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EXPORTS AND MNE LINKAGE IN SMEs INTERNATIONALIZATION IN WESTERN BALKAN

Abstract

This article examines the internationalization of small and medium-sized enterprises (SMEs) from the Western Balkans region (WB), observed through the lens of their exports and integration into Global Value Chains (GVCs) by building a solid nexus with Multinational Enterprises (MNEs). The study using both a quantitative and qualitative approach reveals that SMEs, despite their importance in domestic economies, are generally underrepresented in international markets. Such a conclusion can be illustrated by their minor contribution to total exports and their insignificant share of sales to foreign MNEs with headquarters in their country. The results indicate that the SMEs face many obstacles in their attempts to export and integrate into GVCs by building relationships with SMEs-MNEs. Additionally, the findings demonstrate that all economies in their strategic documents have included broad support for increasing export volumes, improving complexity and sophistication, creating higher value-added, enhancing SME-MNE links, improving the quality of the domestic supplier base, strengthening competitiveness and improving productivity while intensifying the internationalization process of small and medium-sized businesses.

Key words: Internationalization, SMEs, Exports, GVCs, MNEs

JEL Classification: F1, F21, F23

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Introduction

Over the past few decades, internationalization and the organization of international production, trade, and investments within the framework of GVCs have been dominant characteristics of the global economy. Various phases of the production process for different goods are in different countries. Internationalization and participation in GVCs offer new opportunities for firms to integrate into the global economy, allowing them to join global production networks instead of building their own from scratch and utilizing international, rather than national knowledge, resources, and inputs in their production. The intensified process of internationalization and expansion of GVCs is driven by various factors, including reducing barriers to trade and investment, efforts by countries and industries to specialize in activities where they have or can develop a comparative advantage, and increased sophistication of MNE business strategies. The degree of internationalization and a country's participation in GVCs depend on the level of economic development, geographical location, policy stability, and environment, as well as sectoral specialization.

For small and open economies, such as the majority of the economies in the Western Balkans, internationalization, export-led development, and participation in GVCs are key factors for achieving inclusive growth. Considering SMEs' economic and social significance and contribution to production and employment in the region's countries, their importance cannot be overlooked when discussing internationalization. Expanding into foreign markets and the internationalization of SMEs are crucial for increasing the productivity and competitiveness of SMEs on a global scale. Encouraging and facilitating SME participation in international markets is an important means of acquiring international knowledge and technology, promoting innovation, expanding business, fostering economic growth, and so on.

Internationalization and the participation of SMEs in international markets can take several forms that are not mutually exclusive. Most commonly, this involves direct export to foreign countries and indirect export through sales to other exporting firms, as well as imports. Although less common in practice, SMEs can also engage in joint ventures with foreign firms in their domestic or foreign markets. They can also participate in GVCs by focusing on specific segments of production of a set of goods and services, for example, by supplying a foreign firm or MNE in the host market with domestic inputs (goods or services). Conversely, supply agreements occur when SMEs purchase goods or inputs from foreign MNEs headquartered in their home country. Another way to establish such links with MNEs is through licensing agreements,

whereby SMEs or a group of SMEs obtain a license from an MNE to produce and sell goods under a brand or trademark or use patented technology. Yet another way to establish SME-MNE relationship links is through research and development agreements, where MNEs and SMEs undertake joint research and development of a product, service, or production method.

The integration of SMEs into GVCs represents one of the key drivers of growth in small, open economies. Hence, countries aiming to increase productivity, acquire knowledge and technology, and create quality jobs, enabling involvement in higher value-added activities, focus primarily on policies based on leveraging GVCs. Thus, countries in the Western Balkans have long sought to achieve higher export-led growth and increase the value-added of regional production. Therefore, further integration of SMEs into GVCs should be a primary focus in these countries to enhance export complexity and generate greater value-added in each economy.

Given the above, there is a need in this study to examine the participation of SMEs from the Western Balkans region in the process of economies' internationalization, with a particular focus on exports and integration into GVCs through building solid relationships between SMEs and MNEs. The goal is to observe the actual level of SME internationalization, the reasons for the current state, the challenges SMEs face for greater integration into international flows, and the needed policies for their enhanced internationalization. The countries of the Western Balkans under consideration are Kosovo, Albania, North Macedonia, Serbia, Bosnia and Herzegovina, and Montenegro.

The methods used in the study are with the nature of the research question, namely: the method of analysis and synthesis, comparative method, historical method, and inductive-deductive method, while also utilizing basic statistical tools for data analysis primarily obtained from secondary sources.

1. INTERNATIONALIZATION OF SMES IN THE WESTERN BALKAN COUNTRIES ACHIEVED THROUGH EXPORTS

SMEs and entrepreneurs, including those in the Western Balkans, are key economic actors in all countries, which have a significant share in employment and production and play a significant role in innovation and value creation. In 2020, SMEs in Western Balkan region made up 99.7% of all enterprises, with microenterprises accounting for the vast majority (90.1%). They accounted for an average of 71.9% of business employment, and 65% of the business sector's value added in 2020.¹ However, when evaluating

1 OECD, SME POLICY INDEX: WESTERN BALKANS AND TURKEY, 2022, p. 33-35

the degree of internationalization from the aspect of exports, it can be noted that despite their significance in domestic economies, SMEs are generally inadequately represented in international markets. For example, in the countries of the Western Balkans, the contribution of SMEs to total exports mainly ranges between 20-60% (Graph 1).

Graph 1. SMEs’ share in exports in WB economies (2017-21)



Source: Statistical offices, ministries and SME agencies of the six Western Balkan economies
 * Data for Kosovo and Montenegro are not available.

These figures are higher only in two countries in the region, Albania and Bosnia and Herzegovina, with average around 61% and 51%, respectively, while the other countries are far below these averages, especially SMEs in the Republic of North Macedonia (around 26%).

The insufficiently high levels of participation of SMEs in international markets, in terms of exports, are mainly explained by the inherent characteristics of small businesses. For example, SMEs are concentrated in sectors that cannot be traded globally, such as retail, construction, and services. SMEs are also largely absent in internationally oriented sectors where volume is important and where large investments in physical assets are the norm (e.g. commodities, heavy industry, large-scale manufacturing, etc.). This can best be seen in Table 1, which shows the nature of the sectors of operation of SMEs in each of the analyzed economies.

Despite the importance of SMEs in the region and their contribution to production and employment in the region, they still face numerous obstacles in

their efforts to export and integrate into GVCs. Among the most significant are: lack of export capacity, poor quality and narrow export base, administrative barriers, and restricted access to finance. Other barriers to the SMEs internationalization, in terms of exports, include so-called “internal” barriers such as: low capacity to access information (e.g., in foreign markets) and a lack of managerial and technical knowledge and skills (e.g., languages, finance, cultural norms, etc.). These also include “external” barriers encompassing: burdensome regulatory procedures (in domestic and foreign markets), poor infrastructure, and challenging business environments (such as corruption, weak property rights, etc.).

Table 1. Distribution of SMEs by sector across the Western Balkans (2020 or latest available year)

	ALB ¹	BIH ¹	KOS	MKD ¹	MNE	SRB ¹	WB average
Agriculture, forestry and fishing	..	1.20%	1.82%	3.83%	1.86%	3.83%	2.51%
Mining and quarrying	0.66%	0.26%	0.32%	0.51%	0.36%	0.35%	0.49%
Manufacturing	7.96%	4.46%	12.46%	24.69%	11.48%	16.56%	15.52%
Utilities	0.60%	0.73%	0.58%	2.32%	1.01%	1.68%	1.38%
Construction	3.76%	1.91%	7.37%	9.18%	18.67%	8.83%	9.94%
Distributive trade	40.01%	6.98%	38.68%	29.64%	48.32%	31.86%	39.10%
Transportation and storage	4.98%	1.68%	3.59%	8.71%	7.42%	6.58%	6.59%
Information and communication	2.59%	0.96%	2.58%	4.63%	6.06%	6.24%	4.61%
Other services	39.27%	6.22%	32.59%	20.34%	4.82%	24.07%	25.46%

Source: OECD, SME POLICY INDEX: WESTERN BALKANS AND TURKEY, 2022, p. 36
¹ 2019 data due to unavailability of 2020 data. For Bosnia and Herzegovina, data do not include unincorporated enterprises. Due to the unavailability of state-level data, data for Bosnia and Herzegovina have been calculated by aggregating the data of the Federation of Bosnia and Herzegovina and Republika Srpska.

In order for SMEs not to encounter additional barriers hindering their internationalization, governments need to ensure appropriate export-oriented policies and facilitate access to foreign markets for SMEs. Together with their respective export promotion agencies, they should provide support that recognizes the needs, capabilities, and limitations of SMEs.

Regarding the internationalization of SMEs in the Western Balkans, the OECD conducts analyses on several sub-dimensions, one of which is the dimension related to the promotion of SME exports. This dimension examines export promotion programs for SMEs with potential for internationalization. It evaluates the design of schemes for financial and non-financial support and their alignment with domestic strategies, while also assessing their implementation and effectiveness. This section also examines existing monitoring and evaluation systems to analyze the extent to which export promotion strategies and support schemes are being followed.

According to the latest analyses and assessments by the OECD, all economies in the region, except Kosovo, have improved their performance compared to the previous assessment cycle regarding this dimension. Despite the COVID-19 pandemic, which significantly impacted the operations of SMEs and export promotion activities throughout the region, overall implementation has been improved. Monitoring and evaluation have also been enhanced, but they remain weak for export promotion, lacking independent reviews and measurable objectives in key strategic documents.²

The assessments indicate that all strategic documents specific to SMEs in the Western Balkans region emphasize export promotion. All economies have included broad support to increase export volume, as well as to improve its complexity, sophistication, and creation of higher value added. As part of various programs, all WB economies provide SMEs with financial and non-financial support for their internationalization efforts. Financial support entails trade financing, export credits, and grants, subsidies for participation in fairs, and business-to-business (B2B) linkages. Non-financial support for SMEs includes capacity-building activities, training, and technical assistance. The effectiveness of this support varies throughout the region. However, in many economies of the WB, fragmentation of information sources on available export support for SMEs occurs, as governments inform SMEs through government portals or various project websites. Additionally, all WB economies, except Montenegro, have export promotion agencies, but with different mandates. For example, KIESA in Kosovo has extensive mandates to manage broad support for SMEs, not only in the area of export promotion.

Such assessments promise potential for improvement in terms of increasing exports, and thus in the level of internationalization of SMEs in the countries of the region.

2 OECD, Internationalisation of SMEs (Dimension 10) in the Western Balkans and Turkey, <https://www.oecd-ilibrary.org/sites/bdb2a544-en/index.html?itemId=/content/component/bdb2a544-en#chapter-d1e44238>

2. INTERNATIONALIZATION AND INTEGRATING SMES INTO GVCs: LINKS WITH MNEs IN THE CASE OF WESTERN BALKAN COUNTRIES

Given that in the WB region, SMEs often struggle to access GVCs through direct export due to restricted market access or limited export capacity, it is assumed that by leveraging MNEs that already have established operations in the region and by facilitating the investment framework to attract new enterprises into the economies, their internationalization and integration into GVCs could be facilitated. MNEs can achieve this through FDI, which, among other things, serves to connect and organize production across countries. Specifically, by fostering links between SMEs and foreign companies, SMEs can become involved in GVCs by providing inputs and services to MNEs based in their countries. The involvement of SMEs in the supply chain largely depends on the volume and intensity of the links, the absorption capacity of SMEs, and the sector of activity.

This approach to linking is beneficial for both sides of the relationship: SMEs benefit from the transfer of knowledge and technology, thereby enhancing their performance and productivity. On the other hand, MNCs reduce their operational and transaction costs by sourcing directly from the local market.

Table 2. Percentage of the domestic companies' sales made to multinationals located in seller's economy (% of total sales in each country)

	Albania	Bosnia and Herzegovina	Kosovo	Montenegro	North Macedonia	Serbia	Western Balkans
2017	2.0	4.0	4.0	3.0	2.0	5.0	3.3
2018	4.0	7.0	9.0	3.0	4.0	9.0	6.0
2019	1.0	6.0	3.0	6.0	6.0	7.0	4.8
2020	1.0	3.0	1.0	4.0	2.0	1.0	2.0
2021	1.0	6.0	14.0	1.0	4.0	6.0	5.3
Average for all years	1.8	5.2	6.2	3.4	3.6	5.6	4.3

Source: Regional Cooperation Council, BALKAN BAROMETER - Business Opinion, Analytical report, 2022, 2021, 2020, 2019, 2018

However, data from Western Balkan countries on sales by domestic firms to MNEs indicate that only a small portion of sales by domestic companies are made to foreign MNEs with headquarters in their country. Over the past five years of research conducted by the Balkan Business Barometer, carried out by the Regional Cooperation Council, the majority of sales made by domestic firms to foreign MNEs were in Bosnia and Herzegovina, Kosovo, and Serbia, while the average for all economies over the entire five years was only 4.3% of sales (Table 2). This suggests that investments by multinational companies in the Western Balkans region have provided few links to the local economy and have done little to develop intra-regional trade. Hence, the effects of the participation of foreign firms (MNEs) in industries supplied by domestic firms are extremely limited.

MNEs are interested in finding suppliers from the Western Balkans region, but face numerous obstacles, including the small size of local companies, the relative lack of capacity and technical quality of local suppliers, as well as the lack of clusters and networking among companies on a local or regional basis. As a result, most MNEs look beyond the Western Balkans region to meet their supply needs.

Furthermore, in establishing relationships with MNEs, SMEs in the WB region face additional obstacles even after establishing a connection with MNEs. In this case, the main obstacles are considered to be weak competitiveness due to insufficient quality of products and services from domestic suppliers, as well as low productivity expressed through their inadequate production capacities and internal processes. Besides these, other obstacles are identified: skills shortages, institutional changes, frequent regulatory modifications, customs delays, unfair competition, and a lack of transparency in regulations.³

Such a situation imposes the need for a more active role of central and local authorities in building the capacity for supplying local SMEs to engage in relationships with the supply chain with MNE producers, both within and outside the enterprises.

The latest analyses conducted by the OECD on the internationalization of SMEs from the WB indicate that governments aim to increase the participation of SMEs in GVCs. The integration of SMEs into GVCs is included in all national strategies regulating the internationalization of SMEs across the region, with approaches ranging from promoting links between SMEs

3 Ilahi, N. et al., "Lifting growth in the Western Balkans: The role of global value chains and services exports", *Departmental Papers Series*, No. 19/13, International Monetary Fund, Washington, DC, 2019 <https://doi.org/10.5089/9781498314916.087>.

and MNEs and developing the domestic supplier base to forming clusters and attracting FDI. The most common approach outlined in strategic documents is to focus on enhancing the competitiveness and increasing the productivity of SMEs.

In order to become suppliers to MNEs, SMEs must adhere to the quality requirements and international standards of larger enterprises, which often pose a challenge, especially for SMEs with limited economies of scale. In this regard, almost all economies have introduced supplier development programs aimed at improving the quality of suppliers in the economy or tools for better connecting domestic SMEs with potential investors and MNEs. For example, Serbia has implemented a Supplier Development Program administered by the Development Agency aimed at improving the quality of the supplier base and supporting SMEs in adhering to international standards by assisting them with equipment procurement and capacity-building to upgrade their operations. On the other hand, Albania, North Macedonia, and the Republic of Srpska have intensified their efforts to increase connections between domestic SMEs by introducing business-to-business linking platforms or supplier directories.

Furthermore, four of the evaluated economies significantly progressed in the area of cluster formation and development. Thus, the governments of Albania, Bosnia and Herzegovina, Kosovo, and Montenegro have implemented cluster development programs and intensified their institutional support for industrial groupings by strengthening financial and non-financial incentives for SMEs with cluster potential. At the regional level, in six of the Western Balkans, an inter-agency initiative was established - the Regional Supplier Development Program - which assists SMEs in building their capabilities and readiness for export for better integration into GVCs.

Most of the GVC links formed in the Western Balkans region originate from low-value-added production and services.⁴ This indicates the need to transition to higher-value activities, increase the regional output's value-added, and attract high-quality profiles for FDI. Recognizing this need, the role of investment promotion agencies becomes increasingly important in attracting investors, creating jobs, and overall productivity growth.⁵ All economies in the region have dedicated investment promotion agencies that vary in terms

4 OECD, Unleashing the Transformation Potential for Growth in the Western Balkans, 2019, OECD, Paris, https://www.oecd.org/south-east-europe/programme/Unleashing_the_Transformation_potential_for_Growth_in_WB.pdf.

5 OECD, Mapping of Investment Promotion Agencies in OECD Countries, 2018, OECD, Paris, <https://www.oecd.org/investment/Mapping-of-Investment-Promotion-Agencies-in-OECD-Countries.pdf>.

of their mandates and effectiveness. For example, in Bosnia and Herzegovina, Montenegro, and North Macedonia, investment promotion agencies do not provide financial support to SMEs and primarily serve informational purposes. On the other hand, KIESA in Kosovo, AIDA in Albania, and the Development Agency of Serbia have broad mandates that go beyond exports and investment promotion, including extensive support for SMEs.

3. RECOMMENDATIONS FOR IMPROVING THE SMEs INTERNATIONALIZATION IN THE WESTERN BALKANS REGION

Despite the importance and contribution to production and employment of the SMEs in the region, they still face numerous obstacles in their efforts to internationalize and integrate into GVCs, both in terms of exports and in building relationships with MNEs. Considering that inadequate export readiness, low quality of supplier base, and suboptimal absorption capacities are the main obstacles to internationalization in the WB region, the government of each WB country can play an important role in facilitating the integration of SMEs into global markets through a well-targeted, comprehensive policy mix of financial and non-financial support.

Some important guidelines for future actions include:

- Removing administrative barriers to exports and investments in economies, as well as building export capacity and a quality expanded export base, and overall improving the business environment by preventing corruption and improving the legal system.
- Establishing dedicated centralized portals for export promotion, which will be regularly updated and where data on all available export promotion support and current policies can be found.
- To continue strengthening monitoring and evaluation of export promotion programs and to enhance data collection mechanisms. In addition to tracking the satisfaction of SMEs using government support schemes, quantitative targets should be defined and monitored, and performance-based monitoring and evaluation should be introduced. The same should be done for policies promoting the integration of SMEs into GVCs through the establishment of SME-MNE relationship links.

Governments and investment promotion agencies should monitor the work of support scheme users and accordingly collect data on potential SME-MNE links.

Measuring the performance of SMEs after undertaking these initiatives can provide significant insight into both the positive and negative effects of selected policies, which will later demonstrate their sustainability for both users and the efficient distribution of resources.

- Creating comprehensive policies to enhance SME productivity, as well as improving and expanding the supplier base in the economy to attract FDI. To achieve this, it is necessary to focus on capacity building in areas such as management, innovation, and upgrading production capacities, as well as achieving alignment with international standards.
- Strengthening the capacities of investment promotion agencies to fulfill their mandates. This could be achieved by ensuring stronger coordination among investment promotion agencies and government bodies responsible for SME policies, especially among agencies with broader mandates that involve extensive support for SMEs, as well as ensuring that budgets and personnel are appropriate for their goals and roles entrusted to them.

Such measures to facilitate export promotion and establish sustainable integration of SMEs into GVCs through building strong SME-MNE relationships can expand SME achievements, improve their productivity levels, and generate greater added value, consequently leading to increased economic growth in the countries.

Conclusion

Encouraging and facilitating the internationalization and participation of SMEs in international markets is an important means of promoting economic growth, innovation, and increased productivity. Moreover, through internationalization, SMEs have the opportunity to expand their businesses and gain international knowledge and technology. In pursuit of these benefits, SMEs in the economies of the WB region are striving to increase their level of internationalization both in terms of exports and in building stronger relationships with MNEs. However, analyses of these efforts indicate that they are not sufficient. At the time of conducting the analyses, SMEs were

characterized by low participation in total exports in each economy and weak links with MNEs headquartered in their country. Specifically, the contribution of SMEs in the Western Balkan countries to total exports mainly ranges between 20-60%, with the highest percentage in Albania and Montenegro (around 61% and 51% on average, respectively), and the lowest participation in North Macedonia (around 26%). Regarding the links with MNEs, it is shown that the average sales made by domestic firms to foreign MNEs for all economies over all five/seven years is only 4.8% of total sales, which is indeed a low percentage.

The above indicates that SMEs still face numerous obstacles in their efforts to export and integrate into GVCs, building SME-MNE relationships. The main obstacles include a lack of export capacity, a narrow export base with low-quality products, restricted access to finance, concentration in sectors that are not tradable, the small size of local companies, capacity and technical quality deficiencies among local suppliers, a lack of clusters and networking among local or regional companies, weak competitiveness, and low productivity. Additionally, other obstacles are identified, such as low capacity to access information, a shortage of managerial and technical knowledge and skills, institutional changes, poor infrastructure, challenging business environments, frequent regulatory modifications, a lack of transparency in regulations, burdensome regulatory procedures, customs delays, unfair competition, etc.

To ensure that economies provide SMEs with no additional barriers hindering their internationalization, they have included extensive support to increase export volume, as well as to improve its complexity, sophistication, and creation of higher added value. Additionally, in all strategic documents specific to SMEs in the Western Balkans region, export promotion is emphasized. Furthermore, all national strategies regulating the internationalization of SMEs include integrating SMEs into GVCs by promoting links between SMEs and MNEs and developing the domestic supplier base, forming clusters, and attracting FDI. The key approach outlined in the strategic documents is to focus on strengthening the competitiveness and increasing the productivity of SMEs. The relevant export promotion and investment agencies should continue to provide support, which recognizes the needs, capabilities, and limitations of SMEs.

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