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# Economic Stability Issues in the Western Balkans

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## **Economic Stability Issues in the Western Balkans**

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Ana Marjanovic Rudan - European Fund for the Balkans

Authors:

Dario Vinš, Senka Imamović and Vesna Bajšanski-Agić - Mozaik

## **This policy brief was prepared for the Western Balkans Summit in London 2018.**

### **Executive Summary**

*This brief is based on a compilation of views, opinions, insights, and conclusions on youth entrepreneurship, digital transformation, and startups in the Western Balkans (WB) region contributed by the civil society organizations and key stakeholders active in the region and compiled from reports, publications and articles listed in the Bibliography section of this document.*

The per capita income of the Western Balkan countries is just 27 percent of the EU15 average. Over 50% of youth population is unemployed, with one country reporting the youth unemployment rate of 63 percent, the Europe's highest. Women participation in the active labour market starts at dismal 30 percent. Similarly, the WB region's small and medium enterprises (SME) sector and social enterprises (SE) in the impact sector provide less than 30% of total employment. The economic hardships, poverty or a lack of jobs, coupled with a lack of opportunities and future prospects result in sizeable migration that drains the region of its most educated and skilled residents. The WB governments have, so far, failed to find a sustainable solution that develops human capital and keeps it within the region, mobilizes (youth) entrepreneurship and support SMEs for the new economy.

To counter this trend, the WB region, its governments and its businesses require a new growth model to reach the digital frontier. It should be based on innovation and entrepreneurial spirit of the new millennial generation. The process should begin with a serious policy discussion on (youth) entrepreneurship, the digital frontier, ecosystem and infrastructure, and conditions required to move key sectors towards a digital economy. The model should, inter alia, entail a tailor-made education of young women and men for the new economy; development and promotion of ecosystems and entrepreneurship for new digital age; identification of sources of innovation and ways to attract innovative companies to the region; mobilization of youth entrepreneurship; ecosystems to support startups, SMEs and SEs; formal (public, government) programs to support youth entrepreneurship in the region, and a solution to the critical SME access-to-finance gap.

Steering the regional economies towards the digital frontier requires: (i) a strong promotion of youth entrepreneurship and development of ecosystems in the WB region to support startups and SMEs; (ii) new sources of intelligent capital and patient financing for the SMEs to bridge the region's critical access-to-finance gap that hinders the SME growth; (iii) incorporating the process of digital transformation in the education of young women and men; (iv) identifying the innovation sources and attracting them to the region to accelerate transition to the new digital economy, and (v) providing the full range of relevant European instruments and toolbox to all countries of the WB region and (vi) initiating region-wide partnerships to drive these processes much further than what any of these actors could achieve alone within their country's borders.

Should it miss out on this opportunity, the Western Balkans region would see the innovation and digitalization gap widen, leaving it behind as a "second grade" region with a high rate of migration of highly skilled experts. Working together, however, towards building a coherent strategy to reach the digital frontier will enable the WB

region to “plug” its economies into the EU’s Digital Single Market and reach its full potential to create new jobs, introduce new skills, enable new growth, and join the mainstream in the EU and on the global stage.

### **Digital Frontier and Youth Education for Digital Economy**

Possible indicators:

- Number of young men and women graduating from programs that incorporate digital economy education;
- Rate of R&D spending in the SME sector;
- Number and rate of training positions in the SMEs (internships, specializations, etc.)

Europe faces a number of challenges that can be overcome only by an innovative, digitally savvy and entrepreneurial society. The digital transformation offers opportunities for innovation and introduction of new products for the global consumer, inclusion in education and workplace, and enables new ways of interacting, working and learning.

The WB region is lagging behind in creating the building blocks and infrastructure for a successful digital economy. Even though the e-government projects in some parts of the WB region have contributed to administrative improvements, further efforts are required at both regional and national levels in terms of taxation, social systems, labour laws, the modernization of education, support for innovation, public-private partnerships (PPP), and social dialogue to prepare for the digital economy. Perhaps the greatest obstacle to the digital efforts in the region is a lack of cooperation and fragmented relationships between and within the WB countries. Financing the digitization efforts is a true regional challenge and one clearly best undertaken as a joint consideration with a sizable support extended by the EU funds, instruments and the toolbox currently available to the EU member countries.

These building blocks should include development of ecosystems in the WB region to support innovation and entrepreneurship, as well as the required infrastructure such as transport links, telecommunication infrastructure, and better regulations. This transformation should aim to mobilize innovation and entrepreneurship for the digital economy, but also deliver more transparent, stronger and accountable governments and public institutions trusted by the public.

A profound change in the teaching methods and daily practices of educational organisations is required - the governments need to partner in promoting peer learning and the exchange of good practices, fostering a strong entrepreneurial mindset. Opening up the learning environments to the key sectors of digital economy (e.g. PPP between universities and SMEs) and adopting learning-by-doing curricula allows us to foster entrepreneurial and innovation-oriented mind-sets. This requires a greater investment in the education sector to not just train people for the new jobs, but retain talent in the region once it is developed.

The prospect and potential of the digital economy promise large benefits for the region. The optimal approach for the digital transformation of the WB region is to follow the EU member countries experience in building the optimal infrastructure and securing greater transparency and data access to the WB citizens.

The region’s ability to reach the digital frontier will depend on navigating and transitioning towards new

models of production and innovation. A continued European commitment to the region should, inter alia, transpose Europe's own efforts to overcome the challenges faced by the member countries in their own efforts to reach the digital frontier.

### Startup Ecosystems in Western Balkans

Possible indicators:

- Number of ecosystems in the WB region;
- Number of stakeholders within an ecosystem;
- Number of incubators, accelerators, and intermediaries in the WB region;

The startup ecosystems in the WB region do not exist in the required form, capacity, and scope to support its SMEs and SEs. There are public and private sector initiatives at various degree of development and capacity, offering subsidies, grants and assistance, but these do not constitute a well-rounded ecosystem that will support startups, SMEs and SEs from launch to reaching their full potential and business, financial and impact goals.

While the SME participation in the economy balances around the EU averages in terms of number, employment, turnover and value added, the overall number of new startups in the region is low. The lack of well-rounded ecosystems, the practices of the informal sector, tax rates, access to finance, and political instability are the biggest constraints to the development of entrepreneurship in the region.

Country	# Startups (FS6 Database)	Density (#Startups per million citizens)
Albania	160	55.7
Bosnia	179	73.0
Croatia	500	119.3
Macedonia	189	89.7
Kosovo	58	30.5
Montenegro	59	87.0
Serbia	631	89.4
Slovenia	439	213.1

Source: FS6, ABC Accelerator Report

Today, there are startups in the region. There are interesting products, innovative technologies, and promising teams led by founders with ambitious mind-sets. There are, however, only few established intermediaries (investors, incubators, and accelerators) and other support systems delivering a limited scope of regional ecosystems. The WB region consequently features very few regional success stories of companies that have successfully grew and scaled-up to offer their products to a wider base of consumers, clients and beneficiaries. These success stories, however, do serve as role models for the other startups and inspire (youth) entrepreneurs to attempt to turn their ideas into viable business models.

The business environment in most countries remains challenging, exhibiting macroeconomic instability, fast and drastic political changes, and a general lack of understanding or support to startup culture and thinking.

The SMEs and SEs usually identify political instability, corruption, poor access to finance, high tax rates as the main constraints to doing business. The World Bank's Doing Business indicators paint an unflattering picture of the regional economies. International actors point to low productivity as the fundamental problem holding back the region's economic development reflecting years of under-investment, weak institutions and a difficult business environment. In the impact arena, a lack of regional social enterprise (SE) business development services, such as incubators, accelerators, hubs, impact investors, and ecosystem operators has been identified as one of the biggest barriers to the development of social and youth entrepreneurship.

The regional governments currently lack the capacity and know-how to support the regional startups' ambitions and potential. While the governments in the region do offer early-stage grants and limited funding, these are not sufficient on their own. State actions should be expanded to include long-term development programs and funding for (cross-border) ecosystems in all countries of the WB region, to promote entrepreneurship, change the attitudes and the public perception of entrepreneurship.

In contrast, the local ecosystems' resiliency and ability to provide support services in the current environment stands to benefit from a systematic and comprehensive development of the regional startup ecosystems, its intermediaries and early-stage financing instruments and opportunities. This has also been referenced by actors in the region as one of the possible means of addressing the youth unemployment and the "brain drain" in the countries of the Western Balkans region.

### **SME Equity Gap**

Possible indicators:

- Number of early-stage venture and impact funds providing equity and quasi-equity and hybrid financing to the SMEs and SEs in the WB region;

The persistent lack of equity (also referred to as the 'equity gap' or 'SME access-to-finance gap') is the most pressing issue in the Central and Eastern Europe (CEE) region, including all countries of the WB region. The SMEs in the WB region continue to face a critical access-to-finance gap caused by disproportionate allocation of resources and capital. The region is critically lacking the right level and type of financial resources: bank financing is typically unavailable to the region's SMEs; only 35% of European resources for social enterprises (SE) are spent in CEE and only a fraction of those amounts are available to the WB region. Venture philanthropy investment level in the CEE region is 65 times lower than in Western Europe while social enterprises (SE) and impact intermediaries source more than 75% of their budgets from donors, a form of financing that often excludes early-stage financing.

Funding opportunities for the startups in the WB region are very limited, and in many areas altogether non-existent. In more developed ecosystems, public funding serves to bridge the gap, but with the WB countries' fiscal constraints and policies this approach has so far had little or no meaningful impact. This lack of equity for seed- and early-stage financing is especially detrimental for the development of startups in the region and affects their survival rate.

*This gap needs to be addressed and a source of patient capital provided to the SMEs and SEs whose products and services respond to the needs of their communities or resolve complex societal challenges. Instruments and impact intermediaries should be developed to offer early-stage intelligent capital and patient financing for the SMEs and SEs in the WB region. The European Union should make all its existing instruments, funds, facilities, programs and its toolbox accessible to all countries in the WB region. The regional governments should*

contribute by developing programs to enable co-investments and early stage investment funds, by introducing conducive taxation programs, modernizing labour laws and education, and by supporting innovation, promoting PPPs and social dialogue to prepare for the digital economy.

### **Youth entrepreneurship**

Possible indicators:

- Number of young men and women graduating from programs that incorporate entrepreneurial education;
- Number of new jobs created;
- Rate of youth employment;
- Rate of women employment.

The Western Balkan countries made great strides in improving labour market outcomes between the second quarter of 2016 and the second quarter of 2017. Over the period, roughly 231,000 jobs were created in this region, and self-employment accounted for almost 60 percent of the total employment increase. Despite these certainly promising labour market developments, low activity rates (particularly among women), high rates of youth unemployment, high rates of long-term unemployment, and widespread informal economy remain key challenges in the regional economies.

Youth unemployment in some countries of the region is the highest in Europe. The countries reporting the highest rates of unemployment (26-30%) were Kosovo, Albania, and Bosnia and Herzegovina. While several Western Balkan countries reported very high percentage of youth population as not in employment, education or training, Bosnia and Herzegovina reports place the rate youth unemployment at a staggering 63%. This is the highest rate in Europe and Central Asia and presents a major socio-economic problem for the country. Consequently, the youth experiences a mix of pessimism and resentment while only 40% of the young people believe that expertise and education are the most important factors in finding a job.

Youth entrepreneurship has long been seen as one of the instruments to mitigate high rates of unemployment and the 2008 global financial crisis placed young people into the policy focus. The EU considers the promotion of entrepreneurship as a key policy to tackle youth unemployment through creation of new jobs. The WB region has some hard work ahead to reach the levels of entrepreneurship, self-employment and youth employment recorded in the member countries. The number of young people opting for self-employment remains small due to various constraints to start a business in the WB countries and the inherent risks of selecting entrepreneurship as a career path.

The entrepreneurship culture and motivation is low - young women and men are reluctant to start a business due low self-esteem and confidence, risk aversion, and fear of uncertainty and failure that stems from the lack of entrepreneurial memory and knowledge. It is a by-product of a society that does not embrace risk, abhors failure, and inhibits entrepreneurial thinking - all of which results in a small number of startups and only a handful of successful companies in the region. All this, in turn, hinders confidence levels of business founders in the region who need to believe that they can create globally successful companies - and convince others to join their ventures.

The prospective entrepreneurs in the region, nevertheless, continue to express positive aspirations towards entrepreneurship and are learning how to accept failure and deal with inherent risks. This points to a way forward to change the status quo by a new paradigm that shifts public opinion and attitudes towards an entrepreneurial

culture. Embracing entrepreneurship promises a possible way forward to address the persistently high youth unemployment rates in the region by turning unemployed young entrepreneurs into job creators that provide new and quality employment opportunities in the high-value sectors of the new economy.

This needs to be complemented by long-term development programs and funding for (cross-border) ecosystems in the WB region that will support innovation and entrepreneurship; include intermediaries and early-stage financing instruments and opportunities for the region's startups, SMEs and SEs; and promote entrepreneurship and change in attitudes and in public perception of entrepreneurship.

Another piece of good news is the youth's focus on acquiring digital skills and renewed interest in entrepreneurial pursuits that carry an inherent promise of new quality jobs in the regional markets. Newly emerging companies are being created to develop innovative digital and social solutions, with some already selling products and providing services to markets beyond the region. These developments and accounts catalyse entrepreneurial sentiment required to attract innovation and encourage creation of enterprises for a new economy.

To sustain this sentiment and create an entrepreneurial momentum that will bring the startup numbers to sustainable levels, regional value-driven ecosystems need to provide ongoing support and financing to enable young women and men, regardless of their identities or location, to succeed in any social or economic sector.

The governments of the region need to address the unfavourable business environment, as shown in the region's doing-business indicators, and remove complex, demanding, and expensive processes to start or close a business and manage business operations in early phases of business lifecycle. Venture and impact investing, ethical banking for innovative forms of social enterprises and impactful SMEs should be promoted. The authorities need to simplify, digitalize, and streamline company registration procedures (e.g. one-stop shops), reduce the fiscal and parafiscal burden, and streamline taxation, simplify the business startup requirements and procedures. The bankruptcy procedures should be improved to allow startups to fail and start again by removing undue, expensive, and lengthy procedures.

The EU needs to support creation of regional ecosystems and intermediaries, and the authorities' efforts in this area. It should, however, also remove all contingencies and non-eligibility statuses preventing full access for the WB countries to the funds, instruments and toolbox available to the SMEs and intermediaries in the member countries.



Successful proliferation of innovative startups, SMEs and SEs will help move the region toward the digital frontier, change the perceptions of the general population and their dissatisfaction with the local social systems, and contribute to mitigating a persistent exodus of talent and skills from the Western Balkans region.

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