Entrepreneurship and Innovation: Evidence from SMEs in Prishtina region, Kosovo

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Abstract

Innovation has become a central theme and challenge in the literature of entrepreneurship, SMEs management, and strategic knowledge management and in the literature of organizational learning. Innovation needs a business environment that is conducive to long-term investments in new business activities. This way, the development of innovation policy in SMEs forms an important environment that needs to be supported by government new economic policies and strategies and especially by new approach to entrepreneurship and innovation.

In this paper we address the innovation strategies of SMEs engaged in the production of products and services. We base our conclusions on an analysis of primary data collected in a survey of 80 small and medium sized firms in the region of Prishtina, held between March 2014 and May 2014.

The results show that innovation in business tends to be driven by external competitive pressures and customer demands. Many SMEs face financial barriers to engaging and undertaking innovation, while a few of them have been seriously engaged in innovation despite the obstacles.

Keywords: Entrepreneurship, Innovation, SMEs, Competition, Strategy, Funding

JEL Classification: M0, M1, M2, O3, O30, O31, O32, O33, O34, O38

1. Introduction

Innovation has become a central theme and challenge in the literature of entrepreneurship, SMEs management, and strategic knowledge management and in the literature of organizational learning. In this context innovation can be understood as continuous improvement or as a proactive attitude towards the external world. In this paper we investigate empirically the innovation behavior of entrepreneurs in small and medium sized enterprises in the region of Prishtina, in Kosovo.

Both economic theory and empirical studies show that innovation is a key enabler of productivity and economic growth. Innovation needs a business environment that is conducive to long-term investments in new business activities. This way, the development of innovation policy in SMEs forms an important environment that needs to be supported by government new economic policies and strategies and especially by new approach to entrepreneurship and innovation. In the European Union (EU), this approach has been incorporated in the "Horizon 2020" which actively supports SMEs by providing both direct financial support, and indirect support to increase their innovation capacity. 'Innovation in SMEs' aims at creating a bridge between the core of the framework program - support to research, development and innovation projects - and the creation of a favorable ecosystem for SME innovation and growth.

Focus on innovation activities and the development of a innovation policy is important for economic development of Kosovo, as this will help local SMEs increase productivity opportunities, competitiveness and the growth of exports. A healthy business environment is a prerequisite for strong innovation performance because it favors foreign investment, which in turn can stimulate innovation through various channels such as investment in R&D investment. In general, the quality of macroeconomic policies to and openness to innovation are likely to have a favorable impact on the effectiveness of innovation policy at level of SMEs community.[1]

In this paper we address the innovation strategies of SMEs engaged in the production of products and services. We base our conclusions on an analysis of primary data collected in a survey of 80 small and medium sized firms in the region of Prishtina, held between March 2014 and May 2014.

An innovation strategy for Kosovo SMEs community must find a balance between building so much needed new production and service capacities and ongoing challenges regarding funding and internationalization. At the level of firms, data on the innovation performance of companies in Kosovo are rare. In survey conducted for this paper, the results show that innovation in business tends to be driven by external competitive pressures and customer demands. Many SMEs face financial barriers to engaging and undertaking innovation, while a few of them have been seriously engaged in innovation despite the obstacles.

2. Literature review

The attitude of entrepreneurs towards innovation and learning and their application is very significant for the performance of the whole enterprise. Porter (1979) ranges innovation behavior from the

[1] Christensen, Clayton M. *The Innovator's Dilemma: When New Technologies Cause Great Firms to Fail*. Boston, MA: Harvard Business School Press, 1997.

innovating entrepreneurs via the imitating ones to the followers. O'Regan and Ghobadian, (2004) make the distinction between prospectors and defenders entrepreneurs, where the crucial difference is contained in their attitude and in their management qualities: the innovative prospector compared to the non-innovative defender type of entrepreneurs. Kahn and Manopichetwattana (1989), came up with 'silver spoons' as these entrepreneurs worked fewer hours than their innovative counterparts and exhibited further low management qualities while their product - and marketing strategies were engineered long ago and continued to serve them well. The innovative small and medium sized enterprises (SMEs) were more proactive and more prone to risk taking and also exhibiting more product differentiation and higher R&D spending.

O'Regan and Ghobadian (2004) explain the attitude towards innovation as a part of the entrepreneurs' strategic orientation and perception of the environment. Continuous business process improvement is very much related to continuous innovation and the former goes back to managerial decision making. Business process improvement is rooted in the design of socio-technical systems, human relations and the discussion surrounding lean and mean manufacturing **(**Imai, 1986; Baba, 1989). Once the capability to continuously improve is established, it can easily contribute to continuous innovation. (Bessant, et al. 2001).

Innovation cannot be done in isolation, that is, relationships matter also and a high level of interdependence grows among groups of firms. Chapman and Corso (2005) highlight that collaboration between companies and company networks in many industries are essential for surviving competition. This encourages continuous innovation which is firmly based on dynamic capabilities of firms (Teece et al., 1997); knowledge creation and absorption, knowledge integration and knowledge reconfiguration (Verona and Ravasi, 2003). Continuous innovation is also connected to the firms' knowledge management systems and processes (Chapman and Hyland, 2004).

The needs and requirements of the environment impact the innovation strategy of SMEs. SMEs that feels pressurized to innovate by the environment needs and requirements react by modifying existing products rather than introducing new ones. SMEs that have a strong external orientation and continuously look for opportunities are much more likely to be engaged in new product development or management practices (O'Regan and Ghobedian, 2004).

Competition and innovation policies

Competition policy is closely linked to innovation**.** High levels of competition in product markets contribute to the growth of GDP per capita, by stimulating the reallocation of resources towards more productive activities. According to Aghion et al. (2005), competition may increase the additional profits from innovation and thereby encourage R & D investment. More competition can encourage innovation and growth because it may reduce pre-innovation earnings of the firm more than reduces the after-innovation earnings. Firms in this way seek to reduce the income that can be withdrawn from a follower who has succeeded in achieving his rival with innovation.

Law on Protection of Competition establishes rules and measures for the protection of free competition and effective market and defines the powers and organization of the Authority for the Protection of Competition, as well as procedures relating to the implementation of this law. Kosovo competition law is now fully compliant with EU standards, but still needs to ranks, for example the definition of a dominant market position. The gates of turnover and the obligation to notify companies of planned mergers

should be adjusted to a level appropriate for the size of the economy of Kosovo (European Commission, 2011).

Access to finance and funding

Access to finance is key to enabling innovation and enterprise growth. In order to engage and undertake innovation, companies should be able to fund research and invest in new equipment. However, businesses, especially those just started, micro firms and SMEs, may find it difficult to obtain external financing. They face obstacles that include asymmetric information, budget overruns and lack of data on the flow of credit.[2]

Innovation in the business sector

In this section we examine the role of innovation in the business sector in Kosovo. Although the business sector still needs to overcome numerous internal and external obstacles to innovation, some examples of good practice can be found.

The main business associations and business support organizations operating in Kosovo should represent the needs and interests of the business sector, and also to provide additional insight and guidance in order to facilitate innovation activities in companies. Business associations and business support organizations play an increasing role in innovation, but they lack the capacity to fulfill their potential in the implementation of innovation policy. This is particularly important in the case of industry associations that need to address sector-specific issues, including those related to innovation.

In this paper we examine the involvement of innovative activities in the SMEs in the region of Prishtina. Based on survey of 80 innovative companies, which was designed and implemented as part of this paper, this section examines the drivers of innovation and perceived barriers to innovation. The survey targeted the SMEs that had implemented at least one recent innovation, whether it is a new for the company, new to the market or new to the world, and whether it is a new product or service, a new process, a new technique of marketing or an organizational change.

The surveyed companies report more innovation activities and consider that such activities have significant financial impact. At the same time, their innovation and growth is largely reactive. It revolves around the product/service enhancements directed by external competitive pressures and customer demands. Companies report a high level of cooperation on innovation, but mostly with suppliers and customers than research organizations. They report limited use of external sources of knowledge, preferring to use resources such as the internet or fairs, more than research or business associations. Number of graduate employees in the surveyed companies was low, with the exception of the ICT sector, and nearly half of all companies reported that "brain drain", had impacted negatively on their operations. Despite this, companies realized that the main obstacles to innovation are financial constraints and the role of government, rather than internal barriers such as lack of qualified personnel or adequate information technology.

Companies report significantly lower levels of government support for innovation activities, and their analysis of government policy most helpful measures were somewhat contradictory. However there has been continued support with importing equipment, regarding R&D, and common feeling was that

[2] Fadil Govori (2011): Financa, IFM, Prishtine

networking and building of links with the Diaspora should be a high priority. Any measure of government policy should be cost effective and reach a wide number of companies and other organizations and help them to share knowledge and develop links.

3. Research Methodology

The research aims to identify innovation activities and their drivers, and to indicate barriers that limit the ability of companies to innovation. The survey also asks respondents to identify potential measures of government policies to encourage more innovation in local companies. Results from the survey will be used for purposes of this paper. The methodology of this survey and the characteristics of the participating companies are described in detail in Appendix A.

Innovation activities

Surveyed businesses were asked to describe their innovation activities in recent years, the rate of innovation and its impact on their turnover and profits. These companies also stated the external financial support they have received to undertake innovation, financial resources they have dedicated for R&D and innovation activities.

For the purposes of this survey, innovation is defined as something that is new for the company, new to the market or new to the world. Innovation may include:

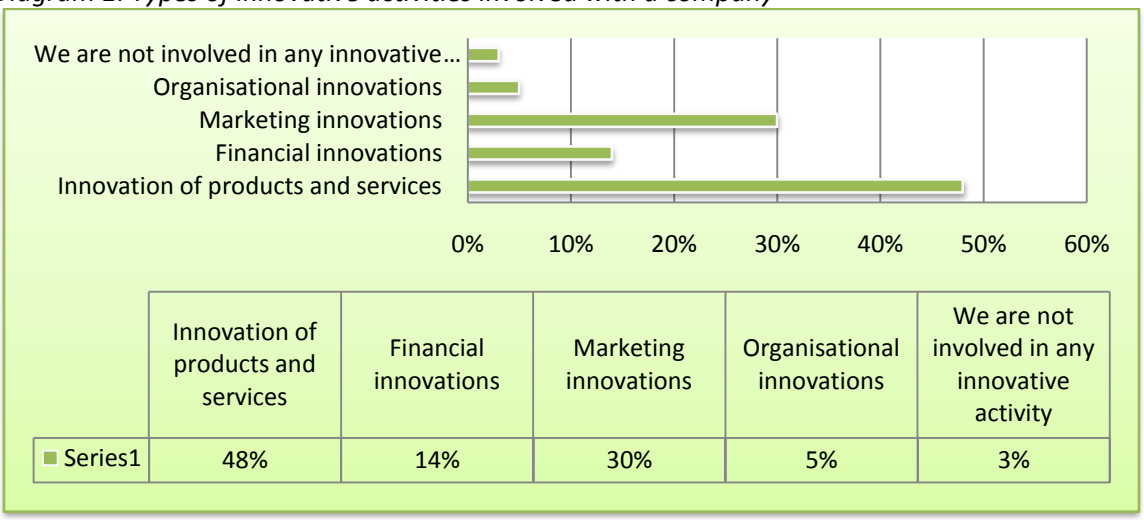
- Independent product or service innovation - new product or upgrade / service with new features and functionalities.
- Innovation of the process - different process for the production of existing products.
- Marketing innovation - an existing product or service, marketed differently (different terms of distribution, other price, market positioning, advertising, etc.).
- Organizational innovation - different logistics, warehousing or insurance.

Results of research for innovative activities

01. At what types of innovative activities are you involved with as a company?

As shown in Diagram 1, during the period 2010-13, the most common activities of the companies participating innovation that were presented were independent products or service innovation (48%). The second most common was marketing innovations, which were presented by 30% of the target companies, followed by financial innovation (14%) and Organizational innovation (5%). The innovation of product/service is in line with those of surveyed companies which they see as the main drivers of innovation, which include customer needs, preferences and pressures. Companies generally will dedicate their scarce resources to types of innovation that are most likely to bring benefits in a secure relatively short period of time. Focus group participants also emphasized that larger companies tend to have more knowledge and be more aware of the process of innovation and better access to resources. Because small companies need immediate income and inventing is dangerous and costly, they are often discouraged from innovations.

Diagram 1: Types of innovative activities involved with a company

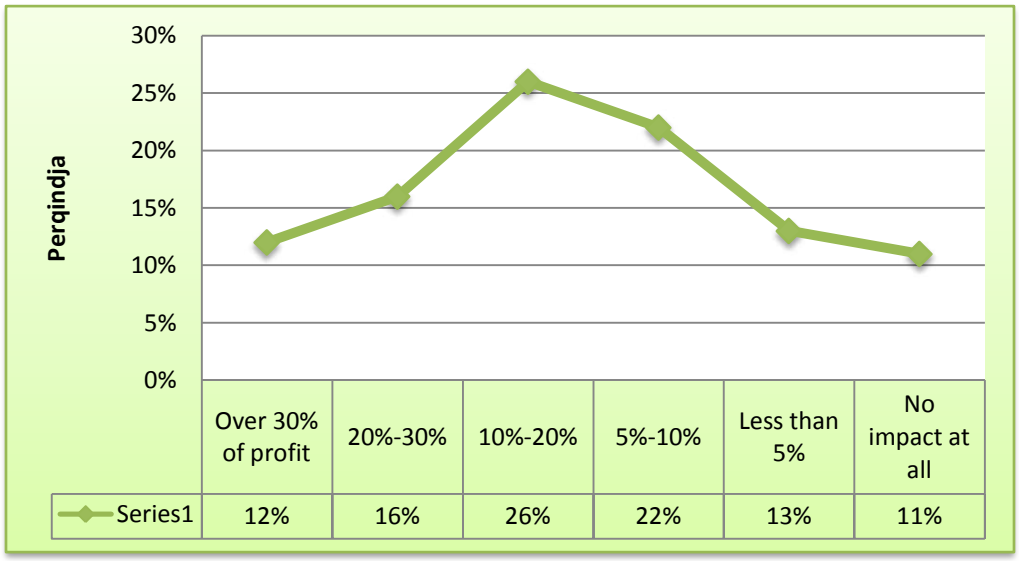


	Innovation of products and services	Financial innovations	Marketing innovations	Organisational innovations	We are not involved in any innovative activity
Series1	48%	14%	30%	5%	3%

02. How would you evaluate the impact of innovation on profits of the operating company?

Innovation is perceived as having a positive impact on turnover and profit. When asked how they would assess the impact of the innovations introduced in the profit of a company, the majority of respondents indicated that they could see a concrete effect (see diagram 2). More than half of the respondents indicated that the estimated impact of innovation has resulted in at least a 10% increase in profits. These results should be treated with caution, as the assessment of the effects of innovation on the profit is usually less reliable than the estimation of these effects on turnover. Profit is a complex category which includes other parameters, some of which are dependent on the accounting policies of a company.

Diagram 2: The impact of innovation on profits of the operating company

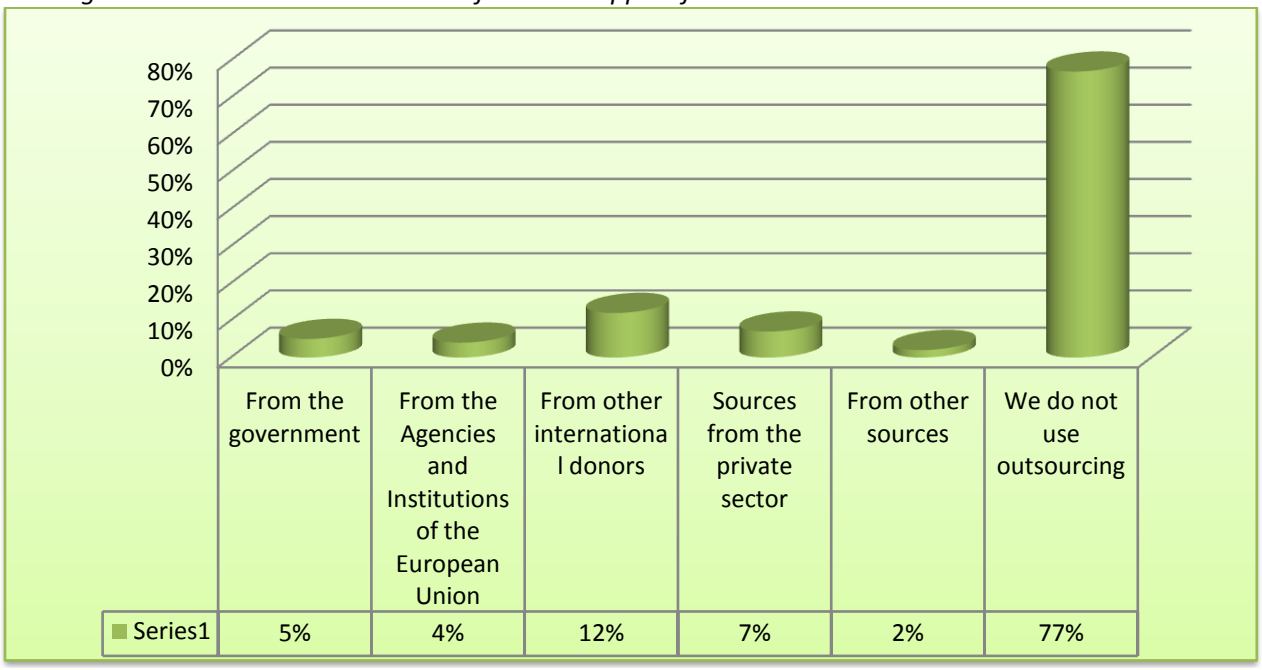


	Over 30% of profit	20%-30%	10%-20%	5%-10%	Less than 5%	No impact at all
Series1	12%	16%	26%	22%	13%	11%

03. Which external source is used as financial support for innovation?

Only a few companies get external funding for innovation. From the total number of companies that introduced an innovation, the majority have not received any external financial support for their innovation activities.

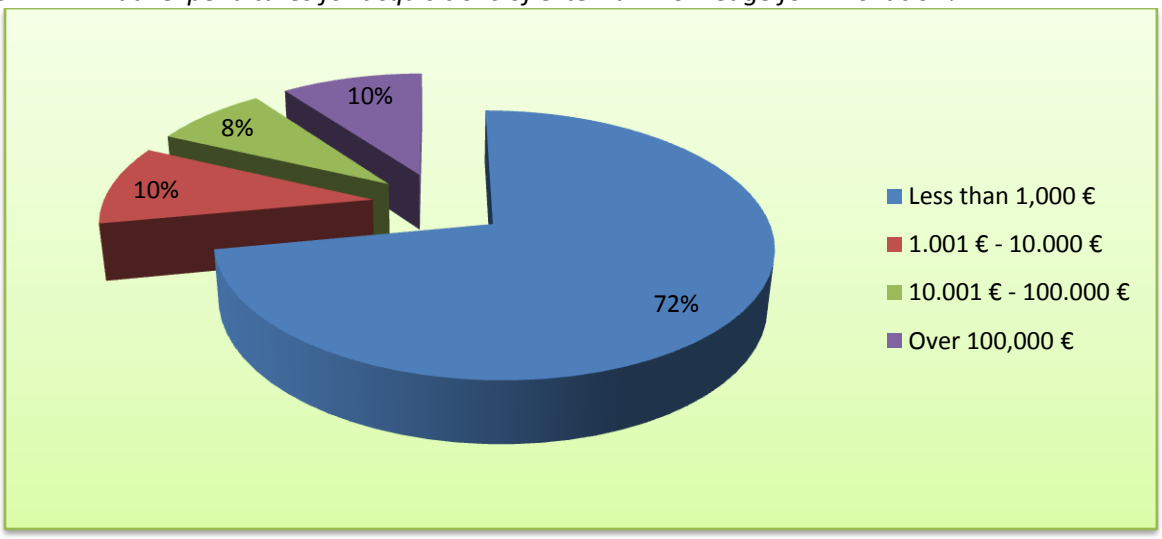
Diagram 3: External sources used as financial support for innovation



04. How much is the value of annual expenditures for acquisitions of external knowledge for innovation?

When it comes to buying foreign knowledge, 72% of companies invest less than 1000€ in these activities, while only 20% of companies invest more than 10,000€ (see diagram 4).

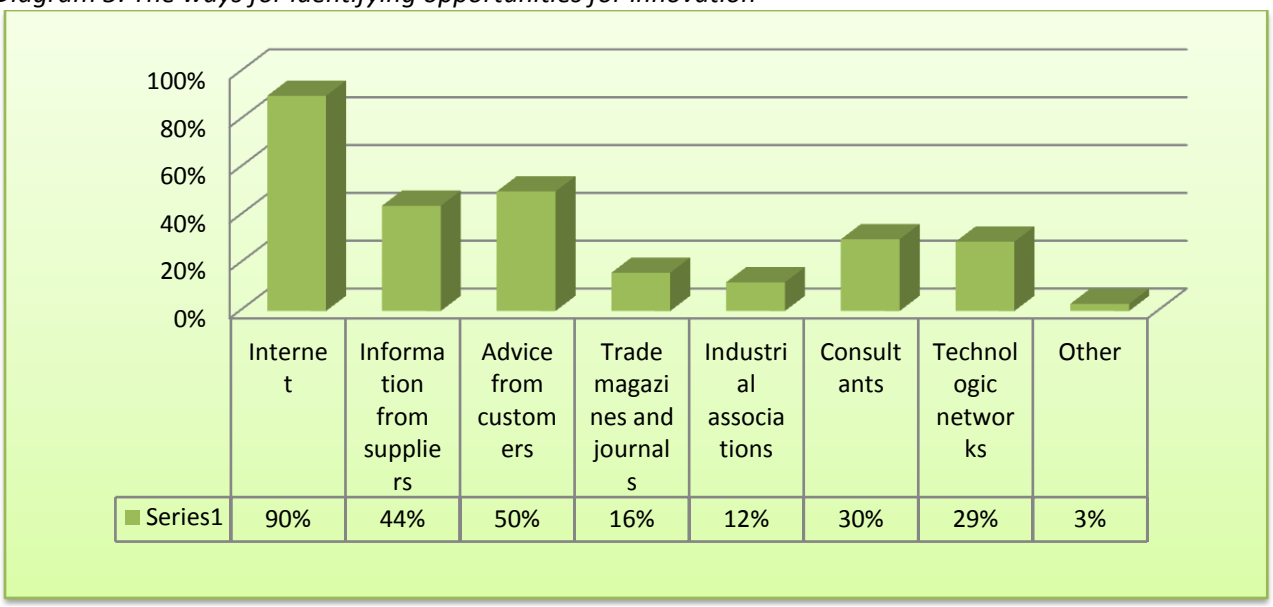
Diagram 4: Annual expenditures for acquisitions of external knowledge for innovation?



05. How do you identify opportunities for innovation?

The four most important sources of information about opportunities for innovation are: internet, advice from consumers, consultants, and information from suppliers (see diagram 5). Given their financial constraints, companies tend to use information sources that are free, or combined with other activities oriented on sale, such as fairs and cetera. Industry associations, trade magazines and research institutions all seem to be scarce; associations' ties within the innovation system and their ability to access more complex sources of knowledge are undeveloped.

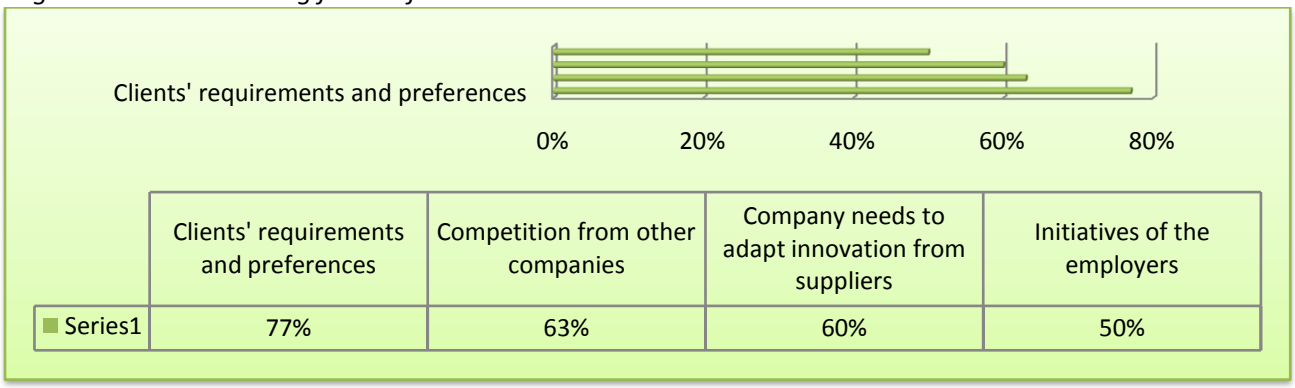
Diagram 5: The ways for identifying opportunities for innovation



06. What are the motivating factors for innovation?

Companies participating in the survey were asked to consider what they have stimulated innovation (i.e., what "drove" them towards innovation), the type of innovation that they wanted to pursue, and what can deter them from inventing (i.e., the main obstacles to innovation).

Diagram 6: The motivating factors for innovation

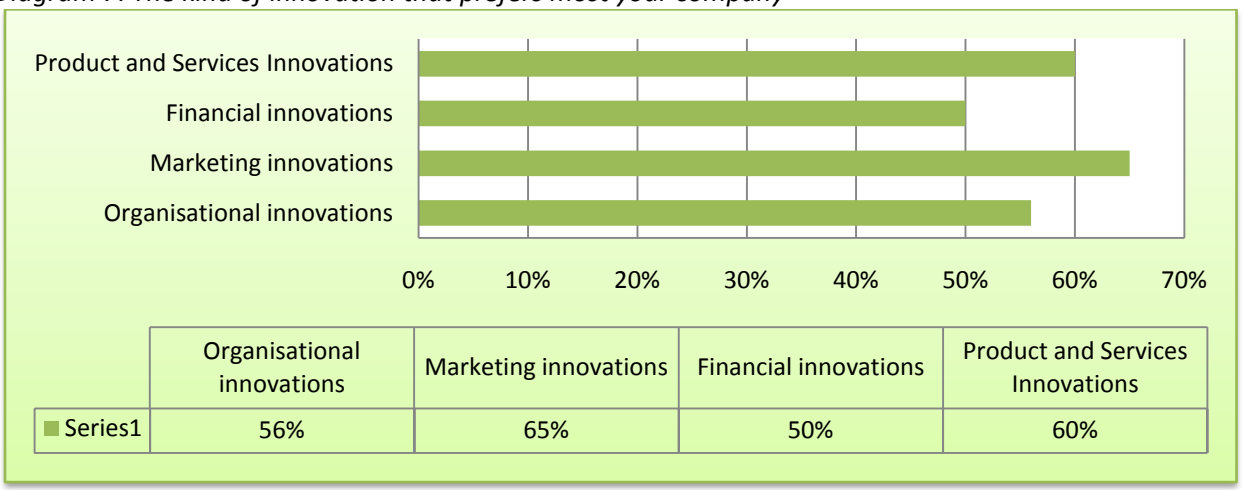


When it comes to the main motivation for innovation, most participants mentioned customer needs and preferences (77%), competition from other companies (63%) and the need for adaptation to innovation from suppliers (60%). However, about 50% of respondents cited the initiatives of its employees as a speaker for innovation (see diagram 6).

07. Which kind of innovation prefers most your company?

Most participants felt that marketing innovations will be very or extremely useful for their company (65%), while 60% also separated independent product and service innovation (see diagram 7). All types of innovation were often more desirable than actually implemented, but the difference is particularly noticeable in the case of financial innovation, followed by organizational innovation and marketing innovation.

Diagram 7: The kind of innovation that prefers most your company

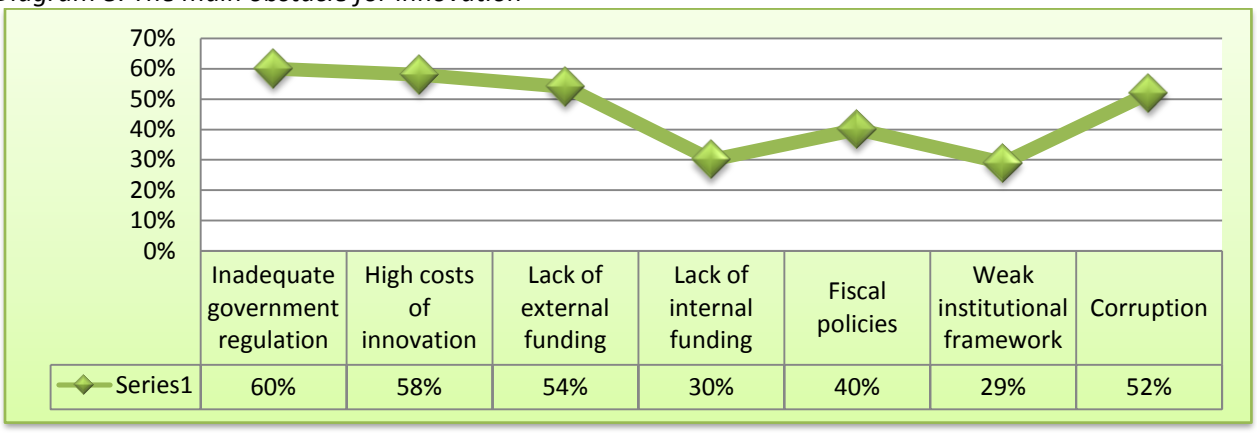


	Organisational innovations	Marketing innovations	Financial innovations	Product and Services Innovations
Series1	56%	65%	50%	60%

08. What is the main obstacle for innovation?

According to the survey, four main barriers to innovation are perceived to be: 1) inadequate government regulation, 2) high costs of innovation 3), lack of external funding, and 4) lack of internal funding (see diagram 8).

Diagram 8: The main obstacle for innovation



	Inadequate government regulation	High costs of innovation	Lack of external funding	Lack of internal funding	Fiscal policies	Weak institutional framework	Corruption
Series1	60%	58%	54%	30%	40%	29%	52%

On the other hand, participants in the focus groups highlighted access to finance, fiscal policy, weak institutional framework (including corruption) and education. The high cost of innovation, which is perceived as a barrier by 58% may also be linked to the lack of resources needed to cover these costs.

4. Testing of hypotheses and interpretation of results

Testing of samples in research is done in three main ways:

1) Statistical test with a sample
2) Statistical test between the independent samples
3) Statistical test between the dependent samples.

First hypothesis:

H0 – Earlier is perceived that innovations do not have an impact on profitability and profits of business firm.

H1 – Innovation has a huge positive impact on profitability and profits in business firm.

Table 1: Descriptive statistics for the impact of innovation on business profits

One-Sample Statistics				
	N	Mean	Std. Deviation	Std. Error Mean
The impact of innovation	80	3.67	1.397	.361

Table 2: The statistical test with a sample for the impact of innovation on business profits

One-Sample Test						
	Test Value = 2					
	t	Df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
					Lower	Upper
The impact of innovation	4.620	79	.000	1.667	.89	2.44

Thus by analyzing significances value, which is smaller than 0.05, indicating that this result has statistical importance, because by the context of data collected from the survey, it appears that testing of this sample is true. Thus the null hypothesis is rejected, while the first hypothesis is accepted or considered. The interpretation will be like this: Inclusion of more innovative activities by SMEs has influenced the profitability and profit growth by 10% -20%.

The second hypothesis:

H0 – High costs of innovation had no impact on the business innovation.

H1 – High costs of innovation have influenced or have had a negative impact on the innovations of businesses.

Table 3: Descriptive Statistics for the cost impact on innovation

Paired Samples Statistics					
		Mean	N	Std. Deviation	Std. Error Mean
Pair 1	The main obstacle	3.43	80	2.065	.552
	Type of innovation	2.57	80	1.158	.309

Table 4: Correlation between the main obstacles and type of innovation

Paired Samples Correlations				
		N	Correlation	Sig.
Pair 1	The main obstacle & Type of innovation	80	-.207	.478

Table 5: Statistical test between the dependent samples

Paired Samples Test						
		Paired Differences				
		Mean	Std. Deviation	t	df	Sig. (2-tailed)
Pair 1	The main obstacle & Type of innovation	0.857	2.568	1.249	13	0.02

The significance value is 0.02, that is, it is smaller than 0.05. In this case, the null hypothesis is not taken into account, while hypothesis H1 is accepted. Therefore the main obstacles for innovation are higher costs of innovation which have impacted negatively on the application of innovations to businesses. This highlights the tendencies facing the management of an SME.

5. Conclusions

Both economic theory and empirical studies show that innovation is a key enabler of productivity and economic growth. Innovation needs a business environment that is conducive to long-term investments in new activities. In this way the development of innovation policy constitutes an important part of any government's economic strategy. According to Aghion et al. (2005), competition may increase the additional profits by innovation and thereby encourage R & D investment.

The survey results show that surveyed SMEs consider themselves to be innovative, to report more innovation activities, to assess that such activities have significant financial impacts, and even report a high level of innovation cooperation. Their annual expenditure reported for innovation is high. Although cooperation is quite common, they seem to not dig enough to external sources of knowledge, which

also will help them build ties within the innovation system. At the same time, their innovation is in fact largely reactive; it tends to be driven by external competitive pressures and customer demands. Consequently, innovation is largely increasing, and revolves around the product / service improvements. Companies mostly fail to see their internal weaknesses and barriers to innovation; by them, financial constraints and government support are the main obstacles to innovation. Their investment in human resources is a potential force, which should enable the future development of innovation in companies.

6. Recommendations

Improving inter-ministerial coordination, design and implementation of innovation policies. Measures and actions to support innovation include a number of policy areas, such as research policy, education policy and business support. For this reason, institutions should work horizontally. In the short term the government should establish mechanisms to ensure effective interagency cooperation, ensuring the involvement and contribution of all relevant institutions.

Networking is an important step in order to support the exchange of knowledge and thus encourage innovation activities. In order to increase their competitiveness, firms Kosovo must effectively engage in innovation activities. The private sector in Kosovo should become aware of the benefits of innovation and of existing supporting measures. This is particularly important in the case of SMEs, which may have less opportunity to have access to resources.

Small companies see innovation as a dangerous and costly prospect, and are often discouraged from inventing or tracking actions which only a few years later would bring benefits.

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