Improving the Kosovo-Serbian Business Community Involvement in Economic Activities in Kosovo" which surveyed 300 businesses, of which 200 where Kosovo-Serbian, about 93 percent turn out to be individually-owned family businesses. Their focus is principally on local markets, and retail (with around 22 percent), agriculture (around 21 percent) and food processing (around 11 percent) represent the dominant sectors.²⁸ Besides, construction, wood processing, tourism and services constitute emerging sectors with high growth potential. In terms of shares of turnover, the main economic contributors are businesses providing services and trade, with around 76 percent, while businesses engaged in production and processing participate with roughly 24 percent. A positive figure of around 59 percent of companies experience long term growth rates in turnover and with a majority of these being active for more than 5 years these businesses can account for steady market operators. According to the Riinvest Institute report "Improving the Kosovo-Serbian Business Community Involvement in Economic Activities in Kosovo" around 52 percent of the businesses in the North had a turnover greater than €50,000 in 2010.²⁹

In general, the private sector in the North developed in spite of the difficult business environment.³⁰ Nevertheless, further advancement is hampered by factors such as inward orientation - merely 20 percent of businesses engage in trade beyond their local market; legal status - as much as 75 percent of companies remain unregistered and only as few as 19 percent are registered with the Kosovo business registry; and most significantly lack of a key economic driver - foreign direct in-

vestment.³¹ Meanwhile, Riinvest Institute report conducted in 2010 found that around 65 percent of businesses in the North were registered in the Business Registry of Serbia, 32 percent in both registries and only 2 percent were registered in the Kosovo Business Registry.³²

Those few businesses that do exhibit an outward orientation target almost equally Serbia, other parts of Kosovo and other regions with a majority of Kosovo-Serbian community in the south. Nevertheless, companies are aware of the potential of the outer trade and an increasing number of them are preparing to enter these markets. The south Kosovo market is indeed considered the most relevant market, surpassing the Serbian market. The Kosovo-Serbian community in the South is of particular interest to the North counterparts; however, entry into this market is more difficult. Besides, over the years issues such as loss of reputation or personal risk associated with trading with the south are weakening and focus is put on potential economic gains, such as increasing revenue and profitability. Businesses of the North expect positive growth rates from entering the south market along with decreasing formal and informal impediments and improving political climate. Furthermore, the same study found that Kosovo-Serbian businesses considered economic growth in Kosovo as the main factor influencing cooperation between the two different communities of Kosovo, followed by potential for increase of economic benefits through cooperation and establishment of regional and central business networks between all business communities in Kosovo.³³

Businesses in the North recognize the importance of outward trade and the relevance of their target markets, nevertheless they face restrictions in trading with the South. Perceived risk from the particular conflict situation is an undeniable obstacle to doing business. However, other more concrete factors hindering the process are imperfect market information, lack of business linkages, limited access to markets and limited access to finance. Only an insignificant number of businesses is able to acquire loans while the majority of businesses in the North invest by their own means, hence, facing restrictions to growth. Other important barriers to cooperation are considered language, lack of security, black market/organized crime and trust. In addition, it is difficult to enter the south market since it is considered more competitive. North Kosovo faces constraints to competitiveness owing to deficiencies in basic economic foundations such as: poor infrastructure, inadequate technology, weak institutional structures, administrative burdens, widespread corruption, extensive smuggling and black

27 European Centre for Minority Issues, "Socio-economic conditions in the North", 2013

28 Aktiv, "An inquiry into the economic situation of north Kosovo businesses", 2013

29 Riinvest Institute, "Improving the Kosovo-Serbian Business Community Involvement in Economic Activities in Kosovo", 2012

30 Aktiv, "An inquiry into the economic situation of north Kosovo businesses", 2013

31 Ibid

32 Riinvest Institute, "Improving the Kosovo-Serbian Business Community Involvement in Economic Activities in Kosovo", 2012

33 Riinvest Institute, "Improving the Kosovo-Serbian Business Community Involvement in Economic Activities in Kosovo", 2012

market, economic distortions caused by Serbian market interventions, and lack of skilled workers.³⁴

In view of the difficult business climate, the North receives assistance and direct support from diverse donor organizations. EU Office in Kosovo, United States Agency for International Development (USAID), Mercy Corps as well as the Government of Serbia represent the largest contributors throughout the years; though countless organizations have made donations on a smaller scale as well. Support is mostly granted in the form of direct financial funding (mostly in the form of grants) and equipment and machinery. Assistance is also given in the form of facilitating access to credit, which is very important to local firms considering the constraints put by the banking sector. Much needed training, workshops and technical consultancy to businesses, however, still remain insufficient. Even though support as such is not absent, a systematic institutional approach, with joint government, private sector and donor involvement, is necessary to achieve substantial business development and sustainability.

Improved market conditions of businesses in the North and access to the broader Kosovo market is a crucial factor for economic growth as well as social and economic integration of the four municipalities. In this context, the identification of potentials and promising business initiatives of northern Kosovo companies, as is intended by this report, allows for the development of relevant programs and projects to address these matters.

³⁴ Ibid.



The core data were collected through a survey involving **129 firms** – approximately **30 businesses** for each municipality in the North of Kosovo.

2. METHODOLOGY

This section provides a general description of the methodological approach used for the study. In order to scan the general business environment in the four northern municipalities of Kosovo and assess businesses' needs; opportunities and challenges the research team relied mainly on a survey of businesses located in these areas. Combining these techniques, the team collected both quantitative and qualitative data.

The core data were collected through a survey involving 129 firms – approximately 30 businesses for each municipality in the North of Kosovo. The businesses were selected, verified and validated by the research team in consolidation with the local experts. The database included 250 active businesses. The database contained sufficient information profiles for each business, including sector, size, and location – based on which the stratification was made. The sample size of 150 businesses in total in the North of Kosovo was large enough to provide statistically significant results at 95 percent confidence level.

The process of designing the questionnaire involved Riinvest research team. The questionnaire contained three main sections, which focused on: (1) business performance and barriers of firms in the North municipalities; (2) the forms of doing business in the North; and (3) relevant questions related to the labour force in the aforementioned municipalities. Before the survey was released to be fully conducted, it was initially tested with 5 businesses to see if the questionnaire had visible 'defects' or if certain questions needed to be modified in order to obtain true answers from the respondents. In addition, the team tested the duration time where it revealed that the survey lasted around 20 minutes.

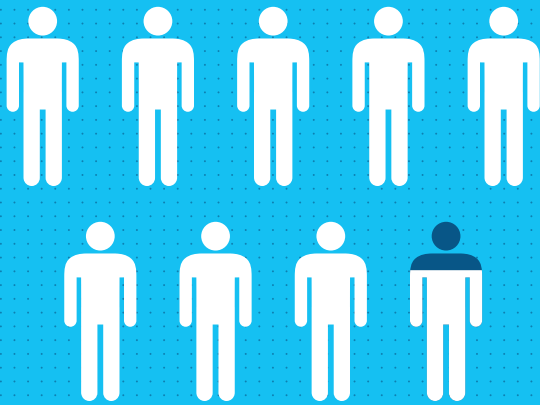
The company survey was implemented by a total of 6 enumerators that were assigned to the four municipalities in North of Kosovo, that of Zubin Potok, Mitrovica/ë, Zvečan/Zveçan, and Leposavić/q. All enumerators received proper training that prepared them for data-collection, questionnaire specification and other requirements. More specifically, enumerators received a survey-specific training manual explaining the importance and the overall goals of the survey. Additionally, clarifications were given for each question included in the questionnaire. The enumerators were led by a consultant with long-standing experiences in the respective municipality and the project leader. The project leader revisited 15 percent of the respondents for each enumerator, ostensibly to thank them for their cooperation. During these visits, selected questions that were considered most crucial to the research were re-asked for

verification. Apart from monitoring them in the field, a similar verification process was carried out by phone by the research team and project leader. Around 40 percent of surveys, selected randomly, were re-verified by the Riinvest Institute research team, which called respondents and ensured that answers corresponded to the ones filled in by the enumerators. Additionally, each questionnaire was verified by researchers to check if there was any irrational answer with previous claims. This helped detect and consequently avoid potential defects within the survey.

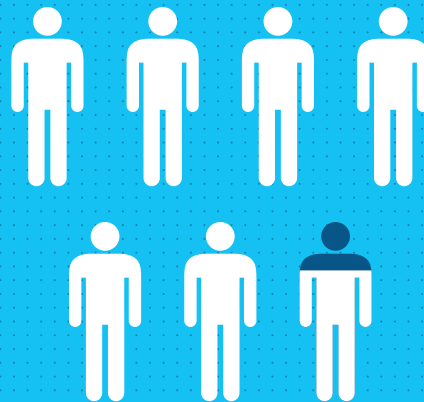
Once collected, the data was encoded by experienced personnel using EXCEL spreadsheets prepared with the data fields and pop-up tables indicating relevant codes. Next, the data were analysed and pre-interpreted using SPSS to identify responses outside of expected ranges, including potential inconsistencies across variables. Changes were made as appropriate. Additionally, periodic checks were made by the project leader, primarily through comparing variable means and distributions across files, to ensure that the data have not been altered, intentionally or otherwise. The research analyses in this report are predominantly based on descriptive statistics using cross tabulation techniques.



The average number of employees in the four northern municipalities is **8.8**



...meanwhile that number for the whole Kosovo is **6.8**.



3. DOING BUSINESS IN THE NORTH

This section will describe and analyse the output of the quantitative part of the study, the survey conducted with 129 businesses operating in the North of Kosovo. Subsection 3.1 describes and analyses the business setting in the northern municipalities. This subsection provides a detailed picture on the structure of businesses in the North, size, sector where they operate, yearly revenues, yearly net profit rate, and employment figures. The data presented are analysed and compared with Kosovo data. In addition to comparing the data with the rest of Kosovo, several cross tabulations have been performed to analyse the findings in more detail and to see if specific factors such as firm size affect more certain conditions. This subsection presents also information on past sales and sales projection. It also presents the perceptions of businesses regarding their future sales to both the Kosovo-Albanian and Kosovo-Serbian community and as to which market do they see primary. This subsection presents also interesting findings on the sources of revenue for the businesses. Subsection 3.2 presents and analyses the barriers faced by businesses in the North. The survey asked the businesses to indicate the severity of 16 potential barriers to business development. Kosovo-Serbian firms were asked to rate each obstacle in terms of intensity. Scores for each obstacle can range from a minimum of 20 up to a maximum of 100, with higher scores indicating greater level of negative impact to businesses³⁵. Besides presenting the main barriers faced by businesses, this section also analyses and provides arguments as to why the barriers have been ranked in such a way by businesses. Subsection 3.3 talks about tax evasion and tax morale in the North. This section provides information on the percentage of sales that are not reported for tax purposes, and how do businesses interviewed feel about not reporting taxes. The data received are analysed and compared with Kosovo data. Subsection 3.4 presents the perceptions of businesses interviewed regard-

ing public services provided and inter-business cooperation. This section provides information on which business registry are the businesses registered, the Kosovo registry or Serbian Registry and to which institutions do they pay taxes. In addition, the subsection provides information on the satisfaction level of businesses with public services such as utilities, roads, municipality services, and government services. This subsection also presents the level of cooperation that businesses in the northern municipalities have and their participation in fairs, seminars or business to business meetings. Subsection 3.5 presents information in the labour force in the four northern municipalities. It describes the gender balance and analyses the level of satisfaction of these businesses with their own labour force and their perceptions about labour force in the North in general. It also presents the most important issues faced by businesses in hiring qualified staff. Similar to the other sections, this section compares the data on labour force in the northern municipalities with the general data on Kosovo.

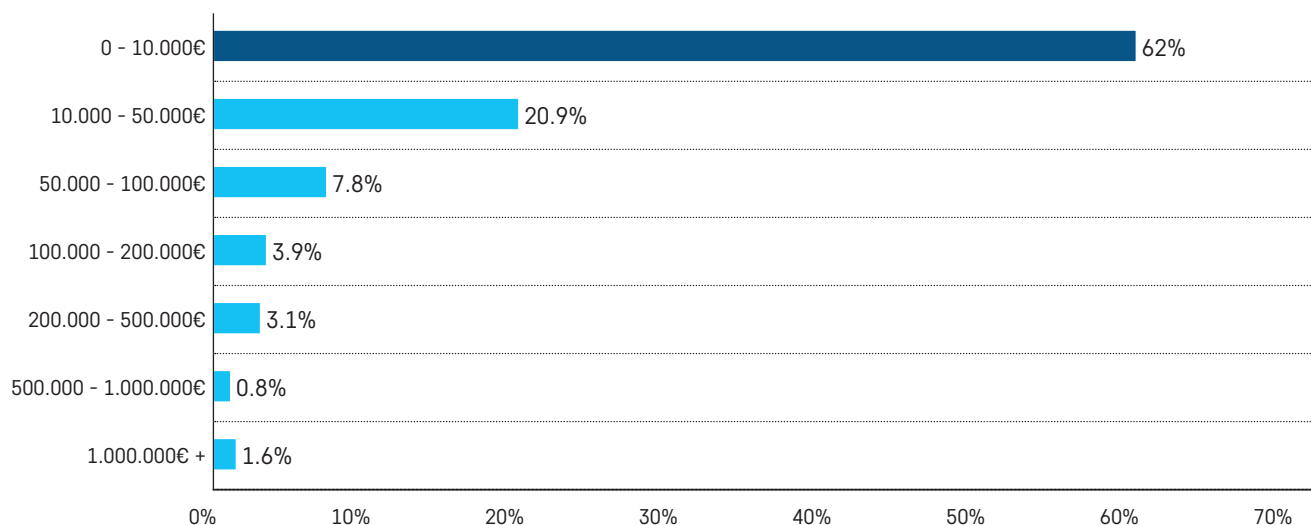
3.1 BUSINESS SETTING

The business setting in the North of Kosovo is characterized by mainly small firms, owned solely by one person. Most of the interviewed owners, 79 percent, are male while the rest are female with an average age of 43. Around 51 percent have completed university education, 48 percent high school and 1 percent has completed only primary education. Most of the surveyed firms generate under €10,000 in revenues and operate in the wholesale and retail trade category (47 percent). Around 15 percent operate in manufacturing, 14 percent in other service activities, 12 percent in accommodation and food services sector and the rest operate in other sectors. There are a few large businesses, especially in manufacturing and construction sector, whose revenues are higher than €100,000. Except for some manufacturing, construction, and some service providing businesses, all other businesses are focused on trade activities. This has many implications for the future of the economy in the North. When production comes to a halt, and the economy is fuelled by trade activities, the economy operates through inertia with an ever-slowing trend.

35 For each obstacle, the rank given by each enterprise (from 1-5) is multiplied by a weight equal to the rank (also 1 to 5), i.e., the more serious obstacles get a higher weighting). The weighted average is then divided by 5 (the maximum rank) and multiplied by 100 in order to convert the score into a percentage showing how close to the maximum ranking the average rank is. In other words, the score s was calculated as: $s = (\sum w_i x_i / n) * 100 / 5$, with $w_i = x_i$; s is the score for the intensity of each obstacle, w is the weight, x is the ranking given by each respondent and $i=1,2,\dots,n$ stands for each respondent.

FIGURE 1: REVENUES BY BUSINESS SIZE FOR 2014

SOURCE: AUTHORS' CALCULATIONS



These figures can be compared with the general Kosovo figures by using the data from “Business Climate in Kosovo”, a Riinvest Institute study done for the first time with 1,000 businesses in the five regions of Kosovo (200 businesses from each region were surveyed) and financed by European Union Office in Kosovo. The figures are comparable since the same methodology was used for both studies. Similar to the North, the Kosovo market in general is made up of mainly small businesses with the majority (around 74 percent) making less than €50,000 per year. However, slight differences can be observed when comparing with higher ranges, for example the national average for €50,000 - 100,000 range is 11 percent, meanwhile in the northern municipalities it is slightly less, standing at almost 8 percent. Around 6 percent of businesses in Kosovo fall in the €100,000 - 200,000 range, while almost 4 percent of the businesses in the northern municipalities fall in the specific range. Around 8 percent of businesses in Kosovo generate more than €200,000 in sales while around 5 percent of northern businesses generate such an amount or more (see Figure 1).

The average number of employees in the four northern municipalities is 8.8; meanwhile that number for the whole Kosovo is 6.8.³⁶ It is interesting to note that the average number of employees for the four municipalities is a bit higher since only Leposavić/q reported an average number of 22.5 employees, meanwhile the other three municipalities North Mitrovica/ë,

Zubin Potok, and Zvečan/Zveçan reported to have on average 2.5, 6.1, and 4.5 employees, respectively. One explanation as to why companies from Leposavić/q reported a higher number of employees is the existence of larger firms such as production/manufacturing firms. Additionally, Leposavić/q is the largest municipality from the northern ones and has the largest number of full time employees compared to the other municipalities.³⁷

The average net profit rate for all businesses is

19.4%

The average net profit rate for all businesses is 19.4 percent; however, this result is significantly skewed (the mean falls short of the median). As seen in Figure 2, most businesses have a net profit rate between 10 and 20 percent; still some businesses perform incredibly well with net profit rates above 40 percent. Of course, this only includes businesses that have managed to thrive and to stay in business. It is in the nature of regions not very prone to business making to have some very well performing businesses, but this is not necessarily a good thing. These businesses very often reach a high level of performance

by pushing out competition through illegitimate means such as unfair business practices, thus making it difficult for start-ups to succeed. A slightly higher net profit margin, 22.2 percent, is reported by businesses in Kosovo. However, 70 percent of businesses in Kosovo report an average net profit margin between 8 to 26 percent meanwhile in the northern municipalities around 40 percent of businesses have an average net profit rate between 0 to 40 percent.

³⁶ Riinvest Institute, “Business Climate in Kosovo”, 2014

³⁷ Aktiv, “An inquiry into the economic situation of north Kosovo businesses”, 2013

FIGURE 2:

SOURCE: AUTHORS' CALCULATIONS

THE AVERAGE NET PROFIT BY FIRM SIZE (IN %)

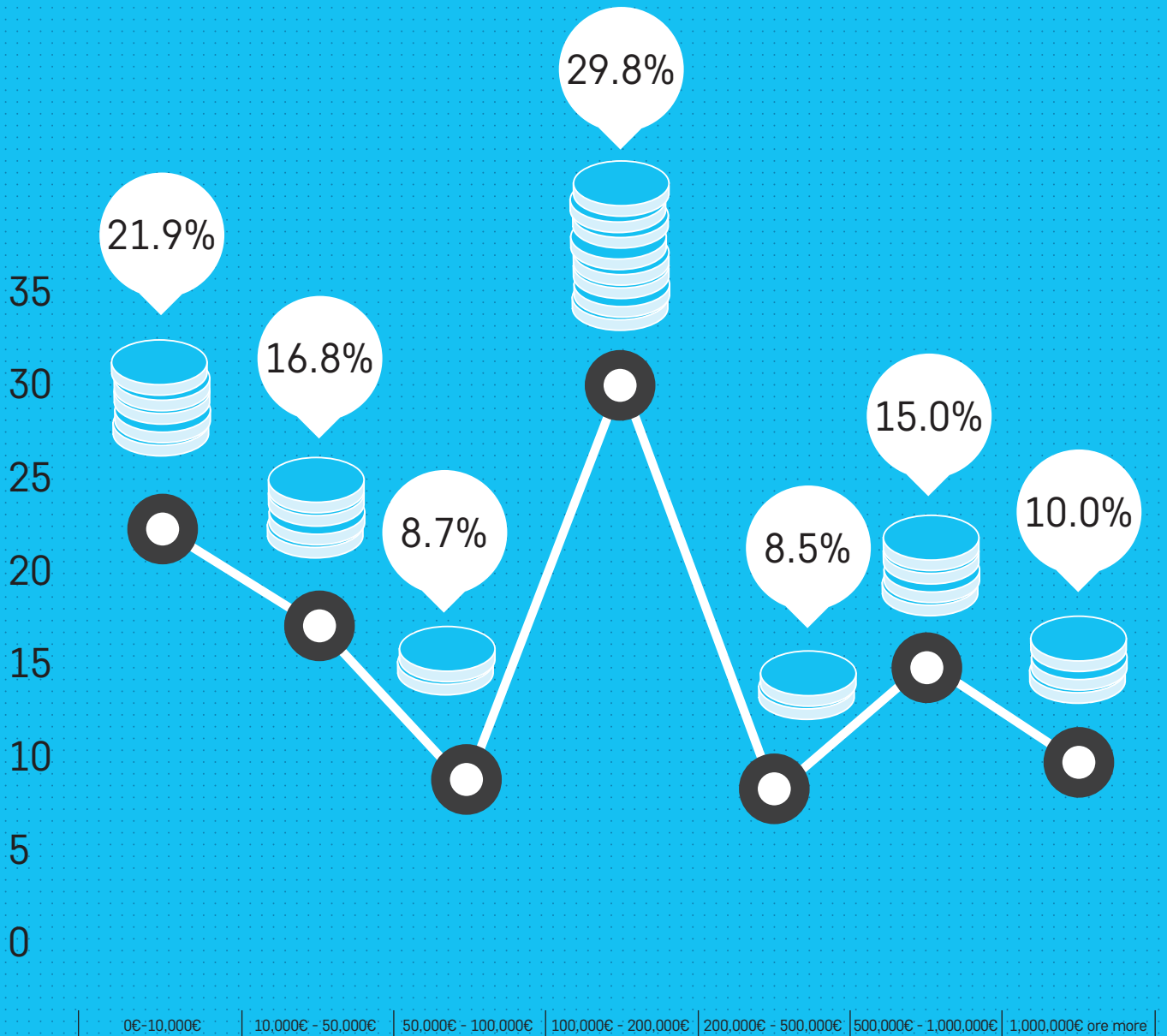


Figure 3: Sales in 2014 compared to previous year

SOURCE: AUTHORS' CALCULATIONS

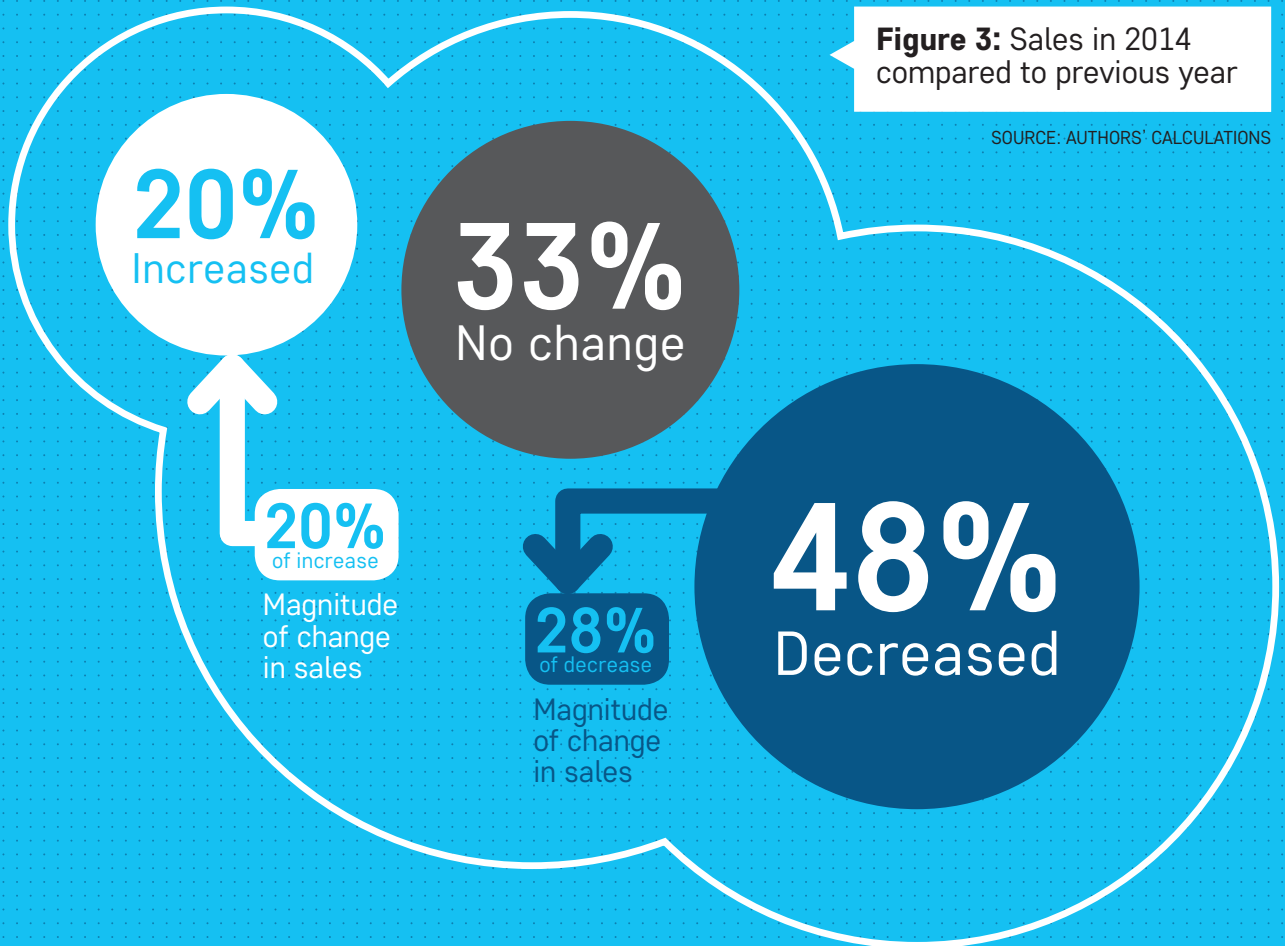
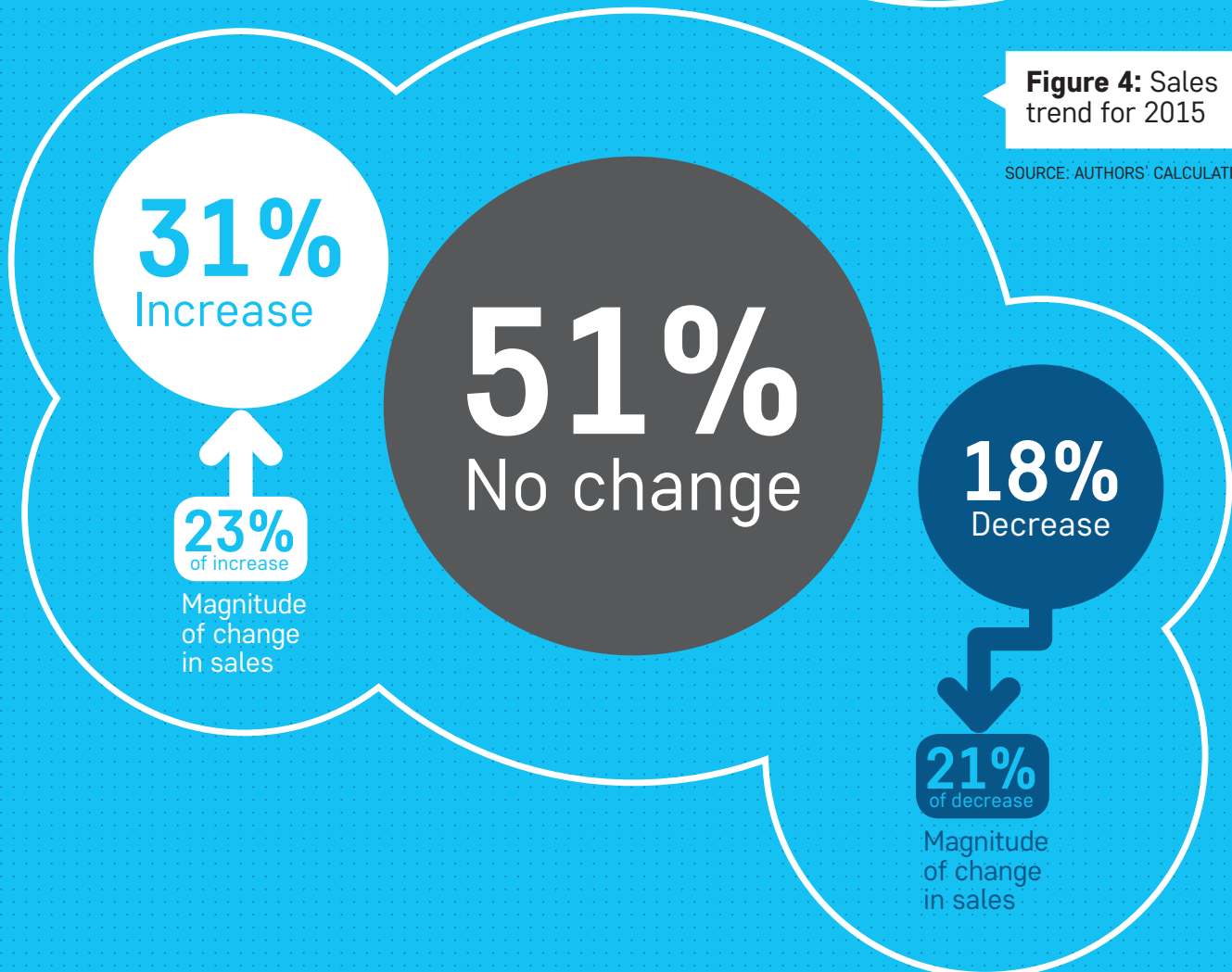


Figure 4: Sales trend for 2015

SOURCE: AUTHORS' CALCULATIONS



There seems to be some correlation between net profit rate and the size of the business with smaller businesses yielding a higher net profit rate. The same has also been noted with the general picture of the businesses operating in Kosovo. Larger businesses are generally more interested and can afford to care about long-run sustainability rather than short-run profit. Small businesses on the other hand invest very little and since the owners time is not accounted as a cost but yields return, and it is a significant part of the business, the net profit rate is higher. Moreover, another explanation as to why small businesses have higher net profit margin is that they tend to have smaller fixed costs compared to larger businesses.³⁸ However, the correlation is inconclusive.

Regarding the sales trend, almost half of the businesses have seen their sales decline in 2014 compared to 2013 (47 percent). The average decrease rate of sales for these businesses has been 28 percent. 33 percent have seen no change in sales, and 20 percent have seen an increase. The average increase in sales for these businesses adds up to 20 percent (as depicted in Figure 3). However, the outlook for 2015 is more optimistic for these businesses. Figure 4 shows that the percent of business expecting an increase in sales is much higher, 31 percent.

The majority, 51 percent, expects no change, while only 18 percent of the businesses expect the sales to decrease. The businesses that expect their sales to increase believe that the average increase rate will be, on average, 23 percent. For the businesses that expect the sales to decrease, the decrease rate they believe will be, on average, about 20 percent.

If we compare this result with the rest of Kosovo we get a few differences. According to the 2014 Riinvest study,³⁹ 27.4 percent of businesses have experienced an increase in sales in the last four years with the average net increase standing at 19 percent. Businesses in the North have experienced a similar rate of increase (20 percent), however, fewer of them have had an increase in sales (20 percent). About the same percentage of businesses have seen a decrease in sales in the North and in the rest of Kosovo, 47 percent and 45 percent, respectively. The rate of decrease in sales has also been about the same, 28 percent and 26 percent, respectively.

It is interesting to note the type of businesses which have experienced an increase in sales. On the largest sector, wholesale

and retail trade, only 13 percent of businesses have experienced an increase. This falls well short of the mean. The businesses that have pulled the average up are the manufacturing and the construction sectors. In these two sectors about a third of all businesses have seen an increase in sales. The explanation behind this discrepancy in the types of businesses and what percentage of them are doing better in each industry boils down to competition and the barriers of entry. The wholesale and retail trade sector is very competitive since it has lower entry barriers; businesses go in and out of business without major risks and lose which fosters competition. This doesn't allow a large number of firms to have a steady increase in their sales.

On the other hand, sectors such as manufacturing and construction have very high entry barriers so they businesses are either performing well or they go out of business and the ones that continue their operations are hardly threatened by start-ups. So the difference is not necessarily explained by "which sectors are thriving" but rather in which sectors we have competition, and in which sectors we have well-established players that do not face much risk. There is also stark difference in the percentage of businesses that have experienced an increase in sales depending on their size. Only 1 business with sales of over €100,000 has seen an increase in sales.

The story is about the same for small businesses with sales under €10,000, only 16 percent of them have seen an increase in sales. The best performing businesses in terms of sales are the mid-range businesses with sales between €10,000 and €100,000. A third of these businesses have seen an increase in sales. The analysis of sales performance with sectors and business size gives us pretty much the same picture. The municipalities of Leposavic and the north of Mitrovica have much more businesses with increasing sales, 33 percent and 35 percent, respectively. The municipalities of Zubin Potok and Zvecan have way fewer businesses with increasing sales, 10 percent and 15 percent, respectively. There is also a difference between businesses with university educated owners and the less formally educated. The former have led businesses with increasing sales much more than the latter, 28 percent and 13 percent, respectively.

The stark difference between the North and the rest of Kosovo is noticed in the business sales forecast. 45 percent of businesses in Kosovo believe that their sales will increase, while only 31 percent for the businesses of the North believe the same. This is a clear indicator of the pessimistic outlook of the North compared to the rest of the country. The difference coefficient is most certainly explained by the political uncertainty that the market and the businesses face. The political uncertainty is reflected in less investment, less creditor support, and less economic activity in general.

47%
of the businesses have reported a decrease in sales in 2014 compared to 2013.

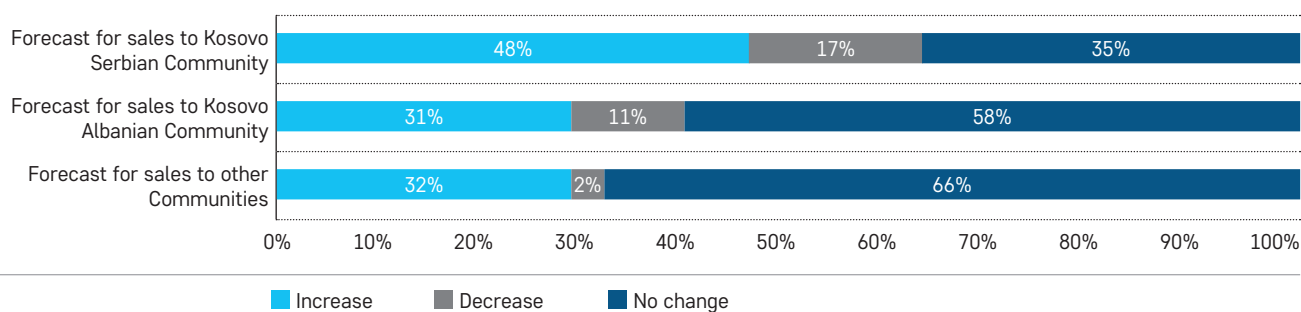
The outlook for 2015 is more optimistic; only 18% of the businesses expect a decrease in sales.

³⁸ Riinvest Institute, "Business Climate in Kosovo", 2014

³⁹ Riinvest Institute, "Business Climate in Kosovo", 2014

FIGURE 5: SALES FORECAST FOR 2015 BY COMMUNITIES (IN %)

SOURCE: AUTHORS' CALCULATIONS



While the sales trend differs across industries, the forecasting is pretty much constant throughout the sample. The standard deviation is very low. We saw that manufacturing and construction had high above average number of businesses with increasing sales, the forecasting for the future however it's the same across the board. About the same holds true when tabulating businesses expecting an increase in sales against the firm size. There is a slight tendency for fewer larger businesses to expect an increase in sales, however, it is insignificant. There is not statistically significance between businesses of different size in their expectations of sales. There is difference however across municipalities. A very low percentage of businesses in the municipalities of Zubin Potok and Zvecan expect an increase in sales, 15 percent and 31 percent, respectively. On the other hand, 41 percent of businesses in Leposavic expect an increase in sales, and 70 percent of the businesses in the North of Mitrovica expect the same.

Around 48 percent of businesses believe that their sales to the Kosovo-Serbian community will increase, 17 percent believe that the sales in the particular community will decrease and 35 percent see no change. Meanwhile, it is interesting to note that around 31 percent believe that their sales to the Kosovo Albanian community will increase, 11 percent believe that their sales will decrease and 58 percent think that their sales to Kosovo Albanian community will remain the same (see Figure 5). This shows a positive change towards the desire to integrate in the Kosovo market since businesses have started to understand that access to a bigger market means more profit for them.

Compared with the results of the study done by Riinvest in 2012, around 70 percent of Kosovo-Serbian businesses saw their local area where they lived as their potential market for the future. Meanwhile, only 20 percent of them saw the Kosovo market as their target. Additionally, the same report revealed that in 2012 the perception of Kosovo-Serbian businesses was that Kosovo Albanians don't want to do business with them although their products were competitive both in price and

quality. Analysing the information from Figure 5, one can note that the expectations to sell to Kosovo Albanian market have increased since 2012. In 2014, businesses reported that they expect their sales to Kosovo Albanian community to increase by 31 percent.⁴⁰

Figure 6 confirms that the North is pretty much an isolated economic unit. Almost all products and services, 90 percent, are sold locally. Less than a tenth are sold in the other regions of Kosovo and in Serbia, 6 percent and 3 percent respectively, and hardly any are exported in other countries. One reason for this is that half of the interviewed companies are very small, generating under €10,000 in revenues. Another reason is that businesses from North do not feel confident to sell their products in other parts of Kosovo. They are mainly concentrated in 4 northern municipalities.

The North is pretty much an isolated economic unit with 90% of products and services sold locally.

The figures are comparable with the rest of Kosovo. The regional business climate study shows that 87 percent of sales in the rest of Kosovo are realized within the municipality (region). Only 11 percent of sales are realized in the other regions of Kosovo, and the rest are exports. However, this does not necessarily mean that the North is just as much integrated in the Kosovo market. As the vast majority of sales are always expected to be realized within the municipality, the small differences are in reality not that small. If for example we take for granted that only about a fifth of sales are expected to be realized outside the municipality, then the difference between 87 percent and 90 percent is not small at all. The business climate study also presented the North as the region with most sales within the municipality. So the story behind the numbers is not written in absolute values, but in margins. The North remains closed within itself in terms of economic activity.

40 Riinvest Institute, "Improving the Kosovo-Serbian Business Community Involvement in Economic Activities in Kosovo", 2012

FIGURE 6: DESTINATION OF SALES BY REGION (IN %)

SOURCE: AUTHORS' CALCULATIONS

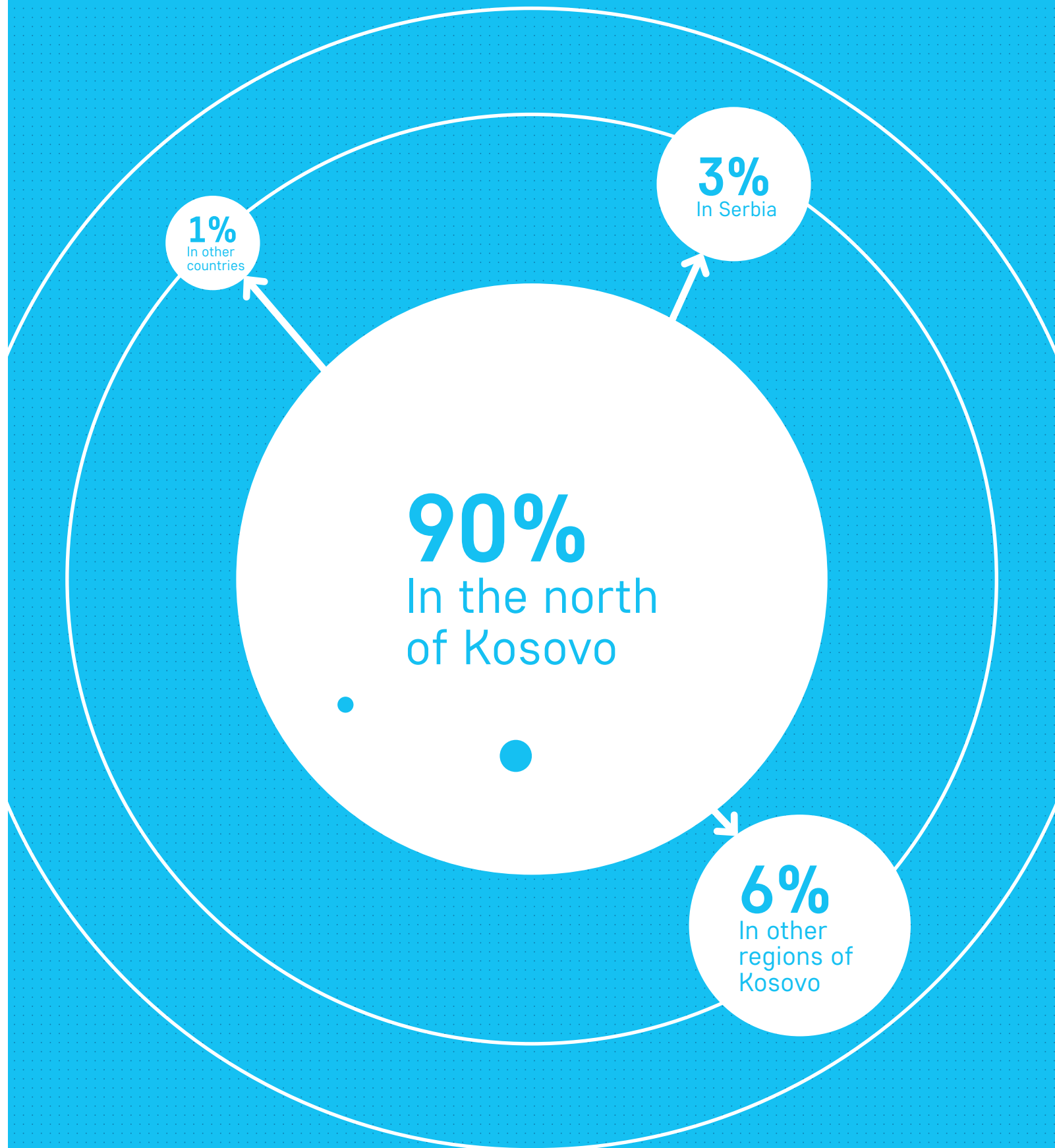


FIGURE 7: SOURCES OF REVENUE BY TYPE OF BUYER (IN %)

SOURCE: AUTHORS' CALCULATIONS

62%



Serbian Households

16%



Kosovar Households

8%



Serbian Businesses

7%



Serbian Government

3%



Kosovar Businesses

3%



Other

1%



Kosovar Government

This is also related to the business structure of the North as most business is trade or services related rather than production. This means that the figure of 90 percent sales within the North is to a large extent made up of imports or non-tradable services (i.e. construction). It is interesting to note that for the sales not realized in the North, there are more so in other regions of Kosovo than in Serbia. Still, even though these are Serb-owned businesses they sell more in Kosovo than they do in Serbia.

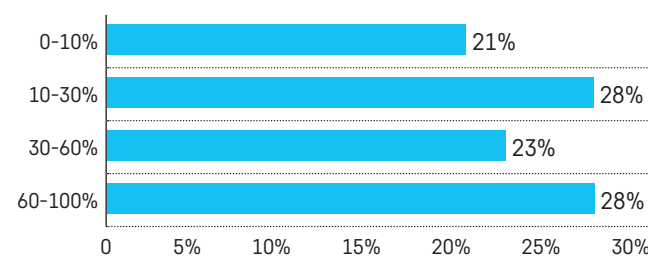
Regarding the sources of revenue, as depicted in Figure 7, almost 62 percent come from Serbian households, and 16 percent from Kosovar households. The rest of the revenues are generated from Serbian businesses (8 percent), Serbian government (7 percent), Kosovo businesses (3 percent) and Kosovo government (1 percent). This trend is not surprising since majority of sales are done in the North where the population is almost all Kosovo-Serbian. It is also worthy to note the presence of Serbian government in this part of Kosovo as they constitute 7 percent of buyers. Overall, three-fourths of sales are realized by Serb households, Serb businesses, and Serb government. Only a quarter is realized from Kosovo Albanian households, businesses, and government.

Regarding the characteristics of businesses that earn 16 percent of their revenues from Kosovar households, 23 percent are from Leposavić/q, 20 percent from Zubin Potok, 29 percent from Zvečan/Zveçan and 29 percent from North Mitrovica. One reason as to why Zvečan/Zveçan and North Mitrovica sell slightly higher amounts to Kosovar household is the geographical proximity of these two municipalities with the rest of Kosovo. The average number of employees for these firms is 5.8. When analysing the sectors from which most of the sales are made to Kosovar households, two main sectors stand out: manufacturing and wholesale and retail sector. Around 37 percent of the manufacturing companies that were interviewed sell to Kosovar households, and around 27 percent of wholesale and retail companies interviewed responded to have generated sales from Kosovar households. One explanation as to why Kosovo Albanians purchase from wholesale and retail companies in the North is that these products are generally cheaper since they are imported from Serbia without paying customs duties. Revenue wise, majority of the companies that generate sales from Kosovar households are small companies making less than €50,000 per year.

Regarding gender, there is no significant difference in terms of generating revenues from Kosovar households. Around 69 percent of the owners whose firms generate revenues from Kosovo households have completed university education, meanwhile from business owners who do not generate sales from Kosovar households only 39 percent have completed university education. A fact like this may indicate that a higher level of education

FIGURE 8: PERCENTAGE OF SALES THROUGH BANKS (AVERAGE: 43.6)

SOURCE:
AUTHORS'
CALCULATIONS



lessens the level of prejudice, helps overcome ethnicity barriers and fosters business cooperation.

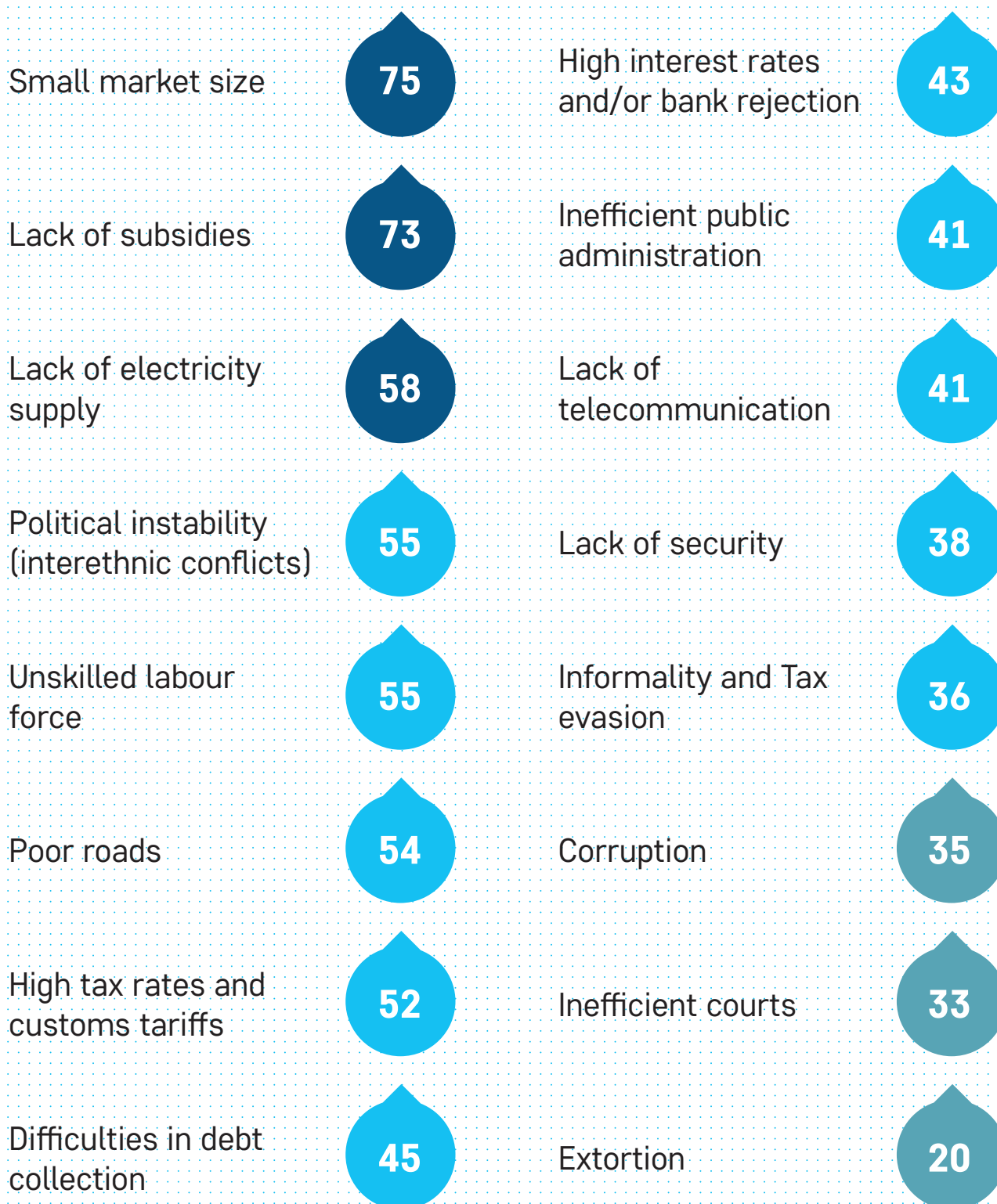
The majority of sales are still done the old-fashioned way, as visualized in Figure 8, using cash. As can be seen in the figure, there are businesses that work very little with banks (12 businesses) since only 10 percent of their sales go through them. There are also businesses (5 of them) that have 30 percent to 40 percent of their sales go through banks. However, there are also businesses (9 of them) that have 90 percent to 100 percent of their sales go through banks. However, it is important to note that only 57 out of 129 businesses provided information of how much of their sales go through banks. Around 40 percent of those who answered this question have less than 20 percent of sales go through banks. The cash based economy is prone to a high level of informal activity, which is never reported for tax purposes. The responses are quite polarized with most businesses having all sales go through banks or hardly any. The businesses in the centre of the spectrum are businesses that generally adhere to the preferences of customers.

3.2 BUSINESS BARRIERS

An important part of the study is the identification of barriers faced by businesses in the North. As a result, the survey asked the businesses to indicate the severity of 16 potential barriers to business development. Kosovo-Serbian firms were asked to rate each obstacle in terms of intensity. Scores for each obstacle can range from a minimum of 20 up to a maximum of 100, with higher scores indicating greater level of negative impact to businesses.⁴¹ From the overall results it can be seen that small market size, lack of subsidies, and

⁴¹ For each obstacle, the rank given by each enterprise (from 1-5) is multiplied by a weight equal to the rank (also 1 to 5), i.e., the more serious obstacles get a higher weighting). The weighted average is then divided by 5 (the maximum rank) and multiplied by 100 in order to convert the score into a percentage showing how close to the maximum ranking the average rank is. In other words, the score s was calculated as: $s = (\sum w_i x_i / n) * 100 / 5$, with $w_i = x_i$; s is the score for the intensity of each obstacle, w is the weight, x is the ranking given by each respondent and $i = 1, 2, \dots, n$ stands for each respondent.

FIGURE 9: THE RANKING OF BARRIERS TO DOING BUSINESS IN THE NORTH OF KOSOVO (IN INTENSITY SCORES)



lack of electricity, are considered the highest three barriers that impede the operation and growth of businesses. The top ranked barrier, “small market size” is explained by the lack of business cooperation and expansion in other parts of the country or foreign countries. The North is to a great extent an isolated economic unit since small market size is ranked 9th in the list of barriers by businesses operating in Kosovo according to a study done by Riinvest Institute.⁴² For detailed information see Figure 9.

This sub-section compares and analyses the rated barriers, which are placed in five groups, covering: a) institutional barriers – ‘lack of subsidies’, ‘inefficient public administration’, ‘high tax rates and customs tariffs’, and ‘corruption’; b) infrastructure barriers – ‘lack of electricity supply’

‘poor roads’ and ‘lack of telecommunication’; c) legal barriers – ‘difficulties in debt collection’ and ‘inefficient courts’; d) political barriers- ‘political instability’ and ‘lack of security’; and e) market related barriers – ‘small market size’, ‘unskilled labour force’, ‘informality and tax evasion’, ‘high interest rates and/or bank rejection’.



a) Institutional barriers

“Lack of subsidies” and “inefficient public administration”, do not rank so high in the top barriers list. “Lack of subsidies” is seen as a great barrier and the responses could to a great extent be triggered by a frustration of businesses towards their governments for not doing enough to facilitate their business affairs. This is closely connected to the sources of investment in which we found that businesses rely mostly on their own funds for investment. The result is comparable to the barriers list for the result of Kosovo⁴³ where lack of subsidies is listed as the third most serious obstacle. Obviously, though the opinion is biased, businesses believe that more public spending should flow directly to the businesses rather than trickle down to them through other public services. “Inefficient public administration” does not rank very high in the barrier list, but by all means this does not mean that it is not an issue. The bureaucracy that businesses, especially those in the North, and the red-tape that must be overcome, can be overwhelming. This is an issue for starting a business, and for operating one. “High tax rates and customs tariffs” ranks significantly high in barriers list, though tax rates are

not comparably high to other countries. However, given the low the level of public services, they might not be justified even at the current level. This can also help explain the high level of informality (see the “Informal economy” section). “Corruption” is not seen as a huge problem. While it may be true as small businesses are less likely to be made to pay bribes or other forms of corruption, the answer could also likely carry a lot of bias as some businesses might see the question as requesting an admission of having paid bribes or corrupting officials in any way. Corruption is the second ranked business barrier in the rest of Kosovo, according to the 2014 Riinvest study.⁴⁴



b) Infrastructure barriers

Lack of electricity supply ranks third in the list of barriers, which does not seem to be the case for the rest of Kosovo where electricity supply has not ranked high in the business barriers for years now. The difficulty not just with water supply but with all utilities is evident in the North. The 2013 study by “AKTIV”⁴⁵ finds that different municipalities in the North face different obstacles related to utilities.

“In Leposavić/q and Zvečan/Zveçan it was recorded that there is an average 22% and 23% respectively outage of water per week, while in Mitrovica/ë and Zubin Potok this amounts to 14% and 11% respectively. Water outages are there other major issue in terms of utilities in North Kosovo, Mitrovica/ë, Zvečan/Zveçan and Leposavić/q suffer between 9-12% outages per week while in Zubin Potok this is reduced to just 5%. This is more than likely due the close proximity of Gazivode Lake to the municipality and the water supply it provides”.

Around 21 percent of respondents believe that “poor roads” it’s a major barrier for business. “Poor roads” ranks 6th, which is quite high, in the barriers list. Unlike the rest of Kosovo, where it has been heavily invested in road infrastructure in the last decade, the North has not experienced the same level of investment. “Lack of telecommunication” ranks very low and it is not an issue. However, more can be done to utilize new technologies by businesses which reduce costs significantly.

The infrastructure barriers rank very high compared to the

42 Riinvest Institute, “Business Climate in Kosovo”, 2014

43 Riinvest Institute, “Business Climate in Kosovo”, 2014

44 Riinvest Institute, “Business Climate in Kosovo”, 2014

45 Aktiv, “An inquiry into the economic situation of north Kosovo businesses”, 2013

rest of the country. Barriers such as lack of electricity and poor road infrastructure are hardly considered barriers at all by the businesses in the rest of country. However, for the businesses in the North these are still real issues. This goes to show the importance of relying on Municipality services and lacking central level government support for major projects.



c) Legal barriers

“Difficulties in debt collection” is the highest ranking legal barrier. The lack of debt collection mechanism, such as bailiffs, which is working well in the rest of country, leaves the businesses in difficulty of collecting from debtors. This barrier is closely tied to the problem of inefficient courts. “Inefficient courts” ranks surprisingly very low in the barriers list but this has more to do with the fact that most business do not have to deal with courts on a regular basis rather than it is not an issue. For businesses that have to deal with enforcement of contracts through courts, such as debt collection, it can be a real hassle.

“Inefficient courts” it’s considered the fifth major business barrier in Kosovo, while for the North it ranks much lower. This does not by all means imply that the judiciary works well in the North. Quite the contrary, the North simply has many other pressing issues to deal with that the rest of the country does not. “Debt collection” it’s an issue that stems from inefficient courts which the whole country, including the North still struggles with.



d) Political barriers

“Political instability” captures pretty much all the political issues related to the North, chiefly the undefined status. This creates many problems because it diminishes investment and consumer confidence. It is the 4th highest ranking barrier. The political issues are not likely to go away soon and they even get worse as the tension is rising over the ownership of “Trepça” and the reborn nationalistic sentiments after recent incidents. Political instability it’s not expected to be solved by the recent bilateral talks, on the contrary, the situation is likely to become even more fragile with any compromise reached likely to trigger widespread protests in both sides.

Political issues are likely to remain an issue even if a compromise is reached as the North is a subject of much emotional attachment for both sides. “Lack of security” does not rank high as a barrier. Businesses do not feel any threat for the physical security of their assets, however, the high risk of security incidents in the North certainly trickles its effect into the business climate.



e) Market-related barriers

“Small market size” ranks as the top barrier for the North of Kosovo municipalities. The North is to a great extent an isolated economic unit with very little business relations with other parts of Kosovo. Business registration and permits determine to what extent each business can utilize other markets and customers other than the ones from the North. The small market size explains why most businesses are trade related, and by we trade we mean chiefly importing business that sell to local customers. “Unskilled labour force” is explained by the lack of opportunities for the labour market participants to obtain quality education and gain skills needed for today’s market (see the “Labour force” section). “Informality and tax evasion” ranks very low as a barrier, however the rate of informality is very high (see “Informal economy” section). It is counter-intuitive that in an environment with such a high rate of informality 62 percent of respondents see it as “No barrier”. This can be explained by the nature of competition and the low tax rate as even though the informality rate is high, it is not seen by businesses as an impediment to their business. Another explanation could be the low level of awareness for the effects that the high level of informality has on the business environment, and indirectly, to their business. “High interest rates and/or bank rejection” is seen, and it is, a very difficult barrier to overcome (see “Sources of investment” section). Though this study captures only existing businesses, it is also a very important barrier especially for start-ups. Businesses that want to expand are either rejected by banks or forced to pay very high interest rates. High interest rates are related to the insecurity of the business environment and lack of competition between banks.

3.3 TAX EVASION

Political turmoil and uncertainty makes the business environment very much prone to informal practices. A recent survey by Riinvest Institute showed that approximately one

third of sales in Kosovo are never reported for tax purposes.⁴⁶ However, the tax evasion rate is much higher in the North due to the political setting and uncertainties. Businesses in the North do not report around 45 percent of their sales for tax purposes. Many factors lead to this rate. In the “Public Services” section (3.4) we see that more businesses pay taxes to the Serb government than to the TAK. We also see that businesses are not very satisfied with the services that they are receiving from either government. The discrepancy between the taxes paid and they public services that businesses receive is a well-documented cause of informality. The probability of getting caught is also very low in the North given the inability of either tax administration to properly inspect that region. The high rate of informality is explained also by the high rate of cash transactions (as explained in section 3.1). Cash transactions are easily kept off the radar of tax authorities.

Table 4 on the appendix shows that larger businesses in the North tend to evade more than the smaller ones. The percentage of sales not reported for tax purposes for businesses with sales up to €50,000 is 37 percent, roughly the same as the rest of Kosovo. The average is pulled up by larger businesses that evade more. The link between business size and tax evasion level is unclear. Intuitively and historically we would expect larger businesses to evade less as they are more sensitive for their reputation, they have less cash activity and more economic activity going through banks, they are inspected and audited more frequently. In other words, they stand to lose more. This does not seem to be the case in the North. One possible explanation could be that larger businesses in the North by virtue of being well-connected and exploit the administrative vacuum. Some might even be operating in North for the very reason that it is possible to exploit such an administrative condition. Smaller businesses on the other hand are usually family-owned and just trying to make ends meet. It is worth noting that other studies of informality in Kosovo have shown the opposite link between business size and tax evasion level.

In the rest of the country the bigger businesses contribute a disproportional fair to the tax vault. Smaller businesses tend to show more of a “nothing to lose” attitude that makes them evade more. They are also less inspected by tax authorities.

Above average rate of evasion is noticed in the construction and manufacturing industries. These are sectors that are

46 Riinvest Institute, “To pay or not to pay: A business perspective of informality in Kosovo”, 2013

characterized to a large extent especially by informal labour. The agriculture sector is the most informal sector in the country as a whole, especially for the labour force as they do not even see themselves as ‘employed’. For the North we cannot reach any conclusions about this sector as only one business was interviewed. Below average level of tax evasion is seen in the largest sector, wholesale and retail. This is a sector with less room for tax evasion as the products are not domestically produced they are traced at different points. Tabulating tax evasion against the characteristics of the owner we find that businesses with female owners evade less, and something we would not expect to find is that businesses with university-educated owners actually evade more.

Tax informality is not only explained by the level of taxation and the probability of getting caught, but also with the moral obligation that businesses feel to oblige with tax requirements.

Frey (1997)⁴⁷ argues about the importance of “intrinsic motivation” of tax compliance, which due to “civic virtue”, makes taxpayers comply; as opposed to “extrinsic motivation”, known also as deterrence impact, in which taxpayers pay because they fear punishment. This “intrinsic motivation” is known today as tax morale.⁴⁸

Tax morale in the North does not seem to be low. On the scale of 0 to 10, where 0 means cheating on taxes is never justifiable, and 10 means always justifiable, business give an average answer of 2.4. This figure is comparable with the one obtained in the Riinvest study of informality in Kosovo in 2013 in which 56 percent of the respondents claimed they “would never justify tax evasion” (see Figure 10 for detailed information). However, bias is omnipresent in studies measuring illegal activities such as tax evasion, especially in the case of tax morale. Businesses are reluctant to answer honestly for the fear of having their answers be interpreted as admittance of guilt.

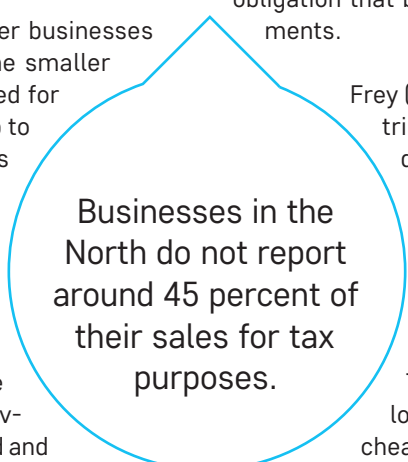
The Riinvest study of informality in Kosovo⁴⁹ gives an average of 2.7 on the 1 to 10 scale of measuring tax morale in Kosovo, with 10 being “always justifiable to cheat on taxes”. The World Values Survey study⁵⁰ gives Serbia a score of 4.7. It is interesting to note that in Serbia tax morale varies with

47 Margit Osterloh; Bruno S. Frey, “Motivation, Knowledge Transfer, and Organizational Forms”, 2007

48 Riinvest Institute, “To pay or not to pay: A business perspective of informality in Kosovo”, 2013

49 Ibid.

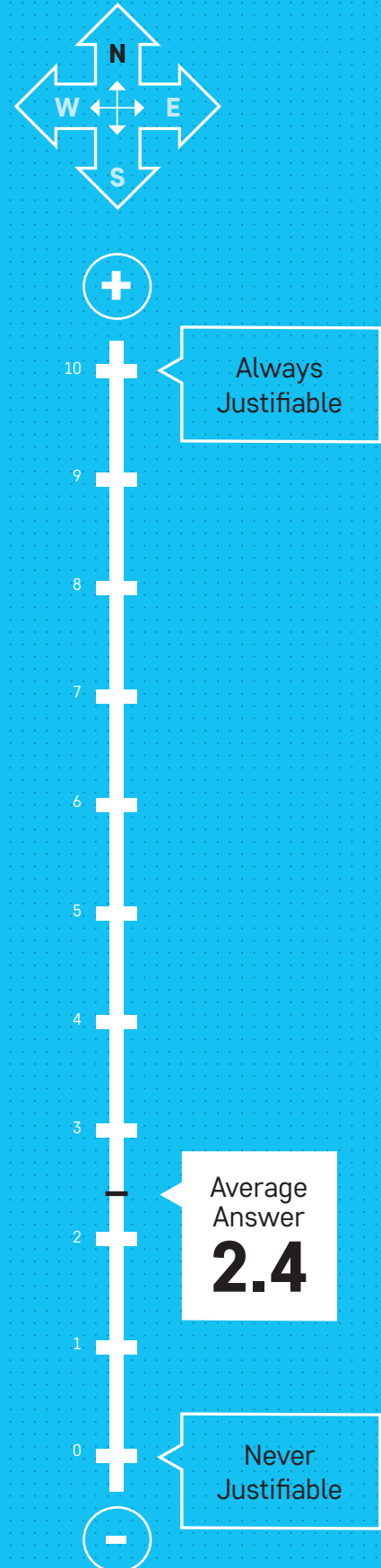
50 World Values Survey, “WV5_Results, Serbia, Technical Record”, 2014.04.28



SALES NOT REPORTED FOR TAX PURPOSES



HOW JUSTIFIABLE IS IT TO CHEAT ON TAXES



age. Older generations are more likely to justify tax evasion, with those older than 50 years old having an average of 5.1. So the tax morale actually appears to be higher in the North than both Kosovo and Serbia. Granted however, comparing results with different sample sizes is not entirely accurate. The sample in the North is 129, in Kosovo it is 600, and in Serbia it is 1220. However, the difference between the North of Kosovo, Kosovo, and Serbia, its large especially between the latter and the former two. Serbia scores very low in the tax morale scale with a high level of acceptance for tax evasion.

Tackling the informal economy is difficult everywhere, and especially so in the North. Given the high level of insecurity both politically and economically, it is very unlikely that tax morale will improve or that the tax administrations will become more effective in collecting taxes. For the economy of the North to be formalized the political issues must first be resolved. The fact that businesses are not contributing to the common good is not as pressing of an issue as the hints that it gives us about the future of tax regulation of the North. Assuming that the status of the North will be resolved, how might businesses react to it in terms of tax compliance? If there is such a high level of informality now that the businesses have some choice of where they want to register their businesses and pay their taxes, how will the businesses comply when such a choice is not available anymore and they are forced to pay their taxes to an entity they do not view as legitimate? The high level of informality is most certainly an opportunist response of the administrative vacuum. However, its relation to the public services that the North receives is not clear. Both governments have been pursuing expenditures in the North for their political agendas, not necessarily in proportion with the taxes that the North contributes. This gives even less incentive to comply.

3.4 PUBLIC SERVICES AND INTER-BUSINESS COOPERATION

More businesses are registered in the Serbian registry than the Kosovo registry. 30 businesses are registered in both the Serbian and Kosovo registry, an additional 49 are registered *only* in the Serbian registry, and an additional 17 *only* in the Kosovo registry. Moreover, 32 (25 percent) of businesses admit to not be registered at all. The main issue of having so few businesses registered in the Kosovo registry is that they do not have access to the south Kosovo market. “Companies registered within the Kosovo business registry automatically gain access to the south Kosovo market without the restrictions placed upon unregistered businesses or businesses

registered under other jurisdictions”.⁵¹ When and if a business is registered have many implications for their business operations, especially for companies engaged in trade (see Figure 11). As most businesses do not interact much with other businesses outside of the North Kosovo economic area and are not involved in trade activities, where they are registered does not hold any “market-related” implications. However, there are implications about how much taxes they are charged and other legislation they must abide by. It is rarely heard of economic regions with businesses pretty much split on the account of the country they are registered in.

The Serbian Government turns out to collect more taxes from these businesses than the Kosovo Government. While almost 30 percent pay taxes to both, a total of 28 percent pay to the Serbian Government and 15 percent to the Kosovo Government (see Figure 12). The number of businesses that pay taxes to different tax authorities is too high. This is obviously related to where the businesses are registered. However, it also shows towards which tax administration show more loyalty. A surprisingly large number of businesses pays taxes to both governments which is rather odd. In the questions related to the level of trust that the businesses have in different institutions and the satisfaction with the public services that each provides we saw that business trust and expect/get the most from the municipalities. Both governments have limited access and offer limited services to this region, which means their give-and-take relation is most close to their local government.

“The Serbian Government turns out to collect more taxes from the businesses (28%) than the Kosovo Government (15%)”.

Regarding the public services offered to the businesses in the North, it seems businesses are most satisfied, or given the low level of satisfaction for all of them one might even say “the least dissatisfied”, with municipal services. 21 percent of respondents say the municipal services are “very good” or “good”. At the other end we have the services provided by the Kosovo government, which are considered “very good” or “good” by only 3 percent of the businesses that have responded (see Figure 13). The low level of satisfaction with Kosovo government services is explained by the lack of services rather the quality of them. More businesses claimed to pay taxes to the Serbian government than to the Kosovo government, so the public services are also reflective of the revenue yielded by the tax authorities. Serbian government and the international community services fall in between. Again, given the low level of satisfaction with all public services providers, these institutions are ranked “from best to worst” but rather from “least bad to worst”. The Serbian government ranks higher than the Kosovo

⁵¹Aktiv, “An inquiry into the economic situation of north Kosovo businesses”, 2013

Figure 11: Business registration (in %)

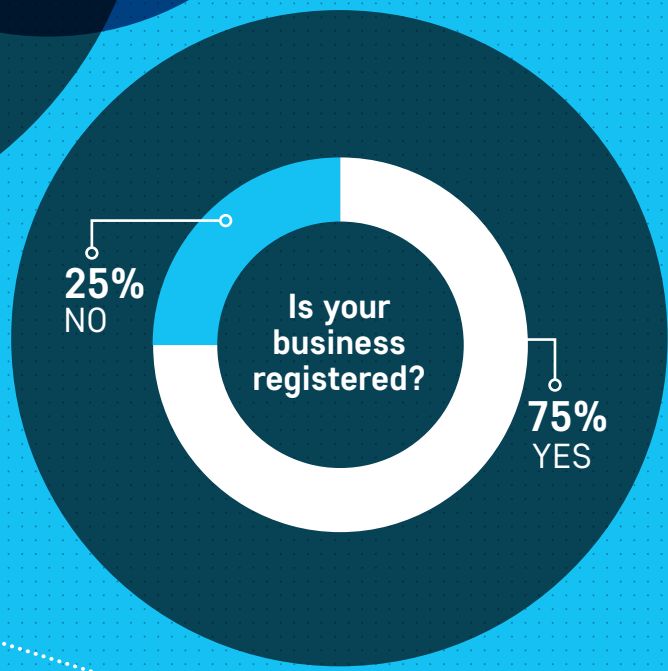
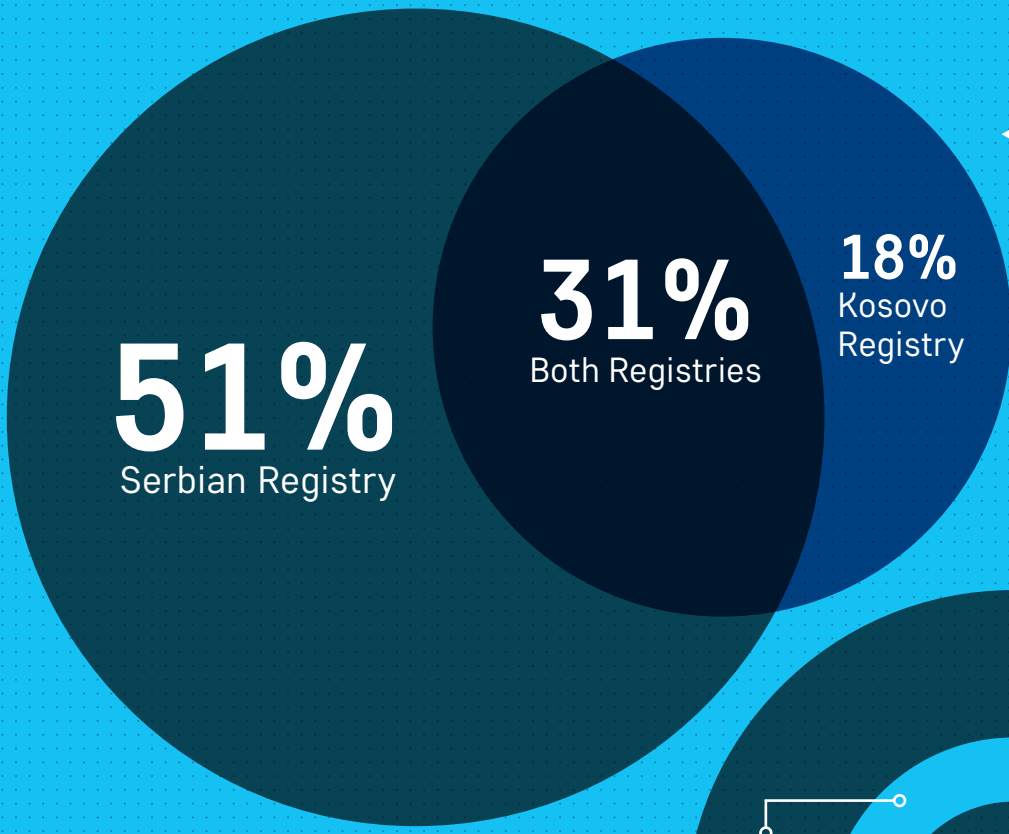


Figure 12: Payment of taxes (in %)

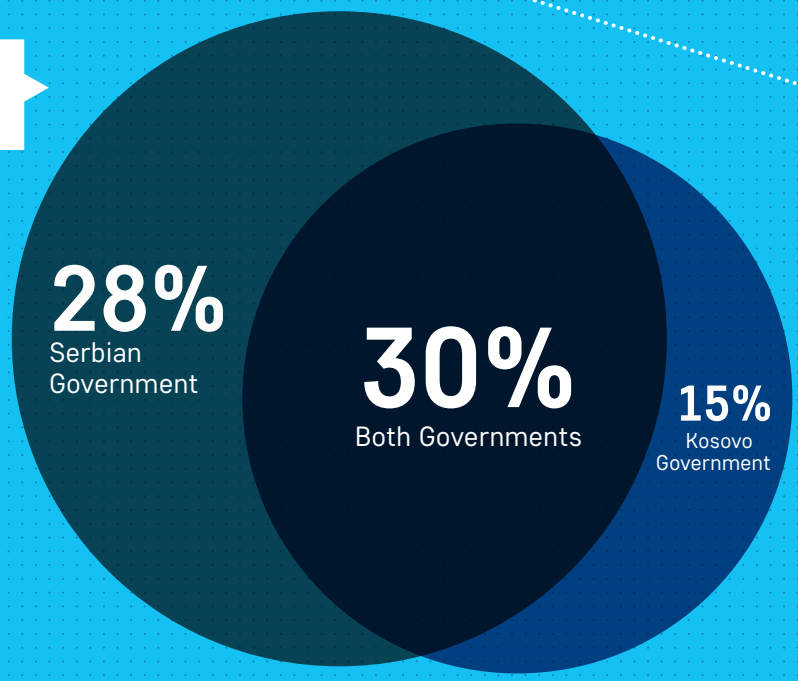
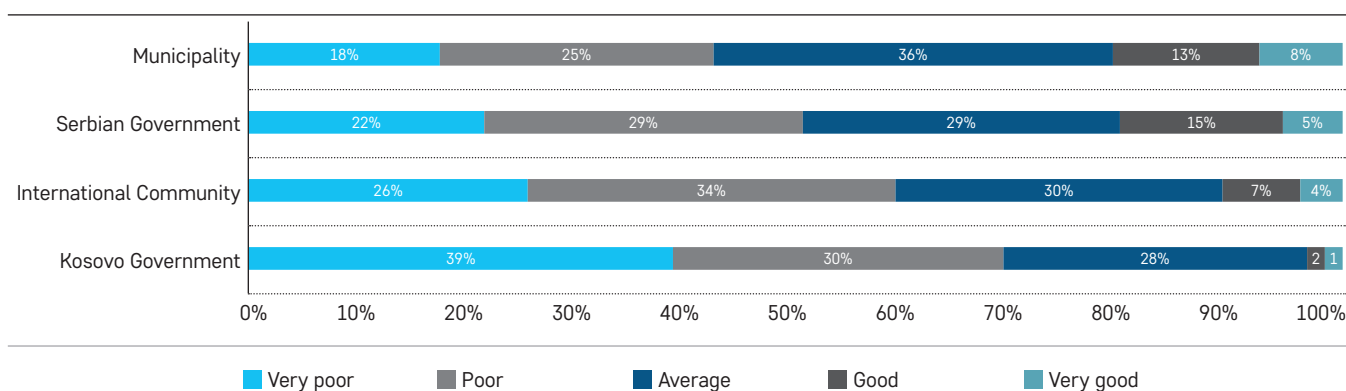


FIGURE 13: PERSPECTIVE OF BUSINESSES ON SERVICES PROVIDED BY INSTITUTIONS (IN %)

SOURCE: AUTHORS' CALCULATIONS



government because the Kosovo government has very limited access to the North municipalities. It is also a part of the Serb government strategy to build loyalty not only from the businesses in the North, but also from households and local governments. Hence, they spend more as part of their geopolitical strategy. The municipalities, as previously stated, are more in-touch with the local businesses as either government, and they enjoy a higher level of trust and give better services to the businesses.

of its presence, seeing as part of the overall strategy for the eventual control of the non-Serb authorities of the North. The media, NGOs and the international community enjoy an average level of trust. While the role of the international community and the NGOs which are mostly supported by the international community is very limited, it is still not viewed in a very good light by businesses, not necessarily as obstructive, but at least not very supportive.

The following Figure 14 explains the level of trust that businesses have in different institutions. Again, the level of trust is low for all institutions (except their own staff) with all of them enjoying below average level of trust. Municipality, Serbian Government, and NGOs enjoy a relatively higher level of trust and European Union Rule of Law Mission in Kosovo (EULEX), Kosovo Government, and “Taxes, Customs, and Inspections” have a very low level of trust. Obviously, the businesses in the North feel more reliant on the municipal government to provide them with services and been accountable for them. The businesses in the North feel more “out of touch” with the central governments, perhaps because of the absence of direct contact, thus they turn to the local level institutions for support, and that is where they place their trust.

Businesses are very satisfied and trust their own staff. This is also reflected in the “Labour Force” section (3.5). Given the fact that it is the only category for which no business gave a “not trust at all” or “no trust” answers, it seems out of place with the rest of the list, which has very few “high trust” or “trust” responses. The highest scoring institution by level of trust is the Municipalities (read also about “public services rating”); however, even this result should be absorbed with caution as most respondents gave an “average level of trust” response. The lowest ranking institution is EULEX. The North sees the EU Institution vested with the authority to ensure rule of law in Kosovo as not able to fulfil this role, or is simply unwelcoming

There is inter-business cooperation, thus much of it is done informally (36 percent), between businesses in the North. Though much of the cooperation is done informally, 54 percent of businesses say they have a high level of cooperation with Kosovo Albanian owned companies (see Figure 15). A relatively high level of cooperation is scored with Serbian owned companies and significantly less so with Kosovo-Serbian owned companies.

The 2012 Riinvest study⁵² sheds light on the obstacles that prevent business from cooperating with each other and the factors that could possibly increase cooperation. The study found that “Kosovo-Serbian businesses considered economic growth in Kosovo (economic growth creates new opportunities for businesses, and hence creates new ways of cooperation) as the main factor influencing cooperation between the different communities of Kosovo”. The study also found that “language” and “security” are the two main barriers for cooperation between businesses.

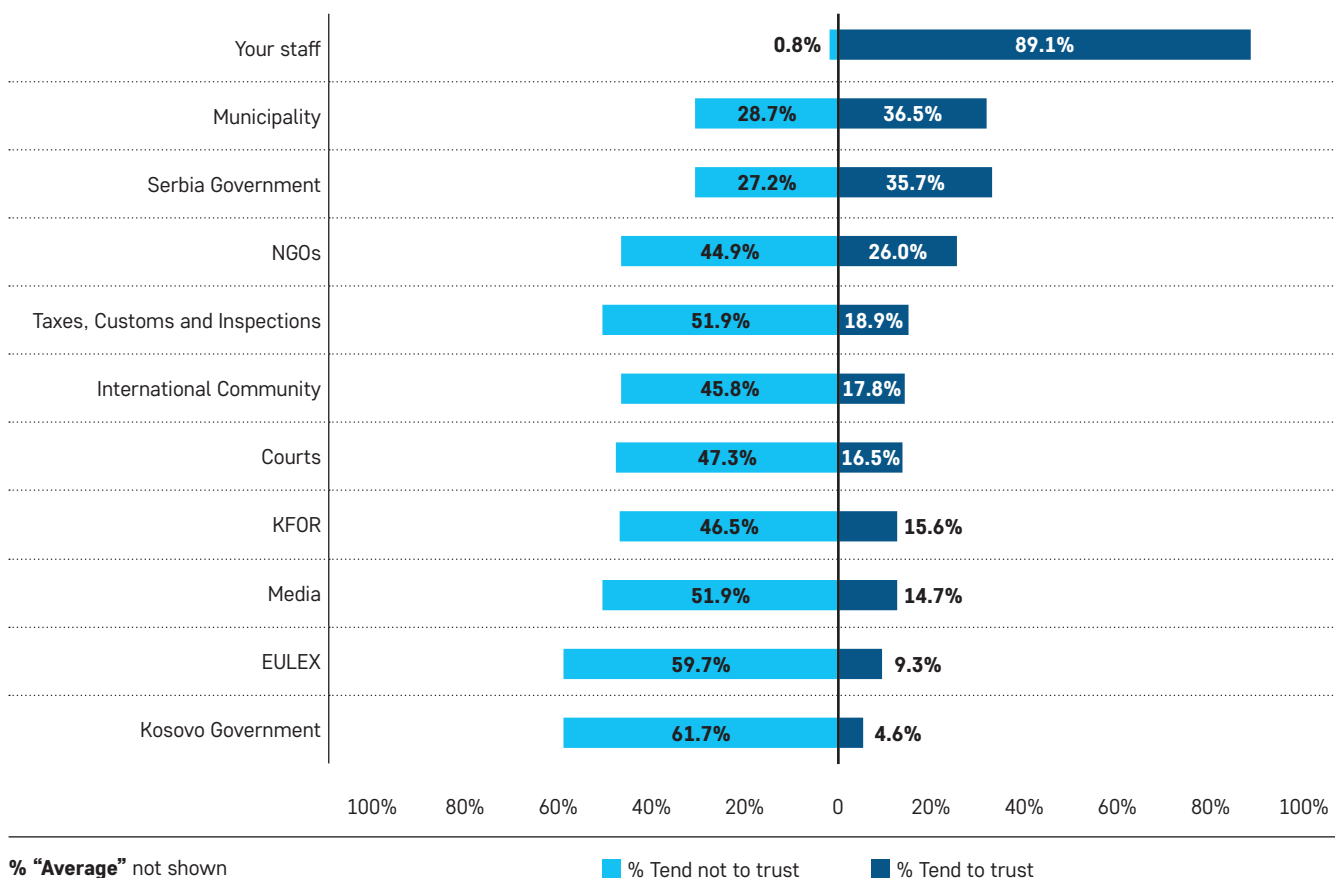
The 2013 “AKTIV” study also highlights an important aspect of North businesses working and interacting with businesses in the south. According to the study, “two of the biggest negative perspectives that were highlighted in the research were ‘the risk to your person or personal security of your family’ where 78 percent

Businesses tend to trust the Serbian Government with 35.7% and the Kosovar Government with only 4.6%.

⁵² Riinvest Institute, “Improving the Kosovo-Serbian Business Community Involvement in Economic Activities in Kosovo”, 2012

FIGURE 14: THE LEVEL OF TRUST FOR THE FOLLOWING INSTITUTIONS (IN %)

SOURCE: AUTHORS' CALCULATIONS



of interviewees believed this to be an issue. In addition to this, 76 percent of companies believed they may suffer a loss of reputation amongst their community by trading with south Kosovo."

The reason why there is not more cooperation between businesses could be explained by the fact that the North is mostly comprised of small businesses that do not have much business contacts other than their suppliers, and which sell directly to the end customer. The language and security barriers however must not be overlooked. If businesses do not feel comfortable to cooperate, especially in the inter-ethnic level, this can have implications for the economic future of the North. The language and security barriers

Hardly any businesses participate in fairs organized in Kosovo, or are members of any Business Association or Chamber, Only 14 percent of businesses are members of associations. Lack of representation and membership in business associations tells us something about the nature of doing business without any sense of collective action. The lack of harmony in business-making reflected in these numbers is also a consequence of the uncertainty and lack of planning for the long-term which is usually what pushes businesses towards networking through business associations and business events.

Around 70 percent of businesses said they will make some investment in 2015. Most businesses are still very reliant on their own capital for investment. Using one's own capital for investment is the most frequent source of investment. 32 percent of future investment will be made using the owner's own capital. Bank loans, despite the high interest rates that they charge, is the second most frequent source of investment. 28 percent of future investment will be made using bank loans. Relatives and retained earnings are also possible sources of investment (for more information see Figure 16). The sources of financing are indicative of the lack of alternative sources of finance other than own capital and borrowing from banks. As a result, the number of start-ups is very small as those with prospects of starting up a business are not eligible for borrowing from banks and do not have capital of their own. The proportion of investment financed through bank loans can tell us much about the business environment in general. Banks are reluctant to finance, especially start-ups, in an environment with so much economic and political uncertainty. When they do so, they finance only well-established business, which are not many, and still at very high rates of interest.

**FIGURE 15: A) LEVEL OF COOPERATION WITH OTHER COMPANIES;
B) WAY OF COOPERATION**

SOURCE: AUTHORS' CALCULATIONS

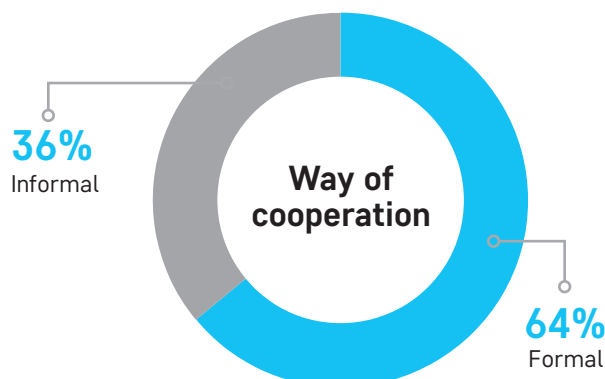
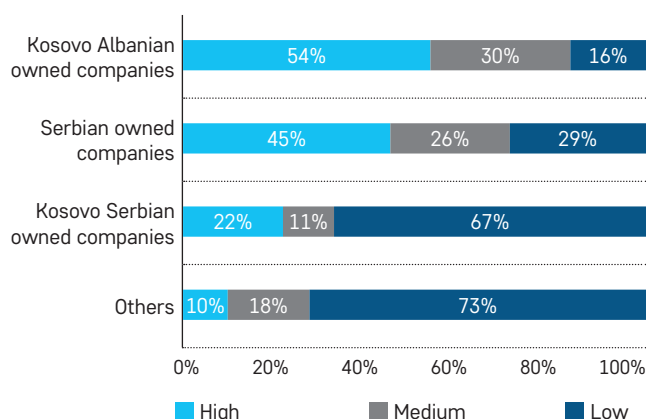
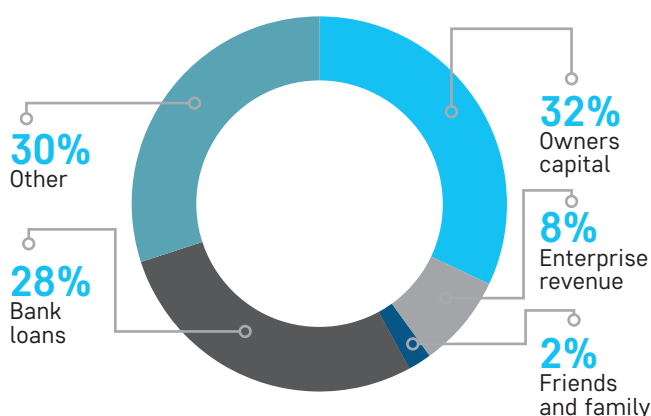


FIGURE 16: INVESTMENT PLANS AND SOURCES OF INVESTMENT FOR 2015

SOURCE: AUTHORS' CALCULATIONS



with university level education, where the North stands with 17 percent, whereas the rest of the country with 16 percent.

Almost all businesses perceive their labour force to be above average, while only half the businesses think the same for the labour force in the North in general, as can be seen in Figure 18. This discrepancy may arise from the fact that businesses are struggling to find qualified and suitable staff and believe that their efforts have led them to find good staff, rather than the job market providing enough of them. A stark difference is noticed between how businesses see the labour force in the North versus the rest of Kosovo. Only 36 percent of businesses see the labour force in Kosovo⁵³ as “good” or “very good”, while this percentage is a full 67 percent for the North. The businesses in North apparently view the labour force as much more qualified than the rest of the country does. Now the answer might lie in the industry type prevalence in the North. The business categories in the North do not require very high skilled staff and therefore even though the labour force in the North does not differ much from the rest of Kosovo (and could possibly even be less qualified), it is seen as “good”.

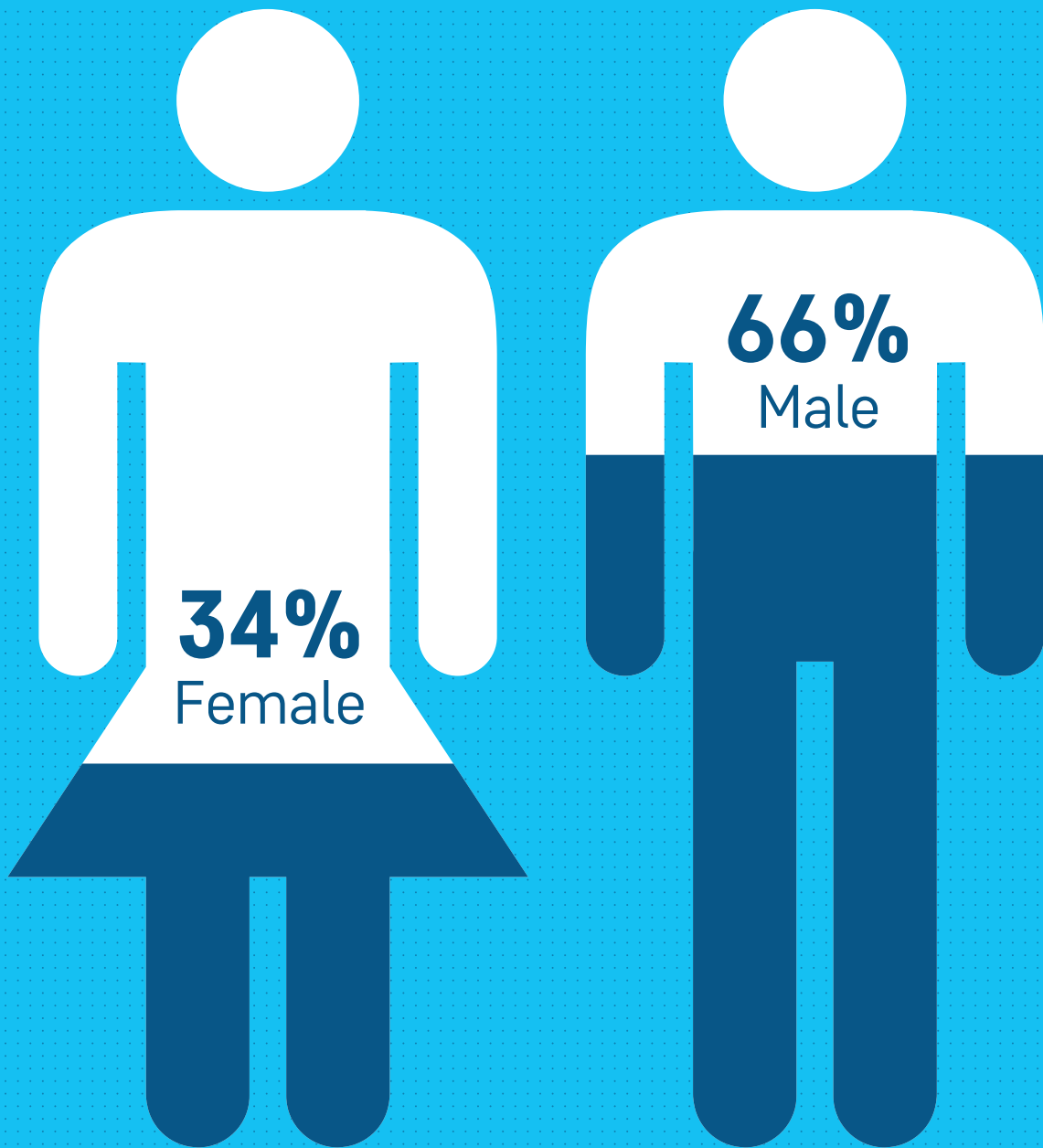
3.5 LABOUR FORCE

The labour market, as it is the case in the rest of the country, is made up mostly of man. Around 66 percent of the workforce in the North is male. This shows the lack of gender balance in the work force in the North. A disturbingly high percentage of the workforce lacks university level education. About 75 percent of the workforce has only completed high school education and only 17 percent have completed university level education (see Figure 17). Compared to the rest of the country, the gender composition seems to be quite different. The gender misbalance seems less accentuated in the North than Kosovo as a whole. While the overall percentage of female workforce in Kosovo is 22 percent, in the North alone it stands at 34 percent. However, there does not seem to be a significant difference between the percentage of workforce

The most important issue in hiring qualified staff seems to be the request for higher than affordable wages and lack of qualified individuals in the market. Request for high wages would not intuitively be ranked the greatest obstacle for hiring even qualified staff, in the region that is facing so many economic difficulties as even overqualified workers resort to underpaying jobs. However, it remains unclear whether qualified workers find opportunities elsewhere and leave the northern Kosovo job market, or are simply unwilling to work underpaying jobs. The insufficient number of qualified workers

⁵³ Riinvest Institute, “Business Climate in Kosovo”, 2014

FIGURE 17: GENDER COMPOSITION OF EMPLOYEES



EDUCATION OF EMPLOYEES

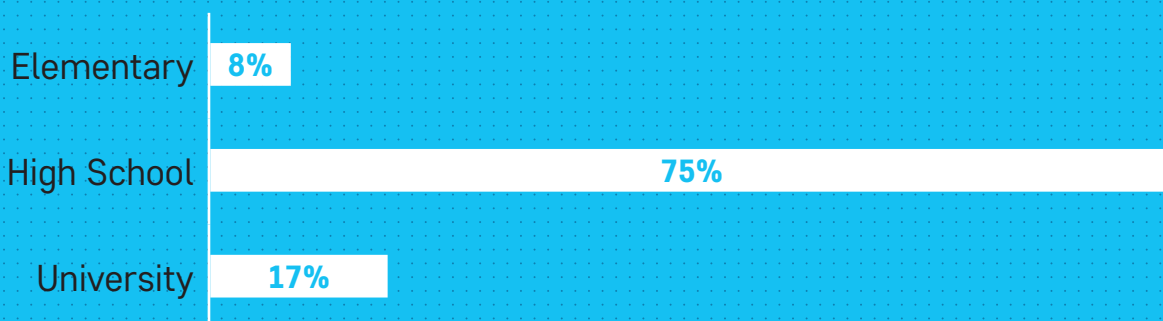
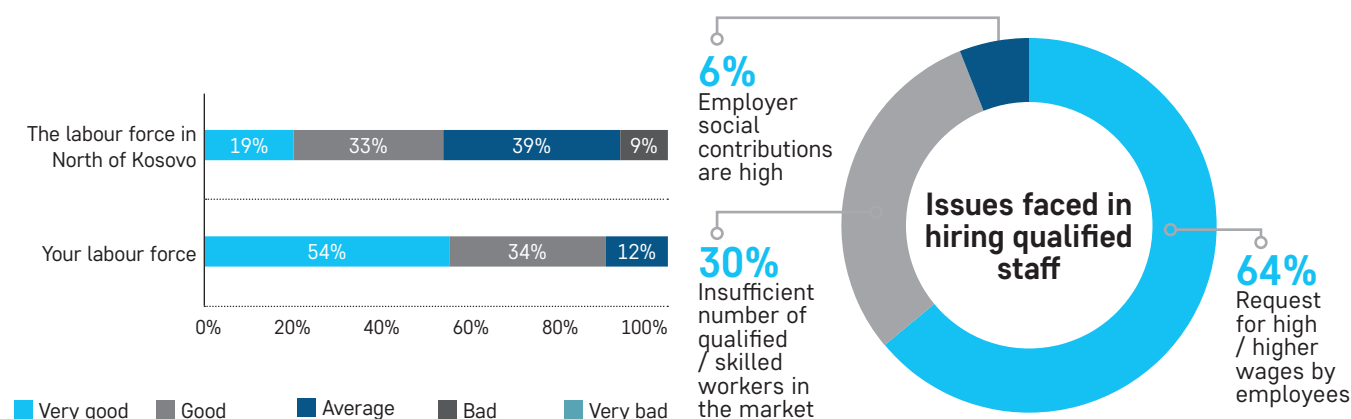


FIGURE 18: PERCEPTION OF LABOUR FORCE

SOURCE: AUTHORS' CALCULATIONS



gives a better picture of where the issue remains. Simply put, the opportunities for quality education and preparation are not there. High taxes and social contributions do not seem to be an impediment to hiring qualified staff. Comparing the issues in hiring qualified staff for the North of Kosovo and Kosovo as a whole we notice some differences. Around 64 percent of the respondents find “request for higher wages by employees” as the most important issue in the North of Kosovo, but for the whole of Kosovo this statistic is smaller by 10 percentage points. “Insufficient number of qualified workers” is also a more frequent answer in the North. The high frequency of these two answers is offset by the small number of people in the North that said the social contributions are high and therefore an issue for hiring qualified staff. Only 6 percent said so in the North, but 24 percent in the whole of Kosovo. The 18 percentage point difference cannot be easily explained; social contributions are not high compared to the global average. However, given the high rate of informality in the north it is likely that more employers are able to evade paying social contributions and therefore do not see it as a great barrier. The unions and other employee protection mechanisms work better in the rest of the country than they do in the North. So, the difference in percentage points between the three options, boils down to the last. The differences between the first two are actually explained by the third. There are no differences in the first two, but the discrepancy in how much they view “high social contributions” as an issue. In other words, it boils down to informality.

Qualified labour force did not turn out to be a major barrier for business making in the rest of Kosovo according to recent studies.⁵⁴ In general, even though opportunities for quality education and the opportunity for gain job skills are scarce, given

the high rate of unemployment, businesses are able to find qualified staff at affordable wages. As almost all businesses believe their staff to be “very good” or “good”, and the issues for hiring qualified staff are not intensive, the lack of quality workforce does not seem to be an issue for the North either.

54 Riinvest Institute, “Business Climate in Kosovo”, 2014

4. CONCLUSIONS AND RECOMMENDATIONS

This report provides an assessment of the economic potentials of the four northern municipalities of Kosovo, North Mitrovića/ë, Zvečan/Zveçan, Leposavić/q and Zubin Potok. The main objective of the study was to present a picture of the current situation of the business environment, barriers faced by businesses, their needs and potentials of the region. To achieve this, a survey was conducted with 129 businesses from the four municipalities. The survey was conducted mainly with business owners, so that the data gathered is accurate. Besides the survey, the team conducted secondary research and included in the report the most important information found.

Regarding business structure, similar to the rest of Kosovo, the business setting is mostly characterized with wholesale and retail businesses which focus on trade activities rather than production. There are also a very small number of construction and manufacturing companies. The average net profit rate for the businesses interviewed is 19.4 percent. However, it is important to note that there are variations among businesses since there are some businesses that perform incredibly well with net profit rates above 40 percent.

The trend of sales for 2014 was not that favourable to businesses since 47 percent have seen their sales decline by 28 percent on average. Around 20 percent have seen their sales increase with an average rate of 20 percent. It is important to mention that the outlook for 2015 is more optimistic for these businesses with 31 percent expecting an increase in their sales.

Up till now, the North has been an isolated economic unit with very little business relations with the rest of Kosovo and other countries; however the business relations with businesses from Serbia was more significant. Majority of their sales, 90 percent, are done in the North and the market share is also almost exclusively made up of a single community, which is the Kosovo-Serb community. However, it seems that Kosovo-Serbian businesses have started to become aware of the benefits of integration and larger market since 31 percent believe that their sales to the Kosovo Albanian community will increase.

A crucial part of this study is the analysis of barriers to doing businesses in the North. The interviewed businesses in the

survey were asked to evaluate the severity of 16 potential barriers to business development. Barriers can vary in intensity from a minimum of 20 up to a maximum of 100, with higher scores signifying greater level of negative effect to firms. The findings show that, as anticipated from sales figures, the top ranked barrier to doing business is market-related due to a small market size. The second highest ranked barrier is an institutional barrier which is experienced by businesses as a result of lack of subsidies. Another highly ranked barrier is of infrastructural nature, more specifically electricity and poor roads. Political instability ranks as the fourth one in the list of the barriers with an intensity score of 55 points. Although it is not the highest ranked barrier as it might have been expected, it is still present and affects the daily operations and development of businesses.

There is high level of informality, higher than in the rest of Kosovo, since businesses operate mainly with cash and do not report as much as 45 percent of their sales for tax purposes. Nevertheless, when asked to rank from 1 to 10 how justifiable is it to cheat on taxes, where 1 means never and 10 means always, the respondents' average score is 2.4.

With respect to registering the business, more businesses are registered in the Serbian registry than the Kosovo registry. Around 38 percent are registered only in the Serbian registry and 13 percent only in the Kosovo registry. Almost 23 percent of the businesses are registered in both the Serbian and Kosovo registry; meanwhile 25 percent of businesses admit that they have not registered their business at all.

There is a low level of satisfaction with all public service providers among the businesses interviewed in the North. According to them, both Kosovo and Serbian public service providers have provided suboptimal services to the North. Similarly, the level of trust is low for all institutions, with all of them enjoying below average level of trust. EULEX, Kosovo Government, and "Taxes, Customs, and Inspections" have a very low level of trust, meanwhile municipality, Serbian Government, and NGOs enjoy a higher level of trust compared to the other institutions.

Around 70 percent of businesses plan to make investments during 2015, mainly (32 percent) by using owners' own capital.

Bank loans are the second most frequent source of investment with 28 percent, despite the high interest rates.

Regarding labour force, there is a significant lack of gender balance with males dominating. Moreover, the education level is basic with 75 percent of the workforce having completed only high school. Almost 25 percent of the businesses perceive the labour force in the North to be very qualified; meanwhile 69 percent think that the employees of their own business are very qualified.

In line with general survey results presented in this study, the Riinvest team provides the following policy recommendations. Note that in the case of business barriers, recommendations are given only for the group of barriers that turned out to be more serious to northern firms.

MARKET-RELATED BARRIERS

- ▶ Businesses operating in the North of Kosovo should register in the Kosovo business registry. Registration would enable them to be entitled to same rules and benefits as Kosovo Albanian companies. One way to motivate them to register is to provide some form of fiscal amnesty to those businesses not yet registered, but which are ready to take the necessary steps to register. This would also encourage formalization of other businesses as well. In addition, information centres could be established in order to stimulate the formalization and facilitate new business registrations and operations. These centres would provide relevant services and information with regards to legal framework, operational requirements, as well as benefits received from registration (application for government tenders, government subsidies, bank loans, etc.).
- ▶ Develop programs that would increase the awareness of businesses to organize into associations which could help their collective decision-making and bargaining power towards public institutions. More opportunities should be available such as Business to Business meetings, fairs, and other promotional ac-

tivities which stimulate cooperation and promotion of products/services.

- ▶ To address the problem that businesses face with unskilled labour force, the public university in North Mitrovica and International Business College Mitrovica should work on matching their curriculums with market needs, since there is great discrepancy what employees offer and what is demanded by the market. Furthermore, a well-developed vocational education and training system for the northern municipalities should be established. Once the discrepancy is tightened, businesses will be able to find workers who match their needs.
- ▶ Besides universities, businesses should offer systematic training to their employees as well as encourage them to attend capacity building training which are organized by non-governmental organizations and are aimed to address the skill insufficiency stemming from low level of education of employees in the North.
- ▶ Promote and facilitate cooperation from within the businesses themselves from both communities. This can be achieved by strengthening relationships between important stakeholders from both the Kosovo - Albanian and the Kosovo-Serbian community or between those working towards a complementary goal and allowing them to come up with their own solutions for cooperation. In this regard, the government could also take an active role by developing strategies and action plans which would lessen the ethnic divide in business making and help integrate Kosovo-Serbian businesses in the overall Kosovo market. This among others would contribute towards addressing the top ranked barrier which is small market size.

INSTITUTIONAL BARRIERS

- ▶ There should be well-orchestrated efforts from both national and local governments to address one of the highest ranked barrier which is lack of subsidies for

businesses. Provision of subsidies should be analysed in more details and if such a policy is undertaken, it should be firmly anchored, among others, in the local development strategies of these municipalities so that the criteria and focus is objectively set and a long-term sustainability is achieved. Some sectors with potential are food processing, tourism (especially in Zubin Potok), agriculture, and food production. A potential form of support can be subsidizing the interest rate given the high cost of access to finance; i.e. use the market to allocate credit based on business case and only use the subsidy to support thereafter. Another option is to use a systemic approach such as Market System Development to ensure market shifts, including affirmative actions to increase cooperation between ethnic communities, for example through supporting joint ventures.

- ▶ Even though the public procurement process at central level is competitive and open; still, central institutions should promote the participation of Kosovo-Serbian owned companies in bids for government tenders and ensure impartial assessment of offers and transparency during contract awarding procedure. In this way, the trust towards government institutions would increase.
- ▶ The government should reduce the tax burden, not necessarily by reducing tax rates, but through reducing additional costs associated with tax payments such as, reporting costs, bureaucratic costs among others.
- ▶ As some public services, such as electricity and road infrastructure, ranked high in the list of barriers, public service providers should focus on improving the roads and ensuring reliable supply of electricity which would reach a wide array of issues and facilitate doing business in the northern municipalities. Moreover, by providing effective public services in infrastructure, health and education, the trust of Kosovo-Serbian community in central and local institutions would increase.
- ▶ Donors who fund projects and actions in the North should develop a common intervention strategy in order to ensure positive synergy and avoid duplication of activities. The joint activities would be more effective and tailored to specific needs of the four northern municipalities. Moreover, similar to the government, donors should look for priority sectors with potential for development and focus on facilitating operations in those sectors; while in all instances aligning the support with local and national development strategies,

- ▶ Government should use its enforcing mechanisms to formalize most of the business stakeholders in the North so that there is a level-playing field for all and competitive setting is ensured.
- ▶ Political risk should be diminished by increasing institutional and business cooperation with other regions in Kosovo; joint fairs could be considered as a first step in this direction.
- ▶ Courts that have jurisdiction over the four northern municipalities should increase their efficiency in order to accelerate the process of settling cases appealed by banks. The risk of not being able to execute the collateral due to the inefficiency of courts has been translated into high interest rates for the clients. A data management system should be developed that could be used to improve the efficiency, transparency, and accountability of the court system, especially of the court dealing with business cases.
- ▶ Financial barriers driven by high interest rates and bank rejection could also be reduced by functionalizing the cadastral system and improving the property rights in the North as well, in order to make the execution of pledged collateral and mortgages less problematic.
- ▶ Another reason reported by banks as to why interest rates are high is low level of financial literacy by business owners. Thus, capacity building programs should be offered to businesses in the northern municipalities on improving financial literacy. This will help entrepreneurs increase their chances of receiving loans since they will be able to present their requests to banks in a professional manner reducing the intrinsic information asymmetry associated with this process.
- ▶ Another way to foster cooperation is through provision of conditional grants or loans. Donors or banks should provide grants or loans to businesses with the condition of inter-ethnic cooperation or partnership. This would increase the motivation of businesses to cooperate, increase trust and allow access to a bigger market.

APPENDIX

APPENDIX

TABLE 1: BUSINESSES THAT HAD AN INCREASE IN SALES IN THE LAST YEAR TABULATED AGAINST: INDUSTRY; FIRM SIZE; MUNICIPALITY; EDUCATION LEVEL OF OWNERS; OWNER GENDER.

	Number of businesses that had increasing sales	Total number of businesses	Percentage of businesses with increasing sales
Industry			
A - Agriculture, forestry and fishing	1	2	50%
C - Manufacturing	6	19	32%
F - Construction	1	3	33%
G - Wholesale and retail trade	8	60	13%
I - Accommodation and food service activities	2	15	13%
M - Professional, scientific and technical activities		1	0%
P - Education	1	1	100%
Q - Human health and social work activities		1	0%
S - Other services activities	3	18	17%
Firm size (annual sales)			
0 - 10,000	13	80	16%
10,000 - 50,000	8	27	30%
50,000 - 100,000	4	10	40%
100,000 - 200,000		5	0%
200,000 - 500,000		4	0%
500,000 - 1,000,000		1	0%
1,000,000 or more	1	2	50%
Municipality			
Leposavic	8	24	33%
North of Mitrovica	7	20	35%
Zubin Potok	4	40	10%
Zvecan	7	45	16%
Education of owner			
Elementary School		1	
High School	8	62	13%
University (BA, MSc, PhD)	18	64	28%
Owner gender			
Male	19	101	19%
Female	7	28	25%

TABLE 2: BUSINESSES THAT EXPECT AN INCREASE IN SALES IN THE COMING YEAR TABULATED AGAINST: INDUSTRY; FIRM SIZE; MUNICIPALITY; EDUCATION LEVEL OF OWNERS; OWNER GENDER.

	Number of businesses that had increasing sales	Total number of businesses	Percentage of businesses with increasing sales
Industry			
A - Agriculture, forestry and fishing	1	2	50%
C - Manufacturing	6	19	32%
F - Construction	1	3	33%
G - Wholesale and retail trade	17	60	28%
I - Accommodation and food service activities	5	15	33%
M - Professional, scientific and technical activities	1	1	100%
P - Education	1	1	100%
Q - Human health and social work activities	1	1	100%
S - Other services activities	7	18	39%
Firm size (annual sales)			
0 - 10,000	28	81	35%
10,000 - 50,000	9	26	35%
50,000 - 100,000	3	10	30%
100,000 - 200,000	1	5	20%
200,000 - 500,000	1	4	25%
500,000 - 1,000,000		1	0%
1,000,000 or more	2	2	100%
Municipality			
Leposavic	10	24	42%
North of Mitrovica	14	20	70%
Zubin Potok	6	40	15%
Zvecan	14	45	31%
Education of owner			
Elementary School		1	0%
High School	17	62	27%
University (BA, MSc, PhD)	26	64	41%
Owner gender			
Male	32	101	32%
Female	12	28	43%

TABLE 3: BUSINESSES THAT SELL TO KOSOVAR ALBANIAN HOUSEHOLDS TABULATED AGAINST: INDUSTRY; FIRM SIZE; MUNICIPALITY; EDUCATION LEVEL OF OWNERS; OWNER GENDER.

	Number of businesses that had increasing sales	Total number of businesses	Percentage of businesses with increasing sales
Industry			
A - Agriculture, forestry and fishing	1	2	50%
C - Manufacturing	7	19	37%
F - Construction	1	3	33%
G - Wholesale and retail trade	16	60	27%
I - Accommodation and food service activities	2	15	13%
M - Professional, scientific and technical activities	1	1	100%
P - Education		1	0%
Q - Human health and social work activities	1	1	100%
S - Other services activities	3	18	17%
Firm size (annual sales)			
0 - 10,000	16	80	20%
10,000 - 50,000	12	27	44%
50,000 - 100,000	3	10	30%
100,000 - 200,000	2	5	40%
200,000 - 500,000		4	0%
500,000 - 1,000,000	1	1	100%
1,000,000 or more	1	2	50%
Municipality			
Leposavic	8	24	33%
North of Mitrovica	10	20	50%
Zubin Potok	7	40	18%
Zvecan	10	45	22%
Education of owner			
Elementary School		1	0%
High School	10	62	16%
University (BA, MSc, PhD)	24	64	38%
Owner gender			
Male	28	101	28%
Female	7	56	13%

TABLE 4: TAX EVASION LEVEL TABULATED AGAINST: INDUSTRY; FIRM SIZE; MUNICIPALITY; EDUCATION LEVEL OF OWNERS; OWNER GENDER.

	Percent of sales not reported for tax purposes	Number of businesses
Industry		
A - Agriculture, forestry and fishing	20%	1
C - Manufacturing	54%	18
F - Construction	63%	3
G - Wholesale and retail trade	38%	36
I - Accommodation and food service activities	43%	11
M - Professional, scientific and technical activities	30%	1
P - Education	100%	1
Q - Human health and social work activities	20%	1
S - Other services activities	48%	11
Firm size (annual sales)		
0 - 10,000	37%	45
10,000 - 50,000	37%	23
50,000 - 100,000	70%	10
100,000 and above	66%	12
Municipality		
Leposavic	53%	23
North of Mitrovica	49%	19
Zubin Potok	41%	17
Zvecan	37%	31
Education of owner		
Elementary School	15%	1
High School	40%	31
University (BA, MSc, PhD)	48%	57
Owner gender		
Male	47%	76
Female	34%	14



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