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REPORT ON COMPETITIVENESS “NATURAL-BORN CLUSTERS”



Pristina, 2014



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ACRONYMS

CAGR	Compound Average Growth Rate
CEFTA	Central European Free Trade Agreement
EU	European Union
EUR	Euro
FAO	Food and Agriculture Organization of the United Nations
FDI	Foreign Direct Investment
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
KI	Kosovo Institutions
MAFRD	Ministry of Agriculture, Forestry and Rural Development of Kosovo
MAPs	Medicinal and aromatic plants
MTI	Ministry of Trade and Industry of Kosovo
OEM	Original Equipment Manufacturer
OSCE	Organization for Security and Co-operation in Europe
ROI	Return on Investment
SME	Small and Medium Enterprise
SOE	State-Owned-Enterprise
TOR	Terms of Reference
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
USD	United States Dollar

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INTRODUCTION

The Aid for Trade project, implemented by the United Nations Development Programme (UNDP), aims to identify and analyse representative existing and potential “natural-born” clusters in Kosovo¹ and to design and recommend actions to support these businesses and help them move into higher value-added products/activities. The terms of references (TORs) emphasised “Clusters that were ignited through direct policy interventions have had a mixed success, whereas more positive results have been seen in the case of “natural-born” clusters, i.e. clusters emerging as a private initiative.”

An international consultant, Cheng G. Ong,² supported by local consultant Ilir Salihu, was commissioned to conduct the study. The study also benefited from the participation and support of another international consultant, Paul Wittrock, a management consultant and entrepreneur.

Clusters consist of networks of interrelated firms and institutions that arise in a region.³ Clusters are geographic concentrations of firms, suppliers, support services, specialised infrastructure, producers of related products, and specialised institutions (e.g. training programmes and business associations) that arise in particular fields in particular locations.

As the TORs commissioned an assessment on “clusters”, this project is based on the *cluster approach*. A cluster approach complements other economy-wide analyses and encourages engagement with a diverse group of stakeholders. A cluster approach enables the policy debate and actions to be formulated jointly by the public and private stakeholders through a shared understanding of the underlying issues. Developing a joint platform, a *cluster initiative*, builds ownership by the stakeholders and is often a crucial starting point to more comprehensive economic reform processes in developing countries.⁴

The “Cluster” Approach in the Context of Public Policy and Economic Development

Governments have long used interventions based on value chains and other tools in an attempt to direct industrial policy. Some of these are related to cluster initiatives and are certainly complementary, but cluster projects can be differentiated mainly by their focus on actively engaging both private and public sector stakeholders throughout the process, from cluster selection to strategy formulation and policy implementation. Cluster interventions try to help change the mindsets of both public and private sector participants. Economic development programmes run the gamut from micro-level projects for specific enterprises to macro-level interventions targeting national policies and institutions. Cluster competitiveness initiatives fill the gap between the firm level and that of sectors and national institutions.

¹ For UNDP, all references to Kosovo on this document are made in the context of UN Security Council Resolution 1244 (1999).

² The author bears full responsibility for the content of this document including any errors or omissions. I would like to thank Messrs Ilir Salihu and Paul Wittrock for their invaluable support.

³ For a description of the concept of clusters and their impact on competition, see Porter (1990) and (1998).

⁴ For more details on developing cluster initiatives, see World Bank, *Clusters for Competitiveness: A Practical Guide and Policy Implications for Developing Cluster Initiatives*, International Trade Department, February 2009.

Malaysia's Second Industrial Master Plan

An example of the cluster approach used by government to successfully launch an economic development programme is Malaysia's Second Industrial Master Plan which involved the author as the Country-based Project Leader. Conducted under the auspices of the Prime Minister's Office, the task of managing the project was assigned to the Ministry of International Trade and Industry, which in turn oversaw a team of international and local consultants.

As Kenichi Ohno wrote⁵ “Malaysia: Second Industrial Master Plan – this master plan encompassing all manufacturing sectors in Malaysia was unique in having a clear over-arching logic and objectives which evolved around the concepts of cluster-based industrial development...”

Consultations with Malaysian government officials, industry associations, and other stakeholders selected eight broad sectors to initiate the cluster studies: electrical and electronic; textiles and apparel; chemicals; resource-based; agro-based and food products; transportation (automotive, etc.); materials; and machinery and equipment.

A Global Halal Hub - from Identification to Global Dominance

During the course of the cluster project, the author identified a global market opportunity and potential cluster for Malaysia and made the recommendation to “Position Malaysia as the global hub for halal products.” The government of Malaysia adopted the recommendation and Malaysia has since become the world leader in the global halal cluster with USD 10 billion of exports in halal products in 2013.⁶ Other countries like United Arab Emirates and Indonesia are seeking to emulate Malaysia's halal cluster.

Economy-Wide Cluster Studies

Economy-wide cluster studies typically involve several phases over the course of at least four months. Country leaders can then decide on the clusters for long-term Cluster Initiatives. To perform an assessment over the course of four weeks for this project, a scan of the traded industries was undertaken, and in-depth interviews conducted with a limited number of firms, and some representatives from donor and institutional agencies, industry associations and trade unions, educational institutions, and consultants on donor funded projects. The assessment indicated a list of emerging and potential clusters in Kosovo. Therefore, this report is not meant to be exhaustive and is presented as the initial work on clusters in Kosovo that can be used to inform a more in-depth diagnostic study of these and other potential clusters in Kosovo.

Policy initiatives aimed at picking winners and nurturing them through subsidies and protection have been widely discredited as they rarely succeeded. Therefore, while this report offers conclusions and recommend actions, such as specifically convening Cluster Development Initiatives to inform the development of a Kosovo Industrial Master Plan, the reader should not expect recommendations for direct policy interventions. A Cluster Initiative is recommended for each cluster to bring together major stakeholders in the private sector and communities in order to co-design policy and specific actions to build competitiveness in that cluster and Kosovo overall.

⁵ Ohno, K., *Industrial Master Plans: International Comparison of Contents and Structure*, November 2009.

⁶ <http://news.yahoo.com/demand-grows-halal-food-industry-evolves-155147413--finance.html>, retrieved April 28, 2014

EXECUTIVE SUMMARY

Kosovo is re-emerging, re-industrialising, re-vitalising. While its history is well known to its citizens and supporters, its future remains undefined. As a newborn, what does Kosovo want to be when it grows up?

Using the cluster approach this project reviewed the export industries that are leading the charge in generating revenues for Kosovo and examined the potential of some of these industries through in-depth interviews with leaders from industry, Kosovo institutions, donors and other institutions.

As with other emerging economies, the need for improvements in physical infrastructure, capacity in governing institutions and rule of law, and education in Kosovo is well documented in numerous donor studies and projects. The public sector is vital for (i) international negotiations and relations, (ii) setting domestic policies covering macroeconomic, regulatory, industrial, trade, etc. (iii) implementation (via the various levels of Kosovo institutions, other institutions etc.) and (iv) investments in infrastructure, education, etc. The private sector is also crucial to Kosovo's economic development and job creation. **The challenge for Kosovo institutions is understanding what it would take to unleash the power, creativity and dynamism of Kosovo's private sector.**

Kosovo's industry structure is dominated by mostly micro and small enterprises. Several industries are anchored by a single medium or large firm e.g. Wine (StoneCastle), Jeans (Kosovatex), and Synthetic Yarn (Remateks), with few linkages between firms as most inputs are imported. While StoneCastle relies on its domestic supply of grapes, most other inputs are imported and most of its output is exported. Even though Kosovatex and Remateks are frequently grouped under the Textiles Sector, each company largely imports its inputs and exports its outputs.

Industries driven by privatised state owned enterprises (SOEs), where capital requirements tend to be more intensive, are currently anchored by foreign investors with the means to invest in vertical integration (e.g. marble quarries and processing/finishing, jeans and denim, etc.). Local firms are also planning to invest in vertical integration e.g. hides and skins and leather, footwear and leather, bread production and retail stores, etc.

This indicates a lack of linkages with other local firms and the rest of the economy which may hinder cluster development. Few micro and small enterprises are suppliers to the anchor firms. **Hence, currently there are isolated industries anchored by medium/large firms, instead of clusters, and these medium/large firms risk being enclaves in themselves.**

Advanced economies are home to fully developed clusters while in Kosovo, where imports far exceed exports, most industries are at the early stage of development based on imported inputs. Early clusters are typically seeded by natural resources, advantage (climate or ores), or entrepreneurs. If the entrepreneur is successful, others will follow and enter the business. With a growing business, both upstream and downstream industries will enter. Soon, an identifiable cluster begins to emerge.

The challenge for cluster development in Kosovo is access to capital, and the development of the network in the cluster especially local suppliers and supporting institutions. Clusters gain in importance as firms migrate from vertically integrated structures to those involving the outsourcing of many activities and functions to outside entities. Outsourcing includes not only traditional parts of production but also contract manufacturing, managing IT systems, training and even research and development. As firms depend more on outside firms, support services, and local institutions, it becomes more important to locate within a strong cluster to access benefits that are difficult for outsiders to tap.

Only sustained, private sector led Cluster Initiatives can be sufficiently specific and persistent in their activities to achieve real improvements in cluster performance. Isolated policy reform is often difficult as there is seldom feedback on the positive and negative impacts they have on industries. Pursuing cluster initiatives together with policy reform provides government with information of the policy implications and business responses.

As a late entrant to many industries, Kosovo can take advantage of the old IT adage, "he who starts last, wins" with the implication that a new entrant to beat entrenched competitors down the experience curve via technological or "know-how" leap.

For example, embracing the latest technology, such as a state-of-the-art waste-water treatment facility for leather processing industries, Kosovo can become a model for modern leather processing. In agribusiness, new varieties and optimizing crop selection and marketing channels will enable Kosovo to maximize output on limited lands with internationally competitive yields. A niche approach and combining retail and bulk wine sales can help restore vibrancy to a once thriving industry and exceed the performance of neighbours in the region.

Key recommendations based on this study are summarised below with the hope that initiatives, whether driven by institutions, donors, private sector, etc. could be coordinated toward joint objectives. While individually well intentioned, the large number of different initiatives and donor programmes carries the potential for conflict and redundancy. Aggressive stewardship is required to optimise these initiatives. The relevant ministries impacted by the initiatives or implementing agencies can be assisted by the corresponding Cluster Initiatives to ensure coordination and optimisation of the various initiatives or programmes. The following are the more critical issues that impact cluster development, especially those clusters that are emerging in spite of the constraints listed above. It is expected that more specific recommendations will emerge as the recommended Cluster Initiatives are implemented and evolve.

1) Convene Cluster Initiatives

The top recommendation is for the institutions to adopt a cluster approach in developing a Kosovo Industrial Master Plan. This convention would provide an overarching vision and coordinated plan of action that engages various institutional agencies, municipalities, private sector, academic institutions, donors, and other important stakeholders. The resulting Cluster Initiatives formed as the underpinning for a Kosovo Industrial Master Plan would ensure that all stakeholders (including donors) are aligned in achieving the same objectives.

2) Organise the implementation of national economic programmes around clusters

Economic development agencies at the national and municipal levels should incorporate clusters into their organisational structures instead of organising solely around generic policies and programme functions. Important that rather than a top down, strictly managed endeavour, clusters be nurtured and allowed to evolve based on the needs of cluster participants.

3) Incentives

Another dimension of cluster policy is *incentives* to spur collective investment by cluster participants in assets that benefit many cluster participants, such as university research centres, community college curricula, testing facilities or training centres. Such incentives aim to improve the business environment or disseminate innovation that affects *all* firms and differ from grants to *individual* firms which tend to be distortive and interventionist.

4) Access to Capital

The "SME Development Strategy for Kosovo" has Strategic Goal 2: Improving SMEs' Access to Finance. The report recognised there is little incentive for banks to lend to SMEs and recommends measures to improve SMEs access: reform of the Cadastral collateral and credit registration system enforceability of debts against the collateral. Most critical would be additional efforts to develop a fully functional capital market in Kosovo. Institutional action and donor programmes can go a long way in addressing this issue.

5) Foreign Direct Investment (FDI)

Emphasising that total value, such as a better executed cluster initiative, will yield the higher ultimate return on investment (ROI) for investors may be able to help Kosovo compete against a neighbouring country's flat per employee subsidy. A targeted case by case FDI offering (for qualified prospects) and communicating the benefits and value relies more on creative and thorough packaging of existing assets than flat subsidies or incentives. With an inviting business enabling environment, FDI can be a very effective tool in helping develop clusters. FDI that targets production and manufacturing sectors would produce long-term economic growth and generate employment. **Kosovo's FDI attraction efforts could target specific countries and their specific sectors with specific packages of benefits.**

With its locational advantages, Kosovo can be a manufacturing/service base for (i) EU companies seeking lower cost production with EU quality and (ii) US/Asian companies seeking access to the EU market. Kosovo needs to distinguish itself as an outsource manufacturing/service hub by connecting into regional clusters and facilitating easier expansion of such regional clusters into Kosovo. With the assistance of donors, Kosovo can present a strong case to US and Asian companies seeking a manufacturing or service base to access the EU market. FDI from the Diaspora can bring added benefits especially if the Diaspora brings external linkages.

6) Procurement

Acting as a demanding and sophisticated customer means institutions should set standards of quality and service levels in addition to price considerations. An emphasis on quality and timely service will recognise the advantages local firms offer over foreign, low cost suppliers and encourage more local firms to adopt a quality and service focus.

7) Data Collection and Metrics

In Kosovo, the business registration, employment, tax and trade classification systems should be aligned with each other and with international harmonised systems. This not only simplifies and streamlines transactions but provides the institutions, private sector and other stakeholders with more reliable metrics by which to monitor performance of the economy.

8) Cluster-based Industrial Parks

Cluster-based industrial parks have specialised facilities configured to the needs of specific industries and sectors. While these parks need to be sustainable, it is important to keep the primary objective of cluster support in mind. Cluster participants should drive the development of these parks rather than real estate speculators.

METHODOLOGY

As the TOR commissioned an assessment on “clusters”, this study is based on the cluster approach. The following describes the various steps followed.

Desk Research

The desk research of prior work conducted on the private sector in Kosovo concentrated on donor studies and interventions. Relevant documents, publications and laws were reviewed. Donor projects ranged from the macro level, such as capacity building in public administration and chambers of commerce to the micro level, such as individual company support with grants and advisory services.

Prior studies indicated that the business environment was a significant constraint to private sector development. An indicative project which summarises the general findings of other projects is GLZ's *Economy and employment promotion (2011-2018)*⁷ which reported that the market competitiveness of Kosovo's various economic sectors is very low due to the following:

1. When compared internationally, Kosovar enterprises score low on productivity and product quality despite their relatively high production costs
2. Horizontal and vertical cooperation among companies within individual sectors remain weak
3. Dialogue between enterprises, trade associations and institutions is weak
4. Due to a lack of expertise, resources and performance capacity, Kosovo's institutions mandated to foster economic development (such as the SME Support Agency of Kosovo and the Investment and Export Promotion Agency of Kosovo) have not yet proven capable of implementing effective promotion programmes on an adequate scale
5. Strategies and promotion approaches for economic development of Kosovo's various industries are inadequately coordinated
6. The statutory and regulatory framework falls short of providing the necessary enabling environment
7. Other areas include: the legal security of investments, land use, high credit costs for SMEs, competition on domestic markets from low-price and often higher quality imported products, and non-tariff trade restrictions and barriers on regional markets
8. Education opportunities and services for entrepreneurs and employees remain scarce
9. Infrastructure outside Prishtina/Priština is inadequately developed

Trade Performance Review

Firms that export compete with other firms on the international stage instead of only in the local market. The importance of “traded clusters” is discussed in Section 2. Traded clusters create the income to afford sophisticated local services and the demand for local industries to grow beyond the size of the local population per se. As a proxy for the revealed comparative advantage of industries in Kosovo, trade statistics were used to identify those industries with high and growing exports.

⁷ GLZ, Economy and employment promotion, <http://www.giz.de/en/worldwide/21125.html>, retrieved May 12, 2014.

Due to the unavailability of comprehensive statistics in harmonised systems, the study relied on Kosovo Ministry of Trade and Industry (MTI) data at the 6-digit level to review exports and imports from 2010 to 2013. The leading exports by value were grouped into broad industrial clusters e.g. agricultural products, wood products, hides, skins and footwear, etc. The leading industry by export value in each broad cluster guided the research and in-depth interviews with companies. Ideally, each industry's share of world exports would be compiled to indicate Kosovo's market share and relative advantage in those industries.

Representative Cluster Case Studies

The analyses of clusters use the case study approach which is more qualitative rather than quantitative surveys. Industry leaders, public officials and other stakeholders are important sources of information about local and regional economic trends, characteristics, strengths and weaknesses.

Representative cluster case studies are presented to indicate the clustering activities that are on-going in Kosovo. It is important to note that the clusters selected for the representative case studies are not meant to indicate that these particular clusters warrant priority action by institutional agencies over others or that they have more “potential” than others.

Clusters were selected for the representative case studies based on 1) export performance (the significance of which is discussed previously) and 2) ownership characteristics, i.e. local entrepreneur vs. foreign investor. While the benefits of foreign investment are well known, it is important to understand the trials and tribulations of local entrepreneurs to truly understand the competitive advantages and disadvantages of Kosovo. Foreign investors are typically well-capitalized and experienced, while local entrepreneurs need to circumnavigate all the barriers around the trail of the local business environment. The leading companies in each industry were identified and interviewed.

The review of Kosovo's trade data identified high and growing exports from certain industries (see Table 1: Top 50 Exports by Value) such as Synthetic Fibre Yarn, Hides and Skins, Conveyor Belts, Flavoured Waters, Tubes and Pipes, Plastic Doors, Wine, Metal Products, Chocolate, Men's and Boy's Trousers (Jeans), Footwear, Raspberries, etc. The leading firms in these industries were identified, of which many were owned by foreign investors who had acquired privatised state-owned enterprises (SOEs). Therefore, the leading export industries founded and managed by local entrepreneurs were selected as representative case studies i.e. Hides and Skins and its related industry, Footwear (named “Leather Goods and Footwear” cluster), Agribusiness – Soft Fruits and Medicinal and Aromatic Plants (MAPs), and Wine.

Though Hides and Skins, Agribusiness and Wine are agro-based clusters, the Footwear and Wine industries compete on skills, technology and marketing/branding with a potential for high value-added returns. Furthermore, the leather footwear industry is a major employer of female workers, representing as high as 90% in certain shoe firms.

The thirty-five (35) in-depth interviews (typically lasted one to two hours, and most included site visits) were with founders/owners of firms, industry executives, consultants and key representatives from donors, institutional agencies, educational institutions, trade unions, and industry associa-

tions.⁸ Company interviews and site visits covered those in agribusiness and food products, decorative stones, footwear, hides and skins (leather), mining and metals, forestry and wood furniture, and wine. Interviews with other stakeholders sought their input on the Kosovo business environment and economic landscape, and specifically their prognosis of existing and potential clusters in Kosovo.

Interviews with founders of companies also delved into factors that helped them become successful. Data was gathered on how the firm competes, how decisions are impacted by institutional policies and procedures, the extent and quality of linkages with suppliers, competitors, institutional mechanisms, etc. For each cluster, we analysed global market trends, reviewed its important industries in Kosovo (including using Porter's Five Forces analyses), and linkages among them as well as linkages with supporting institutions as per the Porter "diamond" framework,⁹ and placed Kosovo in the context of the global market.

Why are certain companies in Kosovo capable of exporting and upgrading in particular fields? Research indicates four broad attributes (Porter's "diamond") of a nation that shape the business environment in which firms compete. These attributes, individually and as a dynamic system, most influence the ability of competitive advantage to be created and sustained.

A. Factor (input) Conditions

The efficiency, quality and specialisation of the inputs available to firms

- To what extent is the cluster's competitive advantage dependent on basic factor conditions, i.e. climate, cost and productivity of land, location, availability of basic inputs, low cost labour?
- To what extent is it based on advanced factor conditions, i.e. human resources such as skilled labour force, physical infrastructure such as efficient transport and logistics, scientific and technological infrastructure, information infrastructure including economic data and corporate disclosure, etc.?

B. Demand Conditions

The presence of sophisticated and demanding local customers

- How directly is the cluster exposed to the most sophisticated and demanding consumers?
- Do local consumers or buyers anticipate trends in global demand?
- Are there sections of the local market that provide sophisticated feedback signals?
- Do the cluster's foreign buyers send signals or provide feedback to monitor the pulse of change?

C. Related and Supporting Industries

- Who coordinates inter-firm activities in the cluster?
- If present, how would you rate the performance of the following institutions: industry associations, chambers of commerce, small business associations, export associations, cooperatives, industry boards, standard setting agencies, other institutions? What are the key reasons behind such performance?

⁸ The full list is in Appendix A and we are grateful for their participation and insights.

⁹ Porter, M.E. *The Competitive Advantage of Nations*, New York: The Free Press, 1990.

- Are there competitive and high quality local suppliers?
- Are there strong ties with research institutions?
- What is the quality of education and training providers?

D. Context for Firm Strategy, Structure and Rivalry

- To what extent are firms investing in new forms of knowledge, innovation and research and development (R&D)?
- To what extent is competition among firms driving the innovation and upgrading process?
- To what extent are firms shielded from outside competition?
- To what extent do the strategies of firms put upgrading front and centre?

1) A CLUSTER-BASED APPROACH: KEY CONCEPTS

What are Clusters?

Clusters are geographic concentrations of firms, suppliers, producers of related products, specialised infrastructure and specialised institutions (e.g. business associations and training programmes) that arise in particular fields in particular locations. Clusters as an economic unit are very different from *sectors* (such as manufacturing) or *industries* (such as tires).

Clusters are key drivers of job growth, wage growth, new business formation and innovation. In any region, there is a mix of local and traded economic activity.¹⁰ Local industries such as cafes and restaurants, and public utilities are present in every region and account for a large part of employment. Traded clusters are those that produce products and services that compete with those produced by other regions and other countries. Traded clusters are the underlying drivers of prosperity because they serve broader markets, can grow employment and exports far beyond local needs, and serve as a measure of an industry's (and a nation's) true competitive stature on a regional or global stage. Traded clusters have far higher average wages than local industries.

For an emerging economy like Kosovo, undergoing re-industrialisation, it would be helpful to understand the stages of cluster development. Advanced economies are home to many fully developed clusters while in Kosovo most industries are at the early stage of development based on imported inputs and its clusters are emerging.

i) Cluster Life Cycles

Typical seeds of clusters include natural resources and advantage (e.g. ore deposits, climate) or particular demand or skill within the region.¹¹ Another typical seed is an entrepreneur who starts a particular industrial activity in a particular location. If the new venture is successful, with factor advantages supporting the business idea, a cluster can begin to grow and prosper.

¹⁰ Porter, M.E., "The Economic Performance of Regions," *Regional Studies* 37, nos. 6 and 7 (August/October 2003): 549-578

¹¹ Porter, M.E., "Clusters and the New Economics of Competition", *Harvard Business Review*, November-December 1998.

The early stage is often identified with one or a few individuals termed the "heroes" of the cluster.¹² If the entrepreneur is successful, others will follow and enter the business. With a growing business, both upstream and downstream industries will enter. Soon, an identifiable cluster begins to emerge.

Clusters are shaped by certain forces (deterministic) related to the overall history and culture of a region, the geographical factors, general institutions and regulations and overall macroeconomic environment. Therefore, it is important not to try to copy another cluster.

Clusters are also shaped by forces (voluntaristic) such as entrepreneurial action and firms that implement new strategies and business models. As a result of these actions, the cluster environment will either develop or decline. Decisions to invest and enhance innovation will build the cluster, but decisions to leave the region will push the cluster toward decline. Through entrepreneurship and innovative strategies clusters will be shaped and reinforced over the longer term.

In addition, there are constructive forces that impact clusters. One type emanates from policies and another emanates from initiatives by actors within the cluster. Local leaders that develop and implement cluster initiatives take on a constructive role. Typical objectives of such initiatives include upgrading human resources, commercial collaborations such as joint export initiatives or coordinated purchasing to increase purchasing power. Other objectives include improving the business environment by initiating dialogue on new regulation and upgrading the infrastructure.

ii) Implications for Government Policies, Action, etc.

Policies impact firms and regions in many ways. Some policies help by fostering a more innovation-driven business environment, while other policies and regulations hinder innovation and upgrading, or even starting a business.

Clusters emerge spontaneously based on market forces and the process of cluster formation occurs naturally as new firms are started, suppliers develop, infrastructure is built, specialised institutions grow and established firms from elsewhere locate new operations in growing cluster concentrations.

Public policy at the cluster level should be neutral with regard to industry or type of economic activity. Governments should not choose among clusters but create policies that support upgrading in every cluster in a location. Cluster policy is pro-competition.

iii) Shifting Responsibilities for Economic Development

In the Old Model, government drives economic development through policy decisions and incentives. In the New Model, economic development is a collaborative process involving government at multiple levels, companies, educational and research institutions, and institutions for collaboration (Porter, 2003).

¹² For a description on cluster life cycles, see Solvell, O., *Clusters: Balancing Evolutionary and Constructive Forces*. Stockholm: Ivory Tower Publishers, 2008.

iv) Cluster Initiatives as Policy Catalysts for Competitiveness

Cluster Initiatives are organised efforts to enhance the competitiveness of a cluster, involving industry, public authorities and/or academic institutions. Led by a competitiveness-oriented leader and underpinned by analytically sound evidence of strategic and operational efficiencies, a cluster initiative generated public-private dialogue can suggest a detailed policy map that is politically more feasible, while it addresses the most critical constraints and improves communication among stakeholders. Such initiatives offer a comprehensive assessment of a cluster's markets, products, linkages, externalities, and synergies that help identify regulatory and business constraints, tap new and wider market opportunities, and develop sound business strategies to compete with its main competitors.

Strategic initiatives vary by country and cluster, but often focus on improving supply chain enhancements, market information, quality standards, workforce development, process improvements, and branding.

A Cluster Initiative involves:

1. Member firms and organisations (private, public and academic)
2. Often a cluster organisation with an office, cluster facilitator/manager, website, etc.
3. Governance of the initiative (e.g. board)
4. Financing of the initiative (international/national/regional/local public funding, member fees, consulting, etc.)

v) Clusters and Value Chains

A value-chain approach is transaction-oriented and linear as it focuses on transactional efficiency within the chain. A cluster approach is systemic; it includes an analysis of a cluster's value chain, has a strategy orientation and focuses on solving information and coordination failures through better participation of supporting institutions outside the value chain.¹³ While clusters are geographically centred, value chains can span multiple geographies.

“Value chain projects tend to have a sharper focus on helping specific beneficiaries, usually those stuck in poverty, such as producers in a region or farmers who are receiving low prices. Cluster projects tend to involve the entire value chain plus any entity that has the potential to influence the cluster and beyond. Such entities include traders, processors, manufacturers, exporters, training institutes, government standard bureaus, etc. Value-chain analysis is only one of the several tools a cluster approach may deploy.”¹⁴

¹³ World Bank, *Clusters for Competitiveness*.

¹⁴ Ibid.

2) KOSOVO COMPETITIVE ANALYSIS

Kosovo is an economy in transition. Kosovo's non-membership in the United Nations (UN) remains a key obstacle to political integration and socioeconomic development. By mid-March 2014, 106 (out of 193) UN member countries have recognised Kosovo's independence. It is a potential candidate for European Union (EU) membership.

With a population of less than 2 million, and Gross Domestic Product (GDP) per capita estimated close to 2,800 EUR in 2013, Kosovo remains the poorest in the region. With an estimated unemployment rate of above 30.9% in 2012 and an employment rate of only 25.6%, Kosovo has one of the weakest employment records in Europe. Kosovo's 36.9% labour force participation rate among the working-age population is substantially below the 70% average estimated for the World Bank's Europe and Central Asia region.¹⁵

The economy has grown steadily averaging 3.4% during 2009-13 and growth outlook remains moderately buoyant.¹⁶ The growth has largely been attributed to public investments in infrastructure, donor assistance and remittances. Furthermore, the pace of growth is nowhere near enough to have significant impact of reducing poverty and unemployment. The World Bank estimates that Kosovo would need to more than double its growth rate to 12% per year for an entire decade just to reach Montenegro's current GDP per capita level.¹⁷ The income gap between Kosovo and its neighbours is expected to remain large despite higher growth.

Macroeconomic Conditions

Kosovo is making progress at a steady pace in both first-stage (trade reforms, etc.) and second-stage (banking, infrastructure, enterprise) restructuring. The budget performance had largely been stable but spending is estimated to continue to exceed revenues by the Ministry of Finance, resulting in a deficit of more than 2%. This rapid increase in public expenditure is currently driving growth in investment as public investment has increased from 5% to 12% of GDP. Private investment has remained at 20-22% of GDP for the past five years.¹⁸

Economic activity remains concentrated in the services sector bolstered by the large international presence in Kosovo and large remittance inflows.

Microeconomic Conditions: The Diamond

The following section takes a quick look at Kosovo's business environment using “the diamond” tool.

¹⁵ World Bank, *Kosovo Snapshot*, April 2014.

¹⁶ World Bank, *Kosovo Snapshot*.

¹⁷ World Bank, *Kosovo Unlocking Growth Potential: Strategies, Policies, Actions; A Country Economic Memorandum*, Poverty Reduction and Economic Management Unit, April 2010.

¹⁸ USAID, *Kosovo: 2014-2018, Country Development Cooperation Strategy*.

Factor Conditions

Kosovo's rank in the World Bank's 2014 *Doing Business Index* improved 10 places to 86, driven mostly by improvements in Starting a Business (up 26 spots at 100); Dealing with Construction Permits (up 16 spots at 136) and Registering Property (up 17 spots at 58). However, **Kosovo still needs to remain focused on improving the business environment as a policy priority.** Compared to its closest neighbours and competitors, Kosovo still has to catch up. Kosovo still suffers from excessive institutional regulation of private economic activity through the use of licenses, permits and other inhibiting processes at the central and local levels that increase the cost of doing business.¹⁹ There are several ongoing donor projects that aim to remove barriers and enhance the business enabling environment..

Financial Market

Cost of capital is comparatively high in Kosovo and companies uniformly complain about the high interest rates. This severely impacts their capacity to expand, even when companies have been successfully growing their business for years.

Education/Skills

Even with widespread unemployment, companies report difficulties in hiring skilled workers and sometimes, like Kosovatex, have to hire foreign skilled workers. The generally poor quality of Kosovo's education system makes it difficult for young people to access and retain jobs.

Kosovo's Locational Advantages

Kosovo is located close to some of the world's leading global European companies and has access to the EU market. As a potential outsource manufacturing hub, Kosovo has the advantage of proximity over potential rivals such as China. Kosovo enables just-in-time manufacturing for these companies if desired. With its access to the EU market, Kosovo is also an attractive base for non-EU companies seeking easier entry into the EU market. This strategy is being pursued by many Turkish companies. However, Kosovo faces competition from its Balkan neighbours and needs to **distinguish itself as a foreign investment destination or outsource manufacturing/service hub by connecting into regional clusters and facilitating easier expansion of such regional clusters into Kosovo.**

Demand Conditions

At the current levels of disposable income, most domestic consumers are in the low to middle level segments of most markets. This highlights the importance of linkages to international buyers who can provide the signals to exporting firms on international market trends. Many exporters have relationships with foreign marketing companies or export agents who provide design, sales and marketing support services.

Institutional procurement policy can aim to upgrade home demand by acting as a demanding and sophisticated buyer, reflecting international needs and facilitating innovation. Procurement at the

¹⁹ USAID, *Kosovo: 2014-2018*, Ibid.

central level is driven by price (allowing for specified gap between the foreign and local bidder) while in the IT sector, firms report suspicious corruptive behaviour.

Related and Supporting Industries

Except for supplies of natural resources like agriculture and dairy, local suppliers are very limited with many inputs and raw materials imported. The taxes on imports add pressure to prices especially when producers are competing in the low to middle price segments. This makes producers uncompetitive especially when imports, often from neighbouring countries, are subsidised.

Context for Firm Strategy and Rivalry

Rivalry is not only domestic but regional as factor and demand conditions influence many producers. Many firms have adopted strategies that place them in international competition, especially in the EU. For the most part, companies are not yet in a position to compete successfully in local and international markets. Largely constrained by public infrastructure and business climate conditions, domestically produced goods are not yet at the quality or quantity required to compete successfully in either domestic or foreign markets. Even though exports increased 6.5% (294 million EUR) in 2012-2013, and imports decreased 2.3% (2.4 billion EUR), the trade deficit is staggering.

Taxes (VAT)

Kosovo's rate of corporate tax for companies with an annual turnover in excess of 50,000 EUR is 10%.²⁰ However, companies and business associations interviewed consistently report Value Added Tax (fixed at 16%)²¹ on imported inputs (raw materials) as constraints that significantly increase their costs, to the extent of rendering them uncompetitive. Interviews with Customs officials clarified the certification for inbound processing which exempts companies for taxes on inputs for exported products. Yet, this procedure appears to be widely unknown except for large exporting firms.

Foreign Direct Investment (FDI)

FDI is a key to economic development in Kosovo and the region. FDI in Kosovo has been mainly focused in the construction, services and telecommunications sectors²² which produce short-term economic growth. **FDI that targets production and manufacturing sectors would produce long-term economic growth and generate employment.**

While Kosovo offers advantages such as competitive wages, young workforce, natural resources, lowest taxes in the region and a bridge to the EU and other Balkan countries, its competing neighbours share many similar advantages. Serbia, in particular, with their free trade agreements with Russia and others in the region, can offer access to 1 billion consumers.

Kosovo has already lost several large FDI deals to its neighbour, Serbia because of more attractive incentives offered by Serbia e.g. 8-10,000 EUR for each new employee, with a job guarantee of 2 years.

²⁰ <http://www.atk-ks.org/wp-content/uploads/2010/09/Law-No.-04-L-103.pdf>, retrieved May 26, 2014.

²¹ <http://www.rks-gov.net/en-us/bizneset/financattaksatdoganat/pages/taksat.aspx>, retrieved May 26, 2014.

²² Kida, Nakije, Kosovo overview FDI and environment, Merit Research Journals October 2013, <http://www.meritresearchjournals.org/aaef/Content/2013/October/Nakije.pdf>, retrieved April 21, 2014.

A Dutch firm acquired the privatised leather processor SOE in Serbia instead of partnering with an interested Kosovo company to locate in Kosovo.²³ A leather shoe manufacturer in Kosovo also failed to attract an established foreign partner when Serbia offered more attractive incentives.²⁴ The related leather and footwear foreign investments will help spur a leather products cluster in Serbia. Kosovo lost out on both these deals even though local entrepreneurs were actively soliciting the investors.

Furthermore, **other neighbours are trying to entice Kosovo's more established firms to re-locate to their countries.**

Firm Strategies to Compete in Spite of Barriers

More than 98% of businesses are family-owned, micro-, small-, and medium-sized enterprises.²⁵ The business environment is saturated with low value-added service or tertiary sector firms. A recent UNDP report²⁶ noted that Kosovo's marketplace is unbalanced with an overemphasis on new enterprise creation. This is perhaps not surprising given that high unemployment frequently leads to self-employment. Encouraging medium-sized enterprises to grow will be a major challenge that requires better access to credit, streamlining of regulatory framework and enhancing efficiency of trade flows internally and externally.²⁷

Several potential clusters have been seeded by anchor firms with local entrepreneurs or foreign investors. Some entrepreneurs first start trading companies and gain business experience and market knowledge before founding their production business. Some conduct market studies to identify new business opportunities.

Some of these entrepreneurs are succeeding in spite of the high barriers though there are those who succumb. For example, the Association of Kosovo Business reported when interviewed that a sunflower seed oil company had to close as it was unable to compete with imported sunflower seed oil due to taxes on imported raw materials. Imports on sunflower seed oils reached 12 million EUR in 2013, offering high opportunities for import substitution but the high costs of inputs result in domestically produced goods being more expensive than imported ones. Another example provided was a fertilizer company which also found it difficult to compete with imports due to taxes on imported raw materials.

Firms are pursuing a range of strategies to compete within a very challenging business environment.

- a) Import substitution.
 - Donors have targeted and been supporting farmers and food processing firms to meet demand in the local market.

²³ Interview with the owner of the firm.

²⁴ Interview with the owner of the firm.

²⁵ Micro (<9 employees); Small (10 to 49 employees); Medium (50-249 employees)

²⁶ UNDP, *Kosovo Human Development Report 2012*.

²⁷ USAID, *Ibid*.

- Having identified another import substitution opportunity i.e. local demand for pharmaceuticals, Trepharm was started by a local trading company and received assistance from donors.
- b) Licensing of international brands for domestic and foreign markets
- Exports of mineral waters and non-alcoholic beverages were over 7 million EUR in 2013
 - Fluidi Company licenses Royal Crown Cola with rights to distribute in 4 countries (Kosovo, Former Yugoslav Republic of Macedonia (FYRoM), Albania and Serbia). Fluidi also licenses Jaffa Champion brands for bottling juices and other beverages.
- c) Original Equipment Manufacturer (OEM) contracts
- Solid Shoes pursued OEM contracts (e.g. GeoX) while producing and marketing their own brands in niche markets such as men's casual and work boots. The company sources its main inputs directly and controls the production process instead of relying on higher priced imports from suppliers.
- d) Niche market for domestic and foreign markets
- Hit Shoes targets low-medium priced points for plastic/rubber summer-beach footwear with fairly automated production lines. The company imports raw materials on which they have to pay 10% duty. Yet, they are successfully competing against low cost producers such as China and leveraging their EU proximity.
- e) Access EU market by foreign investors
- Newco Kosovatex was acquired by Dubai-based Ecolog International. The company manufactures jeans for well-known European brands such as Pierre Cardin, Otto Kern, etc. and exports primarily to the EU.
 - Kamila Chocolate was founded by Turkish investors in 2008 to supply the local market and export to the EU.
 - Key One, established by Italian investors, produces handbags for global brands like The Bridge, Max Mara, Prada, Burberry, etc.
- f) Supply Chain
- Newco Remateks was acquired by a Turkish company Ipliksan (Yikla Textile) to produce synthetic fibre yarns for knitting which are mainly exported. Yilka Textile manufactures knitted fabrics in Turkey.
- g) Resource-driven – Investment in these industries have generally been constrained by the high capital requirements and business environment. The industries tend to be dominated by a single large, foreign-owned firm.
- Mining – NewCo Ferronikeli (Cunico Resources NV)
 - Decorative stones/marble – Fox Marble (UK)

3) KOSOVO CLUSTER PERFORMANCE

Kosovo Trade and Exports

There is an overdependence on imports accentuated by a very small export sector and energy shortages. While a very high negative trade balance (close to 42% of GDP in 2013) persists, exports are projected to increase faster than imports. From 2010-2013 imports increased 4% Compound Average Growth Rate (CAGR) while exports remained stagnant (slight decrease of -0.23% CAGR). However, when the dominant export, ferro-nickel, is excluded, exports grew strongly at 9.85% CAGR. Exports of ferro-nickel decreased from 141 million EUR in 2010 to 88 million EUR in 2013.

The leading exports (see Table 1, the Top 50 Exports by Value, which represents nearly 90% of total Kosovo exports) are dominated by natural resources such as ores, metal products and scrap (mining/metals) with ferro-nickel alone representing 30% of exports; wheat, wine and hides/skins (agricultural products) with a few manufactured products such as synthetic fibre yarn, conveyor belts, plastic doors and windows, and beverages. Some exports show significant growth as new firms become exporters.

Table 1: Kosovo Top 50 Exports by Value

EXPORTS		2013 EUR	Share of Exports	CAGR % (2010-2013)
1	Ferro-Nickel	88,402,350	30.08	-14.40
2	Electrical Energy	21,684,622	7.38	28.91
3	Waste and scrap of iron or steel	20,084,114	6.83	9.30
4	Lead Ores And Concentrates	15,195,630	5.17	-1.21
5	Waste and scrap, of copper	10,105,266	3.44	-5.87
6	Wheat or meslin flour	8,420,856	2.87	10.90
7	Yarn Containing >= 85% Synthetic Staple Fibres	7,580,888	2.58	20.47
8	Whole raw hides and skins of bovine or equine animals > 16 kg	7,136,962	2.43	38.96
9	Waste and scrap, of aluminium	5,777,778	1.97	1.87
10	Conveyor Belts Or Belting, Of Vulcanised Rubber	5,475,706	1.86	12.04
11	Zinc Ores And Concentrates	5,069,753	1.72	1.17
12	Whole raw hides and skins of bovine or equine animals <= 8 kg	4,236,652	1.44	-13.61
13	Waters With Added Sugar, Sweetener Or Flavour	4,231,261	1.44	29.16
14	Doors, Windows And Frames Of Plastics	3,856,639	1.31	76.83
15	Tubes, Pipes And Hollow Profiles	3,552,532	1.21	25.65
16	Parts For Compression-Ignition Internal Combustion Piston Engine, N.E.S.	3,436,645	1.17	1084.10
17	Waste and scrap of primary cells, batteries and electric accumulators	3,124,695	1.06	76.11
18	Wine of fresh grapes, in containers of > 2 l	2,938,537	1.00	29.79
19	Non-alcoholic beverages	2,747,201	0.93	64.79
20	Flat-Rolled Products Of Iron Or Non-Alloy Steel, >= 600 Mm	2,704,516	0.92	655.83
21	Plates, Sheets, Film, Foil And Strip, Of Cellular Polymers Of Styrene	2,611,694	0.89	118.78
22	Line pipe of flat-rolled products of iron or steel, <= 406,4 mm	2,368,000	0.81	10.88
23	Portland Cement	2,192,119	0.75	123.32

24	Rubberised textile fabrics	2,110,574	0.72	n/a
25	Chocolate <= 2 Kg, Filled	1,757,210	0.60	-0.55
26	Beer made from malt	1,596,545	0.54	34.24
27	Tubes, pipes, of circular cross-section, of iron or non-alloy steel	1,554,463	0.53	n/a
28	Fresh or chilled potatoes	1,391,261	0.47	54.43
29	Bitumen And Asphalt	1,375,063	0.47	285.25
30	Men's or boys' trousers	1,306,423	0.44	911.46
31	Flexible Tubes, Pipes And Hoses, And Fittings, Of Plastics	1,181,403	0.40	90.87
32	Tubes and pipes, of square/rectangular cross-section, of iron or steel	1,158,775	0.39	n/a
33	Central heating boilers, non-electric	1,112,804	0.38	n/a
34	Chromium Ores And Concentrate	1,042,691	0.35	-5.28
35	Wine of fresh grapes, in containers of <= 2 l	1,012,859	0.34	25.21
36	Machines For Reception, and Transmission Of Voice, Images	944,944	0.32	82.38
37	Fresh cranberries, bilberries and other fruits of the genus Vaccinium	880,098	0.30	20.52
38	Roasted Coffee	826,611	0.28	35.89
39	Pallets, of wood	794,749	0.27	24.96
40	Recovered "waste and scrap" made of mechanical pulp	770,285	0.26	122.86
41	Lead Powders And Flakes	752,331	0.26	61.65
42	Transmission Belts Or Belting, Of Vulcanised Rubber	708,712	0.24	29.81
43	Bran, sharps and other residues of wheat	704,400	0.24	19.47
44	Fresh raspberries, blackberries, mulberries and loganberries	680,025	0.23	521.70
45	Radiators For Central Heating, Of Iron Or Steel	613,939	0.21	25.28
46	Non-Refractory Surfacing Preparations For Facades	603,058	0.21	23.01
47	Plants, used in perfumery, pharmacy or for insecticidal, fungicidal	601,795	0.20	155.26
48	Agglomerated Lignite	587,642	0.20	170.55
49	Plates, sheets, film, foil and strip, of plastics	569,686	0.19	-1.94
50	Waste And Scrap Of Alloy Steel	555,222	0.19	56.35

Source: MTI

Revitalisation - Clustering in Kosovo

Typical seeds to clusters include natural advantages (e.g. ore deposits, climate) or particular demand or skill within the region (Porter, 1998). Another typical seed is an entrepreneur who starts a particular industrial activity in a particular location. If the new venture is successful, with factor advantages supporting the business idea, a cluster can begin to grow and prosper. Therefore, this study presents three representative cluster case studies that are driven by entrepreneurs who are using the factor advantages offered by Kosovo. It is hoped that these examples can inform further study and initiatives to support the growth of clusters in Kosovo.

Representative Cluster Case Studies

Three emerging clusters were selected as representative case studies:

- Leather Goods and Footwear
- Agribusiness - Soft Fruits and MAPs
- Wine.

These emerging clusters are anchored by entrepreneurs who are planning to expand and whose potential can be unleashed once business environmental constraints are removed.

Leather Goods and Footwear Cluster

Summary

In the last four years, Kosovo has seen increasing exports in hides and skins as well as footwear and handbags. Exports of hides and skins grew 8% CAGR from 2010-2013, from 9 million EUR in 2010 to over 11 million EUR in 2013, representing nearly 4% of total exports from Kosovo. Export growth for footwear was more significant at 159% CAGR from 2010-2013, from 36 thousand EUR in 2010 to 628 thousand EUR in 2013.

Recent foreign investment by an Italian OEM handbag manufacturer in Gjakovë/Đakovica has established an important link to Italy, the world's largest leather handbag exporting nation, thus offering the potential to bring skills and technology to the domestic industry. Other evidence of this emerging cluster includes prominent domestic companies exploring vertical integration into leather processing and a local footwear company competing successfully in the Balkan region with Chinese manufacturers in the area of value priced shoes. The complementary relationship of these industries, increasing exports and competitiveness, and developing relationship with Italy, renowned for its expertise in leather, is indicative of the potential for the emerging leather goods and footwear cluster in Kosovo.

With a combination of institutional, investor and donor support, Kosovo has an opportunity to become a regional and perhaps global model for efficient, high quality, environmentally friendly leather production and ultimately as a trusted, OEM partner for Italy and other EU based leather industry players. Unable to compete with the sheer scale of the Asian leather producers, Kosovo can instead engage with premier brands in the EU and focus on providing the quality, craftsmanship, and short delivery lead times required by the EU market as a competitive advantage over the high volume Asian exporters.

This window of opportunity will not remain open indefinitely as Serbia and other neighbours are restarting former SOE leather enterprises with aggressive FDI incentives in an attempt to buy their way to a leather and footwear cluster. Lacking the resources to simply outbid competing neighbours (and such FDI strategies are rarely sustainable and historically produce mixed net results), Kosovo's advantage may be that starting fresh with the latest leather processing technology, and a better executed cluster initiative with all participants aligned, will yield the higher ultimate ROI for partners both foreign and domestic. The goal, and preferred FDI incentive strategy, is not a bidding war but the targeted packaging of FDI offerings and communicating the benefits and value to FDI prospects. This is an opportunity for central and municipal institutions and donors to ensure that the appropriate support is given to industry.

Introduction

Kosovo has a tradition of leather tanners and saddle makers in Pejë/Peć with SOE leather shoe factories established in the 1940s. In the last 15 years or so, new companies have emerged out of trading companies, some from families with a history in hides and skins and footwear, and new foreign investment in leather products.

In the last four years, Kosovo has seen increasing exports in bovine hides and skins of 11.5 million EUR in 2013, and increasing exports of footwear and handbags. Further, recent foreign investment by an Italian OEM handbag manufacturer in Gjakovë/Đakovica has established an important link to the world's largest leather handbag exporting nation thus offering the potential to bring skills and technology to the domestic industry. Other evidence of this emerging cluster includes prominent domestic companies exploring vertical integration into leather processing and a local footwear company competing successfully in the Balkan region with Chinese manufacturers in the area of value priced shoes.

The complementary relationship of these industries, increasing exports and competitiveness, and developing relationship with Italy, renowned for its expertise in leather, is indicative of the potential for the emerging leather goods and footwear cluster in Kosovo.

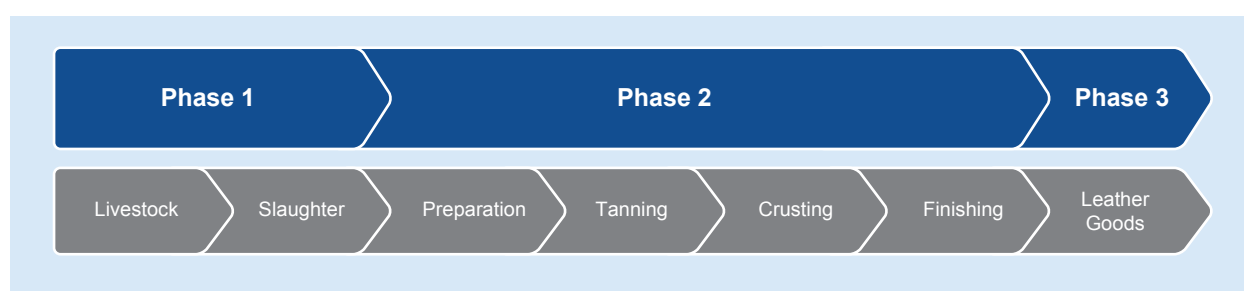
Trends in the Global Leather, Footwear and Handbag Market

World Leather Industry

The leather (goods) supply chain is a globalised one, affected by the availability of animals, capital and cheap labour and different regulatory frameworks. Besides Italy, the other major producing, processing, importing and exporting leather countries are located outside of Europe. China is the world's leading producer, importer and exporter of leather and Italy is the world's second. European high cost of labour and more stringent environmental legislation have led to a loss of competitiveness in the European leather sector, especially in relation to upcoming markets such as South Europe and Asia.

There are three broad stages in the supply chain of leather goods (see Figure 1 below). The first stage is raw materials i.e. animal hides and skins. In the second stage the raw hides and skins are tanned and finished to convert them into leather. In the third stage, leather products are manufactured. The first stage is generally considered a by-product of the meat industry while the second stage can be considered the most capital-intensive and the third stage the most-labour intensive.

Figure 1: Phases and Steps of the Leather Supply Chain



Source: Ernst & Young, *Sustainability in the leather supply chain*, June 2013

Bovine hide production has expanded over several decades in developing countries while it contracted in the developed countries. As a by-product, the supply of hides and skins depends primarily on the production of meat. Raw hides and skins constitute a relatively small and declining proportion of the total value of trade in the hides, skins, leather and leather footwear sector. The

top producers of bovine hides in the world (by weight) are the United States (13%), Brazil (12.3%), China (11.4%), India (6.6%), and Argentina (6%).²⁸

The production of hides and skins, and pre-tanning processing are practiced throughout the world, but locations for the production of finished leather and the manufacture of leather products are less widespread. Two thirds of finished leather comes from ten countries with the four leading producers being Italy, Korea, China and India.

Italy is the world's leading exporter of leather (bovine light leather by value) with 23% share of world exports, followed by China (12.7%), and Brazil (10.3%).²⁹ **Italy is one of the most important actors in the leather supply chain and the country chooses to source nearby.** It imports its hides and skins mainly from France (25%), Germany (9%) and the Netherlands (8%).

The European leather tanning industry is still the world's largest supplier of leather in the international market place, even if the share of the EU on world markets is shrinking with the development of the leather industry in Asia and the Americas. The leather tanning industry is a global industry and EU tanners depend highly on access to raw materials and to export markets. This is, however, often hampered by tariff and non-tariff barriers hindering the export of finished leather and restricting access to raw materials. Since access to European raw materials has become more difficult (slaughter rate and beef production have dropped in recent years), access to raw materials outside of Europe is crucial. EU tanners are exposed to increasing competition from a large number of non-EU countries, notably low-labour cost ones.

To cope with competition, EU tanners are aiming their production to higher quality and high fashion leather. Another aspect that influenced the sector is the investments made by EU tanners in environmental protection, waste reduction, recycling, recapture of secondary raw materials, etc.³⁰

With soaring raw materials prices and a finite number of quality hides and skins, there has been an explosion in demand for high-value leather goods. Consequently, some of the world's largest luxury brands have snapped up tanners to secure supply and maintain an artisan tradition.³¹ These luxury brands are strengthening their vertical integration by owning the production chain from the raw material through to the end retailer.

PPR SA (renamed Kering), the Paris-based luxury and sporting goods group (Gucci, Saint Laurent, etc.) will start making branded leather goods in Serbia. The company will invest 6 million EUR in a bankrupt tannery in Ruma, receiving 8,000 EUR from the Serbian government for each of 120 employees it plans to hire.³²

²⁸ FAO, *World Statistical Compendium for raw hides and skins, leather and leather footwear 1993-2012*.

²⁹ FAO, *Compendium 2013*.

³⁰ Ernst and Young, *Ibid*.

³¹ http://www.fashionnetasia.com/en/BusinessResources/6110/Raw_Materials_Luxury_All_you_need_to_know_about_tanneries_being_snapped_up_by_luxury_brands.html; retrieved April 19, 2014.

³² <http://www.bloomberg.com/news/2013-05-15/ppr-to-make-luxury-leather-goods-in-serbia-with-state-support.html>; retrieved April 19, 2014.

Demand for leather products is expected to be influenced by the uncertain prospects for the global economy. In the medium to longer term, demand for leather, for footwear, automobile upholstery and other applications is expected to continue to expand, particularly in the faster-growing developing countries of Asia and Latin America.³³ Demand for leather footwear, the major application for leather, has continued to grow modestly despite athletic shoes eroding the market share for traditional leather footwear.

World Footwear Industry

Developed countries have reduced their footwear production and exports since the 1970s. As a result, developing countries were able to step in and grow this market mainly due to its lower costs in labour. The developed countries concentrated on higher value activities such as creation, design and marketing. Italy and Spain have significant footwear production still, but their strategy has been to shift production to lower costs countries, keeping design and finishing at home base.

Since the 1980s, China and India have become major producers with Asia responsible for 87% of world footwear production since 2010. China is the lead producer by volume with 62% of total production (12.5 billion pairs), followed by India with 10.2%.³⁴

In the last ten years, world exports of footwear increased by 79% in quantity and 108% in value. This reflects an increase in the average price of exports, though the trend has not been constant. The composition of exports also changed in the last decade, with an increase in the share of Rubber and Plastic category and a significant decrease in the Leather shoes exports. However, while export volume of Rubber and Plastic shoes increased (54% of total volume exported), Leather shoes were responsible for more than 52% of the value of exports, showing the much higher value of these shoes when compared to the other categories of shoes.³⁵

This difference in prices also explains why Europe is still responsible for 38% in the value of footwear exported, though it produces far less in volume. European countries, Italy in particular, have focused on the different mix of products exported, more concentrated in leather shoes that are more expensive than the Rubber and Plastic shoes that is the bulk of Asian production. As a result, the average price of Asian exports remained around USD 4 a pair while European exports averaged USD 23.³⁶

³³ Ibid.

³⁴ World Footwear Yearbook 2011.

³⁵ Ibid.

³⁶ Ibid.

Table 2: Top Leather Footwear Exporters by Value USD

Top Leather Footwear Exporters (Trade Value in USD Billion)			
	2010	2012	CAGR (2010-2012)
China	\$35.63	\$46.81	33.2%
Italy	\$9.85	\$10.84	51.1%
Vietnam	\$5.23	\$7.52	25.2%
China, Hong Kong SAR	\$5.58	\$5.18	70.7%
Germany	\$3.94	\$4.63	44.3%
Total World Exports	\$96.01	\$114.34	42.8%

Source: UN Comtrade (United Nations Commodity Trade Statistics Database)

Key Players in the Global Footwear Market³⁷

- Italy – Design, marketing and production of premium shoes; Export widely to the world market
- United States – Design and marketing; Focus on specific market segments like sport and recreational shoes and boots; Manufacturing only in selected lines such as hand-sewn casual shoes and boots
- Portugal – Production; Focus on short-production runs in the medium price range
- Romania – Production subsidiaries of Italian companies; Focus on lower to medium price range
- China – OEM production; Focus on low cost segment mainly for the US market
- Vietnam/Indonesia – OEM production; focus on low cost segment mainly for European market

World Leather Handbag Industry

Despite Asia's dominance in footwear, Italy retains their top global position in the export of leather handbags.

Table 3: Top Leather Handbag Exporters by Value USD

Top Leather Handbag Exporters (Trade Value in USD Billion)			
	2010	2012	CAGR (2010-2012)
Italy	\$1.80	\$3.11	10.1%
China, Hong Kong SAR	\$1.29	\$1.87	24.5%
China	\$1.34	\$1.80	31.2%
France	\$1.01	\$1.76	9.7%
India	\$0.25	\$0.33	30.8%
Total World Exports	\$6.84	\$10.45	20.0%

Source: UN Comtrade (United Nations Commodity Trade Statistics Database)

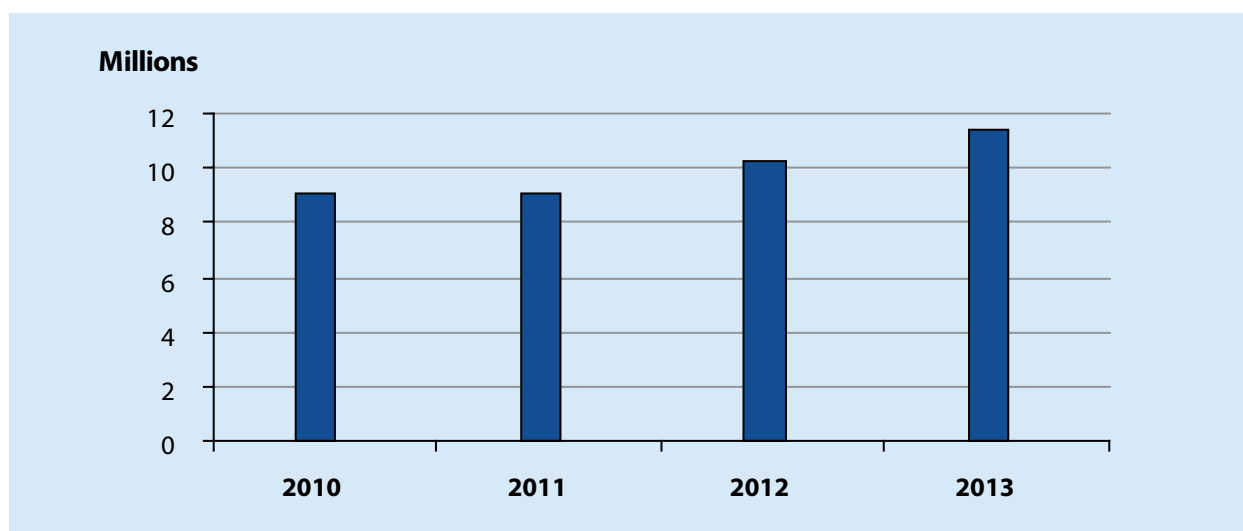
³⁷ Harvard Business School student teams 2002.

Importance of the Footwear and Leather Products Industries to Kosovo

Trade Performance

Exports of hides and skins from Kosovo grew 8% CAGR from 2010-2013, from 9 million EUR in 2010 to over 11 million EUR in 2013, representing nearly 4% of total exports from Kosovo.

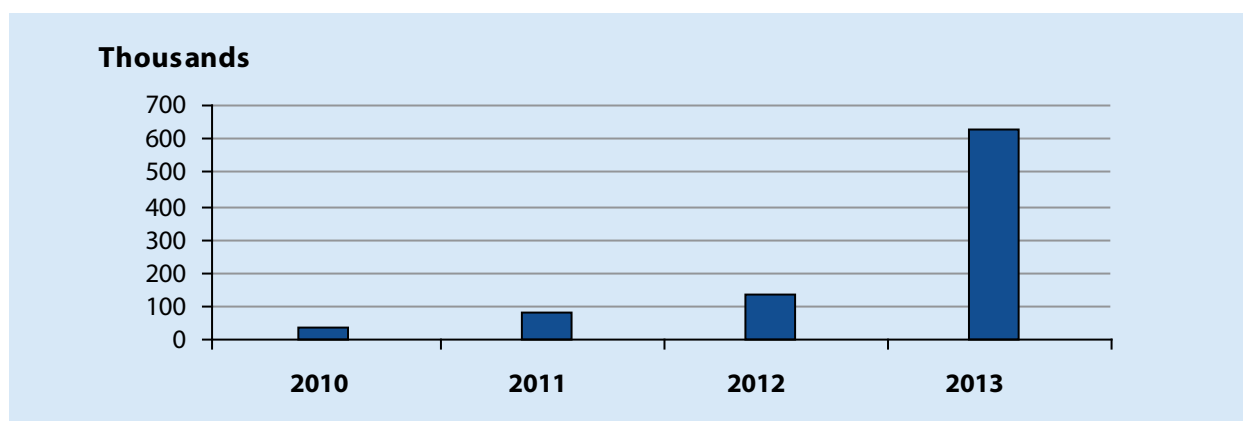
Chart 1: Kosovo Exports of Hides and Skins EUR



Source: MTI

Export growth for footwear was more significant at 159% CAGR from 2010-2013 from 36 thousand EUR in 2010 to over 628 thousand EUR in 2013.

Chart 2: Kosovo Exports of Footwear EUR



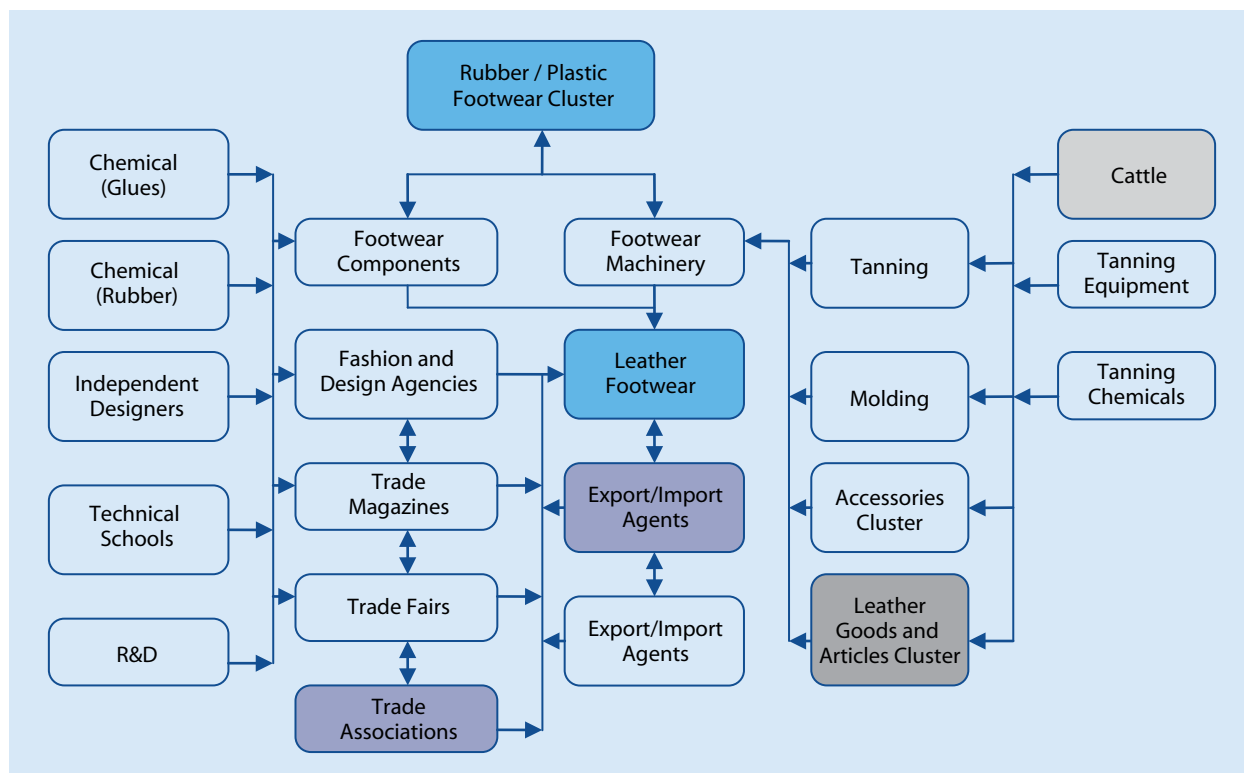
Source: MTI

Cluster Map and Competing Clusters

The Rubber/Plastic footwear cluster interacts with the Leather Footwear cluster, and share resources and factors with other clusters such as accessories and leather goods and articles (e.g. handbags, clothing, etc.), as depicted in the cluster map of Figure 2. Kosovo's clusters are still emerging with most inputs imported (or exported for processing and then re-imported as in the case of hides

and skins originally sourced domestically). Highlighted boxes in the cluster map denote activities present in Kosovo.

Figure 2: Footwear and Leather Goods Cluster Map.



Source: Adapted from Nadvi, 1995. Author revised Leather Clothing to Leather Goods and Articles Cluster

Kosovo has high and increasing exports of hides and skins with over 11.5 million EUR in 2013, which is below the average of some other countries in the region. Exports in 2013 (in USD million)³⁸ from its neighbours were: Bosnia and Herzegovina 66.0, Serbia 45.7, Croatia 27.9, Albania 7.6 and Montenegro 7.2.

While Kosovo did not have finished leather (bovine or equine) exports (e.g. to be used in the manufacture of shoes, handbags, and other leather articles), several of its neighbours did: Croatia with USD 15.7 million, Bosnia and Herzegovina USD 15.3 million, Albania USD 10.9 million, Serbia USD 8.2 million, and Montenegro USD 0.5 million.³⁹

Kosovo has seen significant increases in exports of footwear from 36 thousand EUR in 2010 to 628 thousand EUR in 2013, with leather footwear exports jumping from 9 thousand EUR in 2010 to 356 thousand in 2013. However, even with this increase, Kosovo's exports in this category remain far behind its neighbours. Exports of footwear from its neighbours in 2013⁴⁰ were: Bosnia and Herzegovina USD 370.9 million, Albania USD 320 million, Serbia USD 271 million, Croatia USD 187.2 million, the FYRoM USD 70.2 million, and Montenegro USD 1.0 million.

³⁸ UN Comtrade 2013.

³⁹ UN Comtrade, Ibid.

⁴⁰ UN Comtrade, Ibid.

Although some of Kosovo's neighbours seem to be outperforming Kosovo in terms of exports, it is also an indication that with some of the similar geographic and natural advantages as its neighbours, Kosovo can also compete in these industries.

The Kosovo Cluster Diamond

Factor Conditions

Currently there is no leather production (i.e. the conversion of hides and skins to finished leather suitable for the manufacture of leather articles and footwear) in Kosovo though exports of hides and skins have been increasing over the years. There are proposals to invest in leather processing facilities, whether at the wet-blue or finished stages.

The supply of livestock in Kosovo has been increasing over the years, from domestic farms and imports. The breed of cattle in Kosovo and neighbouring countries produces high quality hides and skins.

Footwear production in Kosovo includes Rubber and Plastic and Leather types. Machinery and main inputs are imported but are readily available.

New employees need to be trained but once trained, skilled labour is available. Leather footwear factories have a relatively high ratio of women workers, predominantly in sewing leather uppers. There are few (high-quality) technical schools in mechanical or electrical subjects.

Location

Italy is the world's centre for design and leather goods, and not surprisingly, governments aiming to support cluster development in their countries are seeking assistance and cooperation with the Italians. Already, the Italian government is supporting the Indian government in setting up 2 leather clusters in India. The Indian government has committed to investing USD 2.7 million on each cluster while the state government has proposed investing USD 37.2 million on two clusters.⁴¹

Kosovo's geographic proximity to Italy gives it an advantage over firms in India or China. Kosovo's proximity to Italy, centre for design, marketing and production of leather products offers firms located in Kosovo opportunities to be production subsidiaries of Italian companies or suppliers of leather. Kosovo is closer to potential OEM customers (leading European brands) and consumers in EU than competitors in China or India. Furthermore, Kosovo has access to the EU market. There is already a trend for leading European brands to invest in the Western Balkans e.g. One Key in Gjakovë/Đakovica and Benetton and GeoX in Serbia. The handbag factory, One Key, produces bags for global brands such as The Bridge, Max Mara, Prada, Burberry and others.

However, **Kosovo is losing out on this opportunity due to uncompetitive FDI incentives and other barriers.**

Serbia appears to be a huge competitor seeking to take advantage of its proximity as well and is luring foreign investors with incentives. One example is GeoX Shoes which opened its new plant in

⁴¹ <http://www.leathermag.com/features/featureitalian-help-to-set-up-leather-clusters-in-near-kanpur/>, retrieved April 20, 2014.

Serbia instead of Kosovo (even though it was initially planning to invest in Kosovo) because Serbia offered 9,000 to 10,000 EUR per new employees, for a guaranteed job for 2 years. The new plant has 900 employees. Other examples are foreign acquisition of tanneries in Serbia. With established foreign firms seeding tanneries and leather products manufacturing, Serbia has almost instantaneously created a leather products cluster.

Demand Conditions

Even though Kosovo is generally considered a small market due to its population size and being the poorest in Europe, its domestic market for footwear is estimated to be higher than its neighbours in terms of consumption per person. In 2013, footwear imports totalled 22 million EUR, extrapolated to be about 4.2 million pairs.⁴² Based on interviews, production is estimated at 2 million pairs with exports extrapolated to be 92,000 pairs. With an estimated population of 1.8 million, apparent consumption can be estimated to be 3.2 pairs per person. This consumption rate is higher than Turkey (2.0), Serbia (1.71), Bosnia (1.5) and Albania (1.33) even though it is still far below the European average of 5.5 pairs.⁴³ As one footwear manufacturer interviewed for this study declared, there are nearly 2 million people in Kosovo and this one factory produced 1.5 million pairs of shoes.

The domestic retail market is very fragmented as there are few retail chains or department stores. This fragmentation results in a sales structure that necessitates salespeople dedicated to serving orders from individual retail stores. Such orders are typically small and may be placed with uncertain frequency, causing a very volatile demand that requires a flexible production structure capable of small production runs in short lead times. Kosovo's manufacturers are small-medium sized with the necessary flexibility to meet the demand of the domestic market.

Product designs and specifications were supplied by OEM buyers or overseas design/marketing firms, though in at least one firm in-house designers who are family members are slowly making their mark. For exporting firms, transactions between local manufacturers and foreign buyers were mostly mediated by agents, who collected a commission from the local manufacturer. These agents conducted market research efforts in foreign markets, prospected fashion trends, provided designs and product specifications, and frequently provided technical assistance to local manufacturers. These agents acted as quality certifiers and innovation diffusers that are essential for the cluster development. While the higher end leather footwear manufacturers used agents in Italy, the lower end rubber and plastic footwear manufactures used agents in Turkey.

⁴² As formal statistics for production and consumption are not available, the author extrapolated the value of imports and exports into volume (i.e. number of pairs of footwear) by dividing the trade values of each type of footwear (e.g. rubber/plastics, leather, etc.) by its average export price as reported by APICCAPS (Portuguese Footwear, Components and Leather Goods Manufacturers' Association).

⁴³ APICCAPS, World Footwear Yearbook 2013.

Related and Supporting Industries

Leather

Livestock: There is some cattle rearing in Kosovo that supplies about 20% of the hides and skins which are exported. The bulk of the hides that were exported (80%) were from imported livestock (9 million EUR imports in 2013). Approximately 5% of exported hides were originally imported hides from Albania and the FYRoM.⁴⁴ Though the absence of cattle ranches and formal slaughterhouses lead to fluctuations in supply of domestic hides, imports of livestock and hides help to stabilize the supply.

It was reported by firms interviewed that the costs of certification have hindered the establishment of formal slaughterhouses. The requirement for certificates has since become a problem for hides and skins suppliers.

Quality: Not all cattle produce the high quality leather. Many leather manufacturers prefer animals that have been grass-fed as they are more likely to produce the best leather. Cattle breeds in the region tend to be grass-fed and this breed of cattle produces thick hides that are preferred over thinner ones from other countries.

Footwear

There are very few local suppliers with most inputs imported. Machinery is all imported with training provided by the foreign suppliers. Sometimes, maintenance is done in-house or by the supplier. Companies report a shortage of skilled workers and consequently, new employees receive in-house training. Design services are procured overseas though local designers, educated locally and overseas (Italy), are also employed in some firms.

A business-institutional coalition service in Suharekë/Suva Reka, *Suhareka Business Support Centre*, has been quite effective in helping local business in that municipality.

Context for Firm Strategy and Rivalry

There are 12 small-medium sized firms companies competing with each other and imports. A relatively new trade association, the Kosovo Footwear Association with 12 members was recently formed to lobby institutions to remove VAT on imported raw materials, machinery, etc.

Gathering data on the various industries was challenging. According to the Tax Administration of Kosovo (TAK) database the textile sector (which includes footwear) employed 1,453 individuals of which 12% (174) were involved in the manufacture of footwear in 2012.⁴⁵ However, from our interviews with just two footwear companies in April 2014, their reported employment alone exceeded 300 workers. Imports of footwear declined from 23.0 million EUR in 2010 to 22.3 million in 2013, while exports increased from 36 thousand in 2010 to 628 thousand in 2013. This can be considered as strong indication that the industry has grown somewhat.

⁴⁴ Interview with industry executives.

⁴⁵ UNDP, Sector Profile of Textile Industry, March 2014.

Recommendations

With the trend for global production of leather, leather products and footwear to shift to countries with lower costs, Kosovo has an opportunity to develop its cluster. Footwear firms are already marketing under their own brands or under OEM contracts. There is an Italian-invested leather handbag manufacturer in Gjakovë/Đakovica.

Kosovo has an opportunity to attract more foreign investors and OEM contracts as production quality is reported to be generally higher than China and other low cost producers. However, Kosovo needs to be able to package a more competitive FDI offering and link cluster benefits to potential investors.

A more in-depth study on this potential cluster would provide an assessment and more information on Kosovo's competitive advantages and disadvantages. Entrepreneurs have already expressed plans for further investments in this potential cluster. Institutional and donor support could provide the needed support and direction.

The leather industry is considered to be a polluting industry and it is therefore important to adopt sustainable clean technologies. Stakeholders would be better able to identify constraints and needed solutions to grow this cluster. The formation of a cluster initiative (CI) comprising stakeholders, especially all donors represented for coordinated strategy and interventions, various institutional representatives from municipal to national level would decide on a Cluster Industrial Master Plan. The UNIDO Leather and Leather Products Industry Panel offers technical assistance programmes.

The CI can appoint consultants/contractors experienced in setting up infrastructure of a similar nature. For example: Donor assisted Public Private Partnership (PPP) for Special Industrial Zone for leather processing with municipality to allocate land with solid waste disposal plant / common effluent treatment plant, power supply including installation of captive power plant, water supply system, etc. With a state of the art waste water treatment facility, Kosovo can establish itself as a state of the art, environmentally compliant leather processing centre that can be the anchor for a leather products cluster.

The CI can determine the needs for cluster development e.g. capacity building, common marketing efforts, branding, technology sourcing, skill development, quality and environmental certification, best practices as per international standards.

The environmental challenges for leather

The leather industry is considered to be one of the most polluting industries with high negative impact on the environment. Therefore, it is important to recognize the importance of adopting sustainable clean technologies.

The leather tanning industry aims to achieve a wide range of environmental protection objectives such as waste water reduction, recycling and recovery of secondary raw materials. A key piece of environmental legislation for the leather sector is the Integrated Pollution Prevention and Control (IPPC) Directive which aims at minimizing pollution from various industrial sources throughout the EU. The IPPC Directive covers leather tanning plants where the treatment capacity for the tanning

of hides and skins exceeds 12 tonnes of finished products per day. As an important user of a large variety of chemical preparations, the industry is also affected by the Regulation on Registration, Evaluation, Authorisation and Restrictions of Chemicals (REACH). Leather tanning companies are obliged under the river basic management plants (Water Framework Directive 2000/60/EC) to take measures to reduce water pollution if the discharge from a plant contributes towards the pollution of a body of water, preventing compliance with the "good status" criteria. (REACH 2011)

Key Environmental Challenges as identified by an example Cluster Organization

The textile-clothing-leather cluster of Tuscany, Italy is one of the largest leather and apparel districts in Italy. The cluster produces 98% of insoles for shoes and 35% of leather for shoes within Italy. The Consortium of Tanneries – Consorzio Conciatori (Tuscany) manages the localisation and allotment of land for the transfer of tanning activities into modern industrial zones. The cluster organization has identified waste water dumping and water quality management as key environmental challenges. Together with various associations in the district, the Consortium improved water quality techniques within manufacturing. The organisation provides members with multiple environmental performance support services. The cluster itself has implemented environmental targets through environmental service providers which have been established locally.

Competitiveness amongst the cluster members is largely viewed on a global level as the industry competes with various non-European players (China and India being the main ones). Standards for environmental performance are not equal across the global industry. In terms of cost in relation to competitiveness, SME members do not place a high value on environmental targets as these hinder them to be competitive on a global playing field. Though the industry does value the importance of eco-innovation as a long-term competitive drivers, SMEs are unable to invest heavily in such initiatives.

With a combination of institutions, investors and donor support, Kosovo has an opportunity to become a regional and perhaps global model for efficient, high quality, environmentally friendly leather production. However, the window of opportunity will not remain open indefinitely; Serbia and other neighbours are restarting former SOE leather clusters with aggressive FDI offerings. Kosovo's advantage may lie in that starting fresh with the latest leather processing technology will yield the higher ultimate ROI for partners, both foreign and domestic. The packaging of such an offering, and aligning the PPP, is the challenge ahead.

Agribusiness-Soft Fruits and MAPs Cluster

Summary

Agriculture has been a traditional mainstay of Kosovo's economy and currently represents over 13% of GDP and 18% of exports. However, selection of sub optimal crops, poor production management, and low profit distribution channels has resulted in Kosovo's export performance remaining well below its potential compared to benchmarks and peers.

Numerous post conflict donor interventions dating from 2001 have helped revive this once strong agricultural sector. Most notably, exports of berries have increased from approximately 500 thousand EUR in 2010 to 1.6 million EUR in 2013 representing an increase of 46% CAGR making ber-

ries the fastest growing agricultural export. Including non-berry frozen fruit exports in total fruit exports yields a total increase of 53% CAGR for total Fruit exports from 2010 to 2013.

While potential exists for other soft fruits and berries, raspberries contributed nearly half of the 2013 berry export value, with raspberry exports increasing from less than 3,000 EUR in 2010 to 680 thousand EUR in 2013. Exports of fresh raspberries grew 522% CAGR from 2010-13. Conversely, Vegetable exports decreased 6% CAGR from 2010 to 2013, largely due to the dramatic decline in sweet potato exports.

The Soft Fruits category, specifically berries, represents an emerging cluster that due to a combination of consistent market demand, pricing advantage, introduction of cold chain capabilities, and raspberry yields per hectare more than double regional leader Serbia (and Dragash/Dragaš the highest in the world at 22 metric tons per hectare)⁴⁶ may enable Kosovo to capture market share from a neighbour and significantly increase exports in this category. However, there are risks inherent with “betting the farm” on one crop but the underlying message is that with proper focus Kosovo’s agribusiness cluster can be internationally competitive as they have demonstrated with raspberries. The challenge rests with the emerging cluster to optimise the berries value chain, forge FDI relationships with international players, and manage the threats and opportunities of vertical integration from both domestic and foreign actors.

Introduction

Agriculture has been a traditional mainstay of Kosovo’s economy and currently represents over 13% of GDP and 18% of exports.⁴⁷ However, selection of sub optimal crops, poor production management, and low profit distribution channels has resulted in Kosovo’s export performance remaining well below its potential compared to benchmarks and peers.⁴⁸

Kosovo farmers often grow large quantities of low-profit crops, make poor production choices and choose less-profitable market channels.
USAID Kosovo Agricultural Opportunities Strategy, 2010

Numerous post conflict donor interventions dating from 2001 have helped revive this once strong agricultural sector. Most notably, exports of fresh berries have increased from approximately 500 thousand EUR in 2010 to 1.6 million EUR for 2013 representing an increase of 46% CAGR making berries the fastest growing agricultural export.⁴⁹ Including non-berry frozen fruit exports in total fruit exports yields a total increase of 53% CAGR for total Fruit exports from 2010 to 2013.

While potential exists for other soft fruits and berries, raspberries contributed nearly half of the 2013 berry export value, with raspberry exports increasing from less than 3,000 EUR in 2010 to 680 thousand EUR in 2013. Exports of fresh raspberries grew 522% CAGR from 2010-2013. Conversely,

⁴⁶ USAID, *Kosovo Agricultural Opportunities Strategy*, 2010.

⁴⁷ World Bank 2011.

⁴⁸ USAID, *Kosovo Agricultural Opportunities Strategy*, 2010

⁴⁹ All Kosovo export data from Kosovo MTI 2013

Vegetable exports decreased 6% CAGR from 2010 to 2013, largely due to the dramatic decline in sweet potato exports.

The Soft Fruits category, specifically berries, represents an emerging cluster that due to a combination of consistent market demand, pricing advantage, introduction of cold chain capabilities, and raspberry yields per hectare more than double regional leader Serbia,⁵⁰ may enable Kosovo to capture market share from a neighbour and significantly increase exports in this category.

Medicinal and Aromatic Plants (MAPs) show similar potential with 19% CAGR increase in export value for 2010-2013.

Global Market and Competition

Demand for fresh fruits in the EU remains strong with imports increasing 60% over the past five years and demand exceeding EU production.⁵¹ Further, worldwide raspberry production has continued to increase from a value of USD 1.3 billion in 2010 to over USD 1.6 billion in 2012.⁵²

While Russia is the world's largest raspberry producer, they do not report any exports as all production appears to be retained for domestic consumption.⁵³ For 2012, the USA was the top raspberry exporter, with the majority of exports comprised of fresh raspberries, followed by Serbia and Poland each with the majority of exports comprised of frozen raspberries.

Table 4: Leading Raspberry Exporters

Top Total Raspberry Exporters 2012 Trade Value (USD Million)		Top Fresh Raspberry Exporters 2012 Trade Value (USD Million)		Top Frozen Raspberry Exporters 2012 Trade Value (USD Million)	
USA	\$295.87	USA	\$272.64	Serbia	\$180.19
Serbia	\$183.69	Spain	\$153.51	Poland	\$146.08
Poland	\$165.32	Mexico	\$149.89	Chile	\$133.22
Mexico	\$157.43	Netherlands	\$53.04	Belgium	\$51.80
Spain	\$154.36	Portugal	\$36.28	Netherlands	\$40.56

EU countries are well represented among the top raspberry importers with Germany's fresh raspberry imports increasing from USD 56 million in 2010 to nearly USD 75 million in 2012.

At the 2014 Global Berry Congress in Amsterdam (7-9 April 2014), the high demand and growth potential of berries was confirmed by Driscoll's Senior Vice President and Managing Director of EMEA (Netherlands) Theo Houwen who expects continued strong demand in the Nordic countries, the Netherlands, Belgium, France, and Germany but that "such continued growth will depend on value chain alignment and a quality focus."⁵⁴

⁵⁰ USAID, *Kosovo Agricultural Opportunities Strategy*, 2010

⁵¹ CBI (Center for the Promotion of Imports), Ministry of Foreign Affairs, Netherlands 2013

⁵² All USD trade value data from UN Comtrade

⁵³ All production data from UN FAOSTAT

⁵⁴ www.berrycongress.com, retrieved 18-April-2014.

Table 5: Leading Raspberry Importers

Top Total Raspberry Importers 2012 Trade Value (USD Million)		Top Fresh Raspberry Importers 2012 Trade Value (USD Million)		Top Frozen Raspberry Importers 2012 Trade Value (USD Million)	
USA	\$489.45	USA	\$404.59	Germany	\$173.55
Canada	\$267.49	Canada	\$240.61	France	\$98.14
Germany	\$248.39	UK	\$111.05	USA	\$84.86
France	\$166.98	Germany	\$74.84	Belgium	\$55.55
UK	\$154.03	France	\$68.84	UK	\$42.97

SERBIA

The Balkan region's primary producer of raspberries, and world's 2nd largest exporter, is Serbia with 15,000 hectares of raspberry cultivation, 2012 production of 96,000 mt, and exports of USD 183 million. The importance of the raspberry crop to Serbia was highlighted last year by the Serbian Raspberry Association of Raspberry Growers when they requested the raspberry be granted status as a Serbian strategic product as it represents 64% of total exports of fruit and generates annual income of some USD 200 million.⁵⁵

However, despite regional leadership in production and exports, cluster development has lagged despite Ministry of Economy and Regional Development support beginning in 2005. *"Clusters in Serbia were unable to develop until middle of 2013. They still possess low operative, innovative and export capacities, and there is a lack of key contributions of clusters to creating a unique regional specialisation of labour and knowledge, as well as increasing regional competitiveness."*⁵⁶

The majority of Serbia's raspberry exports are frozen rather than fresh with key export partners within the EU.

Table 6: Serbia Raspberry Export Destinations

Serbia's Raspberry Exports (Value in USD Million)			
	2008	2010	2012
Germany	\$61.58	\$62.13	\$65.36
France	\$49.92	\$40.62	\$35.34
Belgium	\$19.93	\$19.69	\$23.25
Austria	\$29.85	\$15.89	\$9.36

The Kosovo Soft Fruits Industry

Background and Notable Interventions

Near dormant since the 1990s, berry production in Kosovo was reignited with several donor interventions beginning with a 2001 - 2012 Swiss Project for Horticultural Promotion in Kosovo (SPHPK) which included optimising cultivation of berries at nurseries in Gjakovë/Đakovica and Viti/Vitina. The SPHPK work was complemented in 2005 with the USAID Kosovo Business Clus-

⁵⁵ www.voiceofserbia.org, retrieved 18-April-2014.

⁵⁶ Parašić, Cvijanović and Mihailović, *Market Analysis of Clusters in Serbian Agribusiness*.

ter Support (KCBS) project facilitating grants for cold chain facilities for processors in Leposaviç/Leposavić, Podujevë/Podujevo, and Shtërpçë/Štrpce thus establishing a critical anchor point for farmers and laying the foundation for aggregation. Most important is that the proximity of freezing facilities to farmers helped ensure prompt treatment of harvested berries within the critical 1-3 hour post-harvest window. From late 2010 to late 2013, UNDP's project "Sustainable Land Use Management and Conservation of Biodiversity in Dragash/s Municipality" targeted improvement of capacities of farmers and producers, protection of natural resources, improvement of energy efficiency and good governance and better gender equality.

A USAID KCBS market research report⁵⁷ in 2008, confirmed the potential, and Kosovo's competitive advantage, specifically in raspberry and blackberry production. This report also included recommendations on those berry varieties optimal for Kosovo and with the broadest international sales potential.

In 2011, the USAID New Opportunities for Agriculture (NOA) programme began providing technical assistance to all Kosovo berry production value chain participants ranging from farmers to processors including further refinement on varietal selection, crop management, cold chain processing, and engagement of export partners.

These are but a few examples of the many interventions which have worked collaboratively with local participants to produce tangible results visible in agricultural export growth in targeted areas.

The USAID NOA programme, among others, will continue supporting Kosovo agriculture and is funded until February 2015. In March 2014 Prime Minister Thaçi announced, *"We will invest 500 million euros in agriculture and will create 50,000 new jobs in the coming four years."*⁵⁸ An initial component of this investment includes a 300 EUR per hectare subsidy of cultivated land beginning May 2014.

Kosovo Soft Fruit and MAPs Production Outlook

Kosovo berry production for 2013 reached 1.6 million EUR in exports, a 16.3% CAGR increase since 2010. Other USAID NOA programme initiatives include support of an Albanian and Serbian community farming cooperative in the Shtërpçë/Štrpce region. USAID will provide selected women farmers in the region with 1,000 raspberry canes to support the emerging soft fruit cluster and increase production.⁵⁹

In addition to cultivated berries, which may be processed into a wide range of semi-processed and final products including jams, juices, frozen, dried, and fresh fruit, mountainous harvested fruits and MAPs show similar potential with a 19.3% CAGR increase in export value for 2010 to 2013.

⁵⁷ USAID, *Marketing Research for Kosovo Berries Production*, 2008.

⁵⁸ www.kryeministri-ks.net, retrieved 20-April-2014.

⁵⁹ www.noakos.com, retrieved 20-April-2014.

Table 7: Kosovo Exports by Value (EUR) 2010 – 2013

Crop/Category	2010	2011	2012	2013	CAGR (2010-2013)
Cranberries, Bilberries	502,788	1,397,925	1,018,652	880,098	20.5%
Raspberries, Blackberries	2,830	56,959	165,182	680,025	521.7%
Frozen Berries	5,744	78,536	86,620	40,551	91.8%
Frozen Fruit/Nuts (excl. berries)*	0	12,030	0	218,000	325.7%
FRUITS	511,362	1,545,450	1,270,453	1,818,674	52.6%
MAPs	354,774	280,997	572,421	601,795	19.3%
Peppers	454,399	386,576	552,905	396,726	-4.4%
Fresh Mushrooms/Truffles	356,782	256,605	137,806	333,967	-2.2%
Dried Mushrooms/Truffles	99,262	22,417	91,541	276,753	40.7%
Sweet Potatoes	1,865,199	1,139,601	1,212,774	70,575	-66.4%
Potatoes	377,780	502,468	698,017	1,391,261	54.4%
Onions/Shallots	103,326	101,325	27,310	54,531	-19.2%
Tomatoes	123,124	86,091	20,783	4,510	-66.8%
VEGETABLES	3,734,644	2,776,080	3,313,557	3,130,118	-5.7%

Source: Kosovo MTI

*% increase since 2011 as no data available for previous years.

The Market Opportunity

Serbia's raspberry yields have averaged 5 mt per hectare from 2001 to 2010 compared to Kosovo yields per hectare of 9.2 mt, which are second only to Italy's 9.6 mt per hectare.⁶⁰ Kosovo's raspberry and blackberry exports leaped from a value of 165 thousand EUR in 2012 to 680 thousand EUR in 2013.

The particular profitability of raspberries in Serbia has been well documented. A recent economic analysis by the University of Prishtina agriculture faculty, presented at AgroSym 2013, concluded that raspberry cultivation is more profitable than other fruit.⁶¹ Further, assuming manual harvesting, raspberry cultivation adds an average of 3.5 jobs per hectare.⁶² The USAID NOA project currently has 60 hectares under raspberry cultivation with Dragash/Dragaš yielding 22 mts per hectare,⁶³ which is more than double the yields of regional leader Italy which averages 9.6 mt per hectare.⁶⁴

Serbia's raspberry yields for 2012 averaged 4.3 mt/ha which represents a further decline from their average of 5 mt/ha reported by USAID in 2010.

⁶⁰ USAID, *Kosovo Agricultural Opportunities Strategy*, 2010

⁶¹ Maksimovic and Milacic, *Cost Effectiveness of Raspberries Growing in Rural Areas of North Kosovo*, 2013

⁶² USAID, *New Opportunities for Agriculture*, 2014

⁶³ *ibid*

⁶⁴ USAID, *Kosovo Agricultural Opportunities Strategy*, 2010

Table 8: Raspberry Yields

Raspberry Yields 2012	
	mt/ha
Kosovo (Dragash/Dragaš)	22.0
Netherlands	17.0
Mexico	14.5
Morocco	14.0
Switzerland	12.4
Spain	11.9
Belgium	10.8
USA	10.3
UK	9.3
Kosovo (2010 USAID)⁶⁵	9.2
FYRoM	8.6
Serbia	4.3
Montenegro	3.1
Croatia	3.2

Source: USAID, *Kosovo Agricultural Opportunities Strategy*, 2010.

If the USAID NOA project goal of 5,000 hectares of raspberries under cultivation is reached, Kosovo has the potential, assuming average yields of 10-15 mt per ha, to increase total raspberry production to between 50,000 and 75,000 mts, generate 17,500 jobs, and satisfy domestic demand. While this cluster identification has focused on raspberry production capabilities, there are similar opportunities with other berries, fruits, and MAPs ranging from traditional production to organic and wild harvested.

Specifically, the failure of Serbia's clusters to develop, as noted in the Market Analysis of Clusters in Serbian Agribusiness, and lagging innovation and productivity gives Kosovo an opportunity to beat this neighbour down the experience curve and become a prominent regional actor in raspberry production.

Kosovo's Emerging Cluster

The interventions noted earlier have encouraged and reinforced the already naturally emerging fruits and vegetables cluster with expanded opportunities in Soft Fruits and MAPs. The introduction of collection centres and cold chain facilities convenient to farmers has enabled aggregation of harvests of perishable berries within the 1-3 hour post-harvest window, in addition to other fruits, vegetables, and MAPs. This has now made volume cultivation of high value berries possible with further refinements in irrigation, varietal selection, and production leading to higher yields per hectare. Importantly, the collection centres and cold chain facilities are applicable not only to cultivated and wild harvested berries but other vegetables and MAPs.

The collaborative efforts of farmers, aggregators, food processors, traders, and various donor interventions has transformed what had previously been, post conflict, an informal array of individual

⁶⁵ ibid

farmers with varying crops, yields, and standards into a more structured, collaborative, and reliable supply chain enabling more efficient aggregation of harvests and opportunities to expand product offerings.

Collection Centres and Aggregation

An important evolutionary milestone in the agribusiness value chain was reached with the emergence of collection centres which provide aggregation services including collection, drying, freezing, storage, grading, packaging, and delivery.

Some processors have vertically integrated aggregation, such as Hit Flores in Dragash/Dragaš, which controls collection and aggregation via pickup points and freezing/individually quick frozen (IQF) capabilities at their collection centre. Hit Flores is somewhat unique in that their focus is on mountain harvested fruits and MAPs which makes placement of a collection centre near producers difficult. Therefore, Hit Flores uses a fleet of vans to pick up production and then return to their cold/freeze facility.

Others, such as farmer-led Agrocelina, operate a collection centre and function as independent aggregators linking producers with local processors like Biopak and Ask Foods as well as export customers like Kelmendi GmbH.

The emergence of aggregation, whether via farmer or trader managed collection centres or vertical integration by major retailers, has produced a leveraging effect helping build relationships and trust amongst producers, farmers, processors, traders, and retailers leading to reduced transaction costs, better communication between suppliers and buyers, and increased pre-season investment.

The adoption of aggregator services by suppliers and buyers have lowered search and bargaining costs while encouraging more pre-season planning and investment.

Horticulture Promotion Kosovo Project Review 2012⁶⁶

The HPK 2012 programme review⁶⁷ observed improvements as a result of aggregation in these specific project target areas:

- **Reduced Transaction Costs:** More collective, rather than individual, sales by farmers, more pre-season orders, increased local sourcing vs. imports.
- **Better Information Flows:** Reliability of aggregators has led to better matching of buyers and suppliers, more predictability and planning of product lines.
- **Faster Adoption of Technology:** Appropriate use of pesticides, seed varieties, ROI in collection facilities
- **More Formal Business Management:** Accounting systems, invoicing, tax management, but still limited conversion to IT.
- **Financing Cash Flow Gaps:** Factoring finance options emerge, buyer and aggregator financing of seeds and other production inputs.

⁶⁶ Horticulture Promotion Kosovo Project Review 2012.

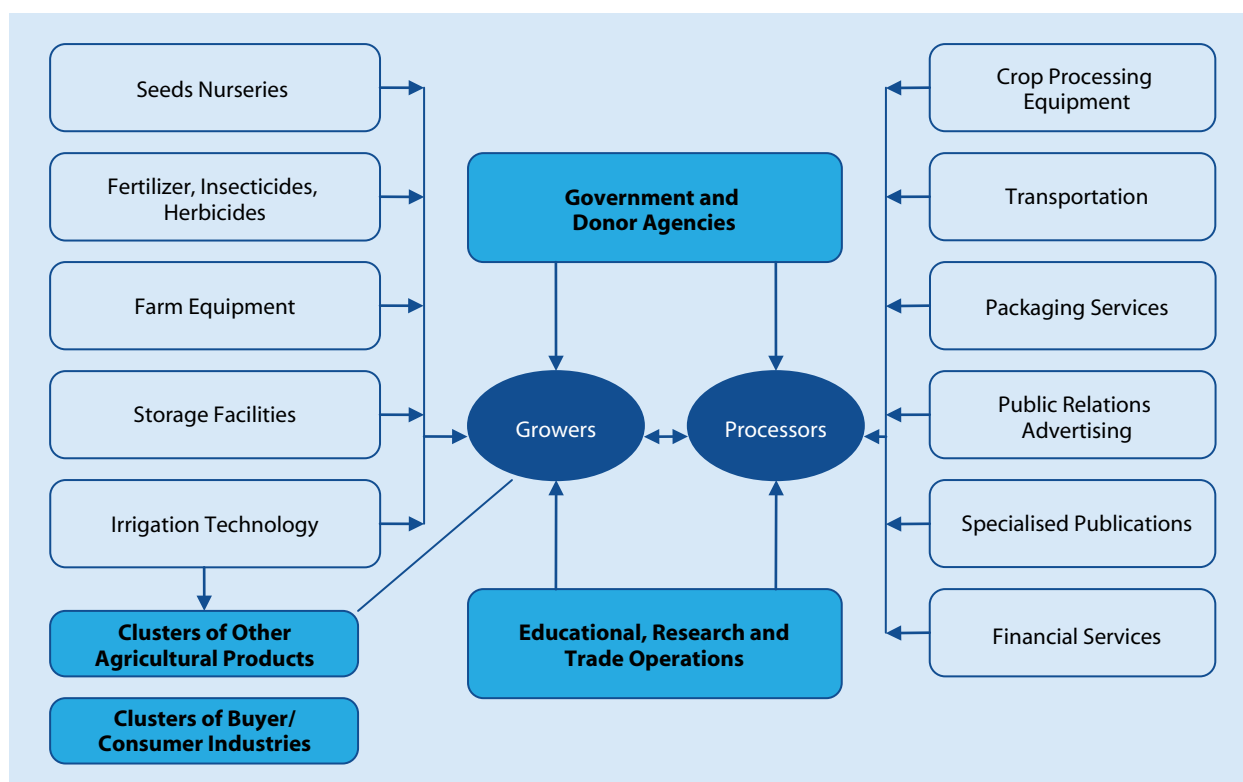
⁶⁷ Ibid.

- **Rightsizing Storage Capacity:** Better balancing of supply, proximity of storage to producers, matching technical needs (IQF vs. cool storage).
- **Upgrading Quality/Grading and Packaging:** Minimal impact locally as no institutional standards; however, HACCP certification needed for some exports.

Agribusiness Cluster

The following exhibit⁶⁸ depicts a typical Agribusiness Cluster. A notable distinction between this typical agribusiness cluster and Kosovo's is the "aggregator" function which exists between growers and processors. The emergence of this aggregation specialty is largely a function of Kosovo's many small farms which individually do not have their own cold chain processing capabilities.

Figure 3: The Agribusiness Cluster



THE Kosovo Cluster Diamond

Factor Conditions:

- Proximity and access to the EU market
- Current low labour costs but not sustainable
- High quality arable land, high yielding berry crops

Demand Conditions:

- High domestic demand particularly fresh berries
- Fresh berry exports 2013 = 1.6 million EUR, imports = 174 thousand EUR
- Frozen berry exports 2013 = 40 thousand EUR, imports = 24 thousand EUR

⁶⁸ World Bank, Clusters for Competitiveness, International Trade Dept, 2009.

- Frozen berries most imported EU product, 18% of total import volume

Related and Supporting Industries:

- Producers, Collectors, Aggregators, Transportation
- Food processing, cold chain technology manufacturers
- Wholesalers, traders, logistics, retailers

Context for Strategy and Rivalry:

- Many small producer farms, few cooperatives
- Few large food processing firms
- Retailers and processors vertically integrating, filling gaps

Kosovo Institution:

- Minimal subsidies compared to neighbours
- Cost of capital limits expansion

The Evolving Landscape

At the moment, the power of buyers appears to outweigh the power of suppliers. Sigrid Giencke, a specialist consultant in regional horticulture markets, observed *“retailers like Agrokor have already learnt that cooperation with farmers in the region is difficult due to small farm sizes, lack of production planning and unwillingness to sort and grade as well as lack of product aggregation. Therefore, these functions have been taken over by company owned collection centres and warehouses.”*⁶⁹

A particular challenge is Kosovo’s small average farm size. While the “c” word (collectives and cooperatives) may run counter to an independent farming culture, a “collaboration” or a “growers’ association” will be necessary for independent growers to remain competitive as retailers and processors expand their networks of contract farming technical assistance and pre-season investment. Further, local growers are also vulnerable to subsidised imports from neighbours which may present attractive options to processors and retailers who find such sourcing more efficient than managing many individual domestic producer contracts.

Change is coming to the entire value chain as wholesalers and retailers vertically integrate backwards to exert more control over supply. Producers are beginning to make production choices based on their own research on market demand but this is not a widespread phenomenon.

Kosovo’s producers, aggregators, processors, and traders/retailers will need to assess the best semi-finished and finished product mix (fresh, frozen, jams, dried) to optimise Kosovo’s limited agricultural land.

Conclusion and Recommendations

The seeds have been planted but will they bear fruit? Can the momentum be sustained? Will this emerging cluster evolve to rely less on donor interventions and become a self-sustaining and maturing organism?

⁶⁹ Sigrid Giencke, *Review of Market System Development in Kosovo and Project Activities for 2010*.

While a near 500% increase in Fruit exports since 2010 is certainly reason to celebrate, perhaps even better news is evidence that the seedling cluster is indeed beginning to bloom exhibiting the self-reinforcing behaviour characteristic of clusters.

...the source of new ideas and up-take has shifted from HPK to owners/operators of aggregation businesses with strong incentives to continuously promote innovation in horticulture production.
HPK Project Review 2012⁷⁰

In addition to the recommendations for cluster support outlined in the main body of this report that each of the representative clusters may benefit from, following are focus areas where a Cluster Initiative for this cluster may wish to focus:

Productivity and Quality Growth vs. Production Growth:

Focus on productivity and quality as these are critical competitiveness measures rather than gross production increases. Production growth, while important, will be short lived if not driven by productivity and quality. Most important is to focus on high profit crops rather than low margin fodder and commodity crops where Kosovo enjoys no competitive advantage.

Kosovo's Soft Fruit and MAPs cluster is in its virtual productive infancy compared to regional giant Serbia. While Kosovo will never be able to compete with Serbia on scale, they can compete on productivity and speed of learning. It is the pace of learning and innovation that will propel Kosovo's seedling Soft Fruit cluster past Serbia down the experience curve.

Wild Harvested Sustainability:

While some firms are having success with mountain-harvested and processed wild fruits, vegetables, MAPs, truffles, mushrooms, etc., management and protection of these public lands will be critical to ensure sustainability. Further, donor activities in this area will require coordination as their respective programme objectives may differ. For example, one donor programme may recommend designation of these public lands as a national park while another suggests introducing formal management of collectors and foragers (similar to those of France and Italy).

The GOK *Policy and Strategy Paper on Forestry Sector Development 2010-2020* recommends the drafting of a law for regulating the collection of medical and aromatic plants following international standards. "The implementation of such a law will serve as a base for harvesting, collecting, processing and trading with medical and aromatic plants. Respecting sustainable harvesting principles, and protecting the biodiversity, will also create incomes for the rural population ..." Strategies recommended include:

- Certification and licensing of enterprises involved in collecting and processing medical and aromatic plants.

⁷⁰ Horticulture Promotion Kosovo Project Review 2012

- o The author also recommends that individuals or families or non-enterprise entities involved in such activities be similarly licensed.
- Promotion of methods and practices for environmentally friendly harvesting of non wood forest products in harmony with sustainable utilisation

Firm Level Strategy:

Refinements such as central or regional (within Kosovo) branding, bulk vs. specialty/niche products, EU organic compliance, semi-processed or processed, etc. will be for the actors themselves to optimise. While firm level strategy is beyond the scope of this exercise, there are several emerging trends that may have potential deep impact on the industry.

The sheer number of farms and producers is a logistical and sourcing nightmare for traders, wholesalers, and retailers which seek standardisation, consistency, and reliability of supply. Buyers are already vertically integrating backward into aggregation and even processing and contract production.

While there are some examples of producer collaboration (the Agrocelina collection centre) it is uncertain whether such collaborations can survive the entry of well-funded distribution and retailing giants like Croatia's Agrokor and Kosovo's ETC/Elkos. Regardless, producer power must be maintained to guard against being used as pure commodity producers serving at the whim of buyers dictating crop selection without regard for national competitive strategy.

A specialty focus, such as berries, organics, and MAPs, which are less easily replaced or substituted, may be an effective strategy for producers.

Wine Cluster

Summary

The Balkan region's wine tradition is well established and perhaps best known for bulk supply to European partners and value priced wines to the rest of the world. A project team member recalled the Avia brand of the former Yugoslavia being widely available as a value priced wine in the US in the late 1980s and early 1990s. Despite the region's reputation for low priced wines, a vine of the Žametovka grape varietal growing in Maribor in Slovenia enjoys the distinction of being the world's oldest wine producing vine and dates from the 17th century.

In Kosovo, most of the wine produced from 1950-1990 was sent to Belgrade for blending with other Yugoslav wines. However, some bulk wine was exported to Germany where it was bottled as Amselfelder, a very popular medium-sweet red wine, marketed by the Racke Company which is now part of Grands Chais de France. In the 1980s, the Rahovec/Orahovac winery, now privatised as StoneCastle, was exporting 32 million litres of wine annually to Germany until trade was interrupted during the conflict period. Today, Kosovo industry leader StoneCastle ships 50% of their production as bulk wine to Germany for bottling once again as Amselfelder. Accounting for 1.6% of exports and increasing 32% CAGR since 2010, Kosovo's wine and other grape-based alcohol exports reached nearly 4.6 million EUR in 2013.

Kosovo's Rahovec/Orahovac region is helping shed the former Yugoslavia's reputation for cheap table wine and instead becoming known for high quality offerings such as StoneCastle's Reserve Cabernet Sauvignon among others. The wine cluster is emerging and the opportunity is evident for regional and varietal branding and increased exports. Breaking into big retail markets such as the US is challenging for small wineries from lesser known regions; however, not unprecedented. California's well known wine cluster, which had been nearly destroyed in the 1920s by Prohibition, was producing quality wines in the 1970s but no one took notice until the 1976 "Judgment in Paris" blind tasting of California and French wines. California wines won both the white and red categories thus propelling California wines to international fame. Kosovo's wine cluster has the potential but will need to rely on relationships with wine distributors and recognition through competitions and wine reviewers to increase exposure and gain a broader retail acceptance.

INTRODUCTION

Kosovo has a long tradition of wine production for more than 2000 years.⁷¹ Production was mostly home-made wine produced by farmers, for their own consumption and sale to their neighbours until the 1950s when three state-owned enterprises were established followed by a new 50 million litre capacity winery in the 1980s.

Most of the wine produced from 1950-1990 was sent to Belgrade for blending with other Yugoslav wines. However, some bulk wine was exported to Germany where it was bottled as Amselfelder, a very popular medium-sweet red wine, marketed by the Racke Company (now part of Grands Chais de France).

In the 1980s the Rahovec/Orahovac winery (now StoneCastle) was exporting 32 million litres of wine annually to Germany until trade was interrupted during the conflict period. Large areas of vineyard were abandoned or destroyed and the total vineyard area fell from 9,000ha to less than 4,000ha.

The conflict period, and the resulting near decade long dormancy of the wine industry, not only suspended production and damaged vineyards but disrupted export relationships. Within 18 months Kosovo's popular Amselfelder wine, which dominated the Kosovo's wine exports, was replaced with Spain's "Amselkeller."

Today, Kosovo industry leader StoneCastle ships 50% of their production as bulk wine to Germany for bottling once again as Amselfelder.⁷² Accounting for 1.6% of exports and increasing 32% CAGR since 2010, Kosovo's wine and other grape-based alcohol exports reached nearly 4.6 million EUR in 2013. This emerging cluster has the potential to not only expand exports but also contribute to related sectors such as tourism in the Rahovec/Orahovac region.⁷³

⁷¹ [http://www.wine-consultants.com/downloads/Stonecastle Vineyards and Winery.pdf](http://www.wine-consultants.com/downloads/Stonecastle_Vineyards_and_Winery.pdf), retrieved April 20, 2014.

⁷² Interview with StoneCastle executives.

⁷³ All export data in EURO sourced from Kosovo MTI.

GLOBAL MARKET AND COMPETITION

The global wine markets faced overproduction for a long time; however this trend is reversing. Consumption grew by 6% from 1995 to 2010, while production only grew by 4%, leading to an overproduction of less than 9% in 2010. The value of global exports increased nearly 20% from USD 33 billion in 2010 to USD 39 billion in 2012.⁷⁴

Table 9: Top Wine Product Exporters and Importers 2012 by Value USD

Top Wine Product Exporters 2012 Trade Value (USD Billion)		Top Wine Product Importers 2012 Trade Value (USD Billion)	
France	\$13.47	USA	\$6.13
Italy	\$6.39	United Kingdom	\$5.10
Spain	\$3.73	Germany	\$3.32
Australia	\$1.98	China	\$2.57
Chile	\$1.82	Canada	\$2.04

The Grapes of Wrath - Terroir vs. Varietal

The world's wine market has undergone dramatic change in the 21st century. Many companies rethought their strategies in the direction of adapting their production and marketing to better fit consumer demand. Europe was far behind in adapting to this new environment and lost market share in almost all of its traditional export markets. The "new world," with wine marketing based mostly on varieties and brands, was very effective in gaining the attention of new young customers, while the "old world," with wine marketing based on a sophisticated system of appellation and terroir, was struggling to maintain its appeal.

Another shock to the world of established players was a significant increase in global trade as wine went from a former regionally focused to a globally competing product in less than two decades. Global trade grew from 83% from 1995 to 2010 and trade value grew 173% to become a USD 30bn market in 2010, indicating increased trade in higher quality segments.⁷⁵

Global companies with commercial, easily identifiable trademarks can be found in any supermarket around the world. These huge firms produce wine in considerable volumes and rely on sophisticated production technologies to produce as much and as fast as possible.

Industry Concentration

The wine market is being modernized in all directions, from production to wine marketing. Powerful firms hold oligopolistic position in their respective countries. While the top thirty American firms hold 90% of the American market, the top four hold nearly two-thirds of it. They therefore have considerable resources. Constellation Brands, for example, has more than 8,000 employees and over 3 billion EUR in global sales, 40% of which is wine.⁷⁶

⁷⁴ All USD trade data from United Nations Commodity Trade Statistics Database.

⁷⁵ Data from International Organisation of Vine and Wine (OIV) and FAOStat.

⁷⁶ www.winebusiness.com, retrieved 20-April-2014.

These worldwide firms are turning wine into a widespread consumer good due to their heavy marketing campaigns. Between 2007 and 2011, wine consumption increased by 2.8% reaching 32 billion bottles. By year 2016, increase by 5.3% is expected, resulting in 34 billion bottles.⁷⁷

As commercial trademarks are taking over wine origins, new generation wines, unconstrained by old world production requirements, contain more alcohol, more sugar, more fruit, etc. and can even be "made-up", "body-built" wines that collide head-on with the legal definition of wine.

Key Players in the Global Wine Market

Europe remains the dominant player in the global market for wine and accounts for two thirds of global production and over 70% of global consumption by both volume *and* value. However, the "new world" wine producers, especially the Americas, mainly USA, Argentina and Chile, and Oceania, Australia and New Zealand, are gaining ground rapidly. This is especially significant in trade as the Americas increased their share of trade volume from 9% to 15% from 1995-2010 and more than doubled the share of trade value from 5% to 12% at the same period. This market disruption happened at the low end as both the Americas and Oceania have higher share in trade volumes than in values.

Regional and National Demand

The EU is the world's most significant importer with over 70% of world imports (2009-2011). The import structure is dominated by wine in bulk (52.7%) followed by bottled wine (46.2%). Cheap wine (in bulk) was prevalent. Most imported wine was from Australia (25%), Chile (21.8%) and South Africa (21.3%), which together accounted for more than two-thirds of total wine imported into the EU.⁷⁸

Germany is the world's leading importing country which mainly imports red wine from Italy, Spain and France. UK is another big importer and mainly imports white wine (46%), with the majority of wines imported from Australia (20%), Italy and France.

The leading EU importer of wine products, and current prominent wine export partner of Kosovo, is Germany with imports of nearly USD23 million in wine in 2012 from the neighbouring FYRoM.

⁷⁷ www.iwsr.co.uk (International Wine and Spirit Research), retrieved 20-April-2014.

⁷⁸ All USD trade data sourced from United Nations Commodity Trade Statistics Database (UN Comtrade).

Table 10: Germany's Wine Import Sources 2012

Germany's Import Sources 2012 Trade Value (USD Million)	
Italy	\$1,173.01
France	\$987.69
Spain	\$480.54
USA	\$121.14
South Africa	\$117.19
Australia	\$86.23
Chile	\$85.84
Austria	\$71.49
Portugal	\$47.22
Greece	\$43.94
FYRoM	\$22.86

Balkan Competitors

Though it has a long history of wine production, Kosovo is a very small producer competing directly with adjoining wine industries in the FYRoM (with 2011 wine exports of USD 62 million), Serbia (USD 17 million), and Croatia (USD 13.8 million).⁷⁹ Since 2011, The United Nations Food and Agriculture Organization (FAO) and the European Bank of Reconstruction and Development (EBRD) have been working in FYRoM to develop Geographical Indications (GIs) in the wine sector. The project registered a GI Association “Povardarski” or Vardar River Valley in May 2013 and developed a logo for the GI Association. FYRoM has also been receiving support from the Netherlands CBI Export Coaching Programme (ECP) for Wine (2012-2016).

THE KOSOVO WINE INDUSTRY

While small scale wine production has existed over the last two centuries, large scale production began with the founding of SOEs in the 1970s. The four state-owned wine production facilities were more “wine factories” than “wineries.” Only the Rahovec/Orahovac facility that alone held approximately 36% of total vineyard area had the capacity of around 50 million litres annually.

Table 11: Former SOEs Annual Processing Capacity

Enterprise	Annual Processing Capacity ⁸⁰ (millions of litres)
NBI Rahoveci	50
NBI Suhareka	21
NBI Ereniku	28
Kosova Vine	13
Total	112

⁷⁹ UN Comtrade (United Nations Commodity Trade Statistics Database).

⁸⁰ ECiKS (Economic Institute for Kosovo), www.eciks.org, retrieved 18-April-2014.

Grape Varieties

Kosovo has some grape varieties indigenous to the Balkans such as the red Vranac, Prokupa and Frankovka while Smederevka is the most widely planted white variety. Some wineries are hoping that a clonal selection programme can be put in place to identify the best clones of Vranac.

The Kosovo wine industry currently consists of about 5,000 ha of land, 4,100 grape growers in 7 regions and total production of over 33 million tonnes (mt) from 7 vineyards (2004). The sector employs 1,300 agricultural workers, 120 informal (family) producers, and includes 12 wineries of which 4 are privatised SOEs.

Importantly, wine (including other grape-based alcohol) contributes significantly to Kosovo's exports with 1.6% of total exports, and is the largest agricultural exports (when wheat or meslin flour is excluded as imports are similar to exports). Wine in containers of >2 litre is the 18th biggest export good in 2013.

Total exports of wine and grape-based alcohol from Kosovo exceeded 4.5 million EUR in 2013⁸¹ and have increased 32% since 2010.⁸²

Table 12: Kosovo Wine and Grape-Based Alcohol Exports

KOSOVO WINE INDUSTRY EXPORTS (EUR Thousand)					
Product/Type	2010	2011	2012	2013	CAGR 2010-2013
Sparkling Wine*	0.00	0.00	44.37	116.29	162.1%
Bottled Wine	516.00	962.52	916.72	1,012.86	25.2%
Bulk Wine	1,344.10	1,317.49	1,688.01	2,938.54	29.8%
Spirits from grapes	123.41	601.20	241.34	498.31	59.2%
TOTAL	1,983.51	2,881.21	2,890.45	4,566.00	32.0%

*% change since 2012 as previous data unavailable.

Grape growing and wine production has a long tradition in Kosovo. With an average of 270 days of sunshine a year in the Rahovec/Orahovac Valley and nearby sub-regions, Kosovo has the climate, good growing conditions, fertile soils and good access to water. However, companies report shortages of skilled workers, disconnect with educational institutions, dependence on donors for training, upgrading, and poor access to capital.

THE MARKET OPPORTUNITY

The Export Market

Kosovo exports both bulk and bottled wines, mostly to EU countries. The biggest foreign market for Kosovo wines has traditionally been Germany, in the form of bulk wine that is re-bottled and marketed as Amselfelder. Germany was the world's third largest importer of wine for 2012 so it is a good sign that Kosovo has gained a foothold in that market and begun to re-establish this traditional export partnership.

⁸¹ Jan-July 2013 exports more than 4 million EUR.

⁸² All Kosovo export data in EUR sourced from Kosovo MTI.

In November 2013, Kosovo gained an EU quota for wines of two million litres of wine per year, free of duty. If Kosovo exporters export more than two million litres of wine in the EU within the year, then Kosovo may have access to the 3 million litre Western Balkans common quota. Bulk wine is excluded from the EU wine quota so Kosovo's exports in that segment can continue to grow unfettered by quotas.

Domestic Demand

Local demand is extremely low compared to other European markets, both in volume and sophistication. According to 2011 statistics from the Wine Institute, Kosovo lags regional consumption significantly (in litres/capita):

Table 13: Wine Consumption by Country

Wine Consumption (Litres Per Capita)	
Andorra	50.39
Luxembourg	49.00
France	45.61
Slovenia	44.98
Romania	25.42
Germany	24.48
FYRoM	6.15
Albania	5.83
Serbia	0.84
Kosovo	0.13

The consumption figure for wine may be misleading as much home-made wine is consumed, even in bars and restaurants. Kosovo produces excellent beer (Birra Peja, from the town of Pejë/Peć) and it is the drink of choice, especially among younger people. To increase local consumption, the wine industry would need to compete with local beer, in addition to home-made alcohol.

Wines geared for exports are not widely available except in top restaurants and hotels. In an informal survey, pricing for wine at bars and restaurants around Prishtinë/Priština was found to be generally three to five times above its retail price whereas prices are usually only about two times above retail in international cities. For example, a bottle of StoneCastle Vranac Premium sells for 3.79 EUR at a retail store but is offered at restaurants from 11-18 EUR. Pricing at such levels may hinder the promotion of domestic wine consumption.

THE EMERGING CLUSTER

Kosovo's economy is being revitalised and its wine industry is finding its place in the global wine market. Compared to a global player like the California Wine Cluster, Kosovo's is still emerging. The Kosovo wine industry lacks strong related clusters like fine dining, specialty food or tourism or the support of strong research or marketing institutions.

While some traditional export relationships and channels exist, many wineries need to develop new export relationships and find buyers themselves. A re-established, privatised former SOE winery like StoneCastle can re-start its relationships with its major German buyer but a newer player like Biopak needs to seek buyers themselves. With relatively low domestic consumption, exports are critical.

Leading wine producing regions have important offerings in universities and schools that support the development of a specialised labour force with deep expertise in wine growing and wine business management. In Kosovo, the University of Prishtina has an agricultural faculty with a food technology department; however, it does not appear to have developed the linkages throughout the Kosovo wine industry as California universities have with the California wine industry.

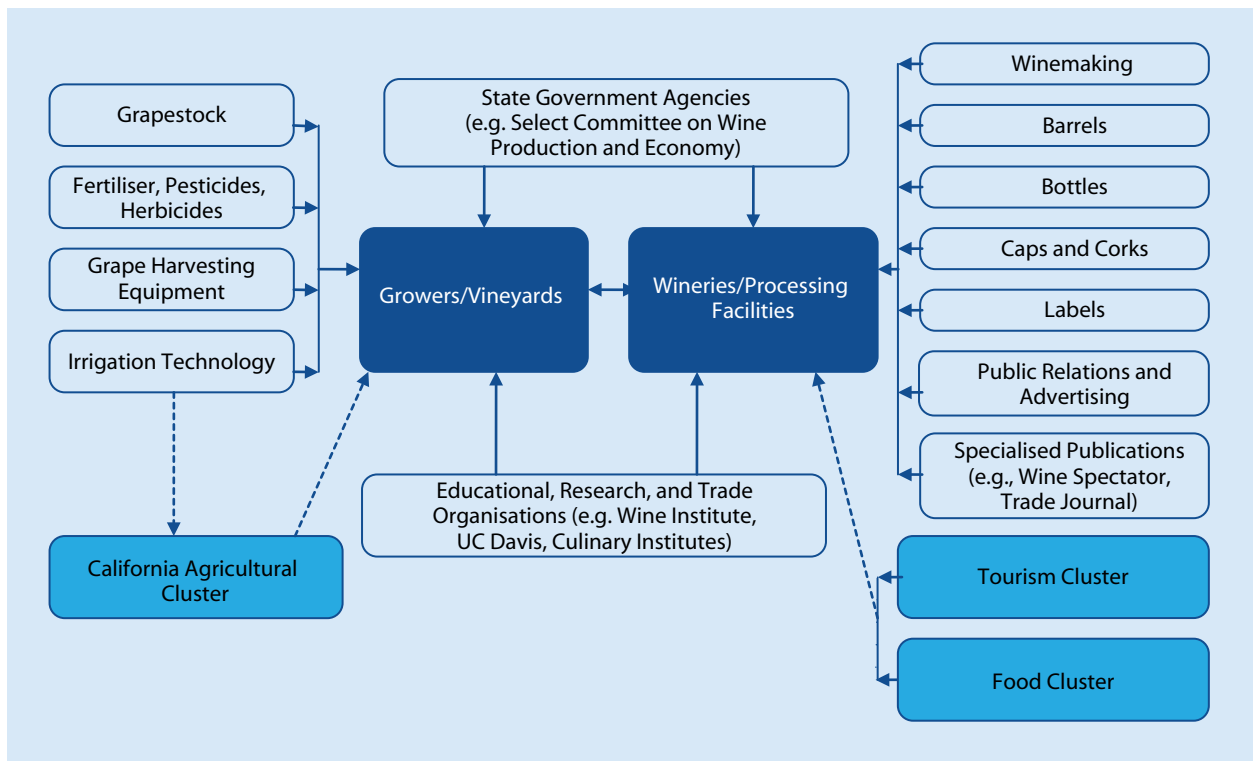
The potential for regional branding and distinguishing Kosovo's wines on the international stage was identified in 2008 by the UN FAO:

The compatibility of indigenous varieties with specific microzone soils and climatic conditions constitutes a unique inheritance for the WBCs (*western Balkan countries*) and the ETCs (*early transition countries*) that could distinguish their wines in the international wine arena. Some of these varieties have the potential, with modern vine cultivation and winemaking techniques, to compete on the international wine market.⁸³

Wine Cluster Map

The following exhibit depicts the California Wine cluster. Some important supporting wine cluster elements such as Tourism and Food remain in their infancy in Kosovo.

⁸³ FAO, *Agribusiness Handbook: Grapes Wine* 2009.

Figure 4: California Wine Cluster

Source: California Wine Institute, Internet search, California State Legislature.

Based on research by MBA 1997 students R. Alexander, R. Amey, N. Black, E. Frost, and A. Shivananda. There are several associations within the emerging Kosovo wine cluster.

- Kosovo Winery Institute in Rahovec/Orahovac (state-run) 2007
- Kosovo Association of Wine Producers “Enologija”
- Kosovar Exporters’ Association
- Association of Grape Growers “Zëri i Bujkut” (Rahovec/Orahovac-based)

Like its neighbours, Kosovo’s wine sector is under the supervision of the Ministry of Agriculture, Forest and Rural Development (MAFRD). Most of the Western Balkan countries have aligned their wine regulations with those of the EU as a precondition for exporting their wines to the EU under preferential zero-duty tariff quotas.

THE KOSOVO WINE CLUSTER DIAMOND

Factor Conditions:

- Proximity and access to the EU market
- Current low labour costs but not sustainable
- Established vineyards, recovering and productive, unique regional varietals

Demand Conditions:

- Low domestic demand but may be underrepresented due to home produced grape beverages
- High demand and historical relationships in EU, especially Germany

Related and Supporting Industries:

- Growers, Vintners, Lab and Viticulture science
- Bottling, storage technology, some food processing,
- Wholesalers, traders, logistics, retailers

Context for Firm Strategy and Rivalry:

- 4 main wineries/vineyards, former SOEs resurrecting old export channels
- Several winemakers purchasing grapes from network of 2,000 growers, some contract farming
- Big former SOEs diversify via bulk vs. high quality vintage bottling
- Some diversification into table grapes and food processing (Ajvar, pickles, peppers)

Kosovo Institutions:

- Minimal subsidies compared to neighbours, reactive
- Wine Institute (2007), collaborative EU funded Wine House 2013
- Cost of capital limits expansion
- EU wine quota (2 million litres) restricts EU exports

The Evolving Landscape

Kosovo's raki traditions have inputs or end customers in common with wine, however, the lack of commercialisation has limited the cluster's evolution. Most inputs such as machinery, cork, bottles, etc. have to be imported.

As there are just a few wineries in Kosovo, it is not surprising that one company tends to dominate the market for both domestic wine sales and exports especially when this dominant actor is the largest of the former SOEs. With more competitors, as in California's wine growing regions in Napa and Sonoma, it is more difficult for one winery to dominate the entire industry.

Conversely, there are many producers with some 2,000 growers on 3,500 ha of vineyards in Rahovec/Orahovac which averages less than 2 hectares per vineyard. As the biggest wine producer in the region, StoneCastle is the dominant buyer of local grapes. In 2010, StoneCastle decided not to buy any grapes from farmers in the area as its own reserves were full. Farmers led large protests leading the Kosovo institutions to offer a subsidy of 1,000 EUR per hectare for the year.

As StoneCastle has already experienced, the unbalanced structure of the wine sector could lead to major social issues resulting from disagreements between grape growers and winery owners over quantities purchased, prices paid, quality required, etc. A more balanced environment with fewer grape growers (ideally replaced with larger vineyards or growers' cooperatives) would tend to create a more competitive and dynamic sector.

Importantly, projects to convert wine grape vineyards to growing table grapes should help balance the environment. The NOA programme converted 10 vineyards in the Rahovec/Orahovac area.

CONCLUSION AND RECOMMENDATIONS

Quality wine does not only come from a good harvest or a long winemaking tradition – cutting-edge technology, rigorous standards, committed staff and complete dedication to making superior wines are also required. Furthermore, it takes a considerable investment in marketing as well to complement the production and trading of a high quality product.

Key Recommendations

- Evaluate proposed positioning in global market (market entry price points, etc.)
- Optimise bulk/commodity production vs. premium bottling
- Formation of cluster initiative comprising stakeholders, especially all donors represented for coordinated strategy and interventions, various institutional representatives from municipal to national level
- Engage with tourism initiatives to promote local and regional interest and awareness of Kosovo wines
- Explore partnerships with global players who may be interested in leveraging the Kosovo and Rahovec/Orahovac brand

Kosovo wines already have a toehold in Germany, the leading importer of wines in the world. Kosovo's production of bulk/table wine has a good customer in Germany while other bulk wine is sold to Italy for wine-vinegar production.

As consumers increasingly seek value, they are shifting demand to “easier” less sophisticated wines⁸⁴. Kosovo has an opportunity to stand out in the field and be known for a particular variety of wine. In this region Vranac would appear to be the clear choice. Donor support in research and development and selection of the best variety would help the industry. Collective marketing efforts can go a long way to establishing Kosovo as the go-to place for quality Vranac wine.

The biggest challenge is going to be recognition. With limited funding, the industry would need to be very creative in marketing and promoting its products, but Kosovo wine can find a place as a “boutique wine” in the global marketplace.

Further in-depth study and a Cluster Initiative are recommended to support the development of this cluster.

Other Potential Clusters

A rapid assessment was conducted on other emerging clusters. Further in-depth studies and Cluster Initiatives are recommended to support the development of each cluster. Some formerly large industrial sectors which were state-owned face challenges in attracting investments and re-industrialising in the private sector in light of the current business environment. While manufacturing and services have consistently proven to be more efficient and profitable when driven by private investments, natural resources and utilities may benefit from being regarded as “strategic assets” to be publicly-owned and managed by external managers. In economies where monitoring and

⁸⁴ Euromonitor International 2012.

enforcement may not be as effective as needed, the profit motive may well lead to negative consequences, especially in health and environment. Furthermore, in the international markets of commodity pricing, state-owned monopolies do not affect local competition.

Mining

Kosovo's large base of natural resources can provide the much needed assistance to meet its economic growth goals and energy needs. In 2013 ferro-nickel was the leading export from Kosovo and represented more than 30% of total exports. The Newco Ferronikeli Complex currently only runs one of the two smelters, limiting its potential production. Exports of ferro-nickel plummeted 14% CAGR from 141 million EUR in 2010 to 88 million EUR in 2013. While mining/metal products has traditionally been a major sector in the economy, it has been relatively dormant while the privatisation process is on-going. As a result, Kosovo's metal processing industry is virtually entirely dependent on imported raw materials.

The World Bank has identified Kosovo's abundant natural resources, particularly those in the energy sector, as a key source of growth.⁸⁵ Kosovo ranks fifth in the world for lignite reserves, used as the main source of energy production in Kosovo. The substantial power deficit in Southeastern Europe provides opportunities for Kosovo to become a power supplier in the Balkans region.⁸⁶ There is a vital opportunity for donors to assist the Kosovo Institutions in the revival of these industries.

Until the status of Trepça/Trepča is resolved, the potential of mining and its much needed revenue for Kosovo's development remains limited. A comprehensive plan for the restructuring of Trepça/Trepča, informed by valuation studies is needed. Valuation studies should be conducted by internationally recognized independent experts on Trepça/Trepča both as one entity and Trepça/Trepča with its assets unlocked to determine the optimal ROI. Should Trepça/Trepča assets be unlocked, they can then be individually established as legal entities to enable investments and to protect them from potential claims. The valuation studies should analyse the optimal path for investments i.e. privatisation, private-public partnerships or publicly-owned.

The comprehensive plan should include an option for institutional investments in these unlocked assets. Even though many SOEs in Kosovo have been privatised, the benefits of Trepça/Trepča remaining publicly-owned should be fully explored as foreign investors are necessarily attuned to the requirements of their shareholders rather than the institutional priorities. While old styled SOEs were tightly controlled by institutions, packed with party apparatchiks, inefficient, and lacking in transparency, some of the largest public enterprises in the world today are traded in stock exchanges, have boards of directors and external managers.

There are numerous examples of profitable, internationally competitive, professionally managed SOEs such as Malaysia's Petronas (ranked 12th most profitable company in the world in 2013 by *Fortune* magazine) and Indonesia's Pertamina. France plans to invest up to 400 million EUR in a new state-owned mining company which would conduct exploration activities inside France and around the globe, including former colonies in Africa and South America.⁸⁷

⁸⁵ Ibid.

⁸⁶ US Department of State, *Doing Business in Kosovo: 2012 Country Commercial Guide for U.S. Companies*.

⁸⁷ <http://www.mining.com/france-sets-up-national-mining-company-84462/>, retrieved June 25, 2014.

While the goal of a state-owned company could be to safeguard the sovereignty over the strategic asset, the entity maintains flexibility in how it decides to function, e.g. award concessions and have supervisory powers over concessionaires; establish joint ventures, sharing both profits and costs; or participate along the value chain. Regardless of the model, productive capacity must be established by independent experts. Operating agreements must stipulate minimum production levels. This guards against an unscrupulous or inefficient operator running the enterprise far below its potential capacity.

There may be apprehension about publicly-owned enterprises, however, research indicates that while private companies may work well in countries with well-developed capital markets, countries without a robust sector for private investment can actually benefit from institutional investments, providing certain conditions are met.⁸⁸

Some SOEs have played a positive role in industrial development, poverty reduction and infrastructure development. The success of these firms hinged on the explicit identification of extra-commercial objectives and the creation of transparent compensation mechanisms.⁸⁹ To facilitate better disclosure by SOEs, ministries exercising ownership rights in SOEs (or one ministry specifically established to manage SOEs) should introduce governance codes and/or guidelines for disclosure and provide incentives for firms to provide better quality reporting on financial and non-financial performance. To further strengthen SOE transparency, the Organisation for Economic Co-operation and Development (OECD)⁹⁰ recommended that all SOEs be made subject to procurement legislation and publish tender offers for all transactions exceeding a certain threshold. To address other risks of impropriety and corruption in SOEs, it is advised that state audit bodies should be given the power to conduct audits of SOEs and publish the results publicly, or at the minimum, report them to the relevant branches of the executive.

As long as Trepça/Trepča remains in limbo, so may Kosovo's development. GOK has made it a priority to modernise and improve Kosovo's energy sector and requested assistance from their development partners. With the support of the World Bank, GOK plans to rehabilitate Kosovo B power plant to bring it into compliance with relevant EU Directives and to build a new, more efficient lignite-fired power plant to replace Kosovo A. Similarly, GOK should make Trepça/Trepča a priority and make similar requests for financing and technical support for Trepça/Trepča from the World Bank and other donors.

⁸⁸ <http://www.forbes.com/sites/hbsworkingknowledge/2013/02/22/what-capitalists-should-know-about-state-owned-enterprises/>, retrieved June 27, 2014.

⁸⁹ OECD, *State-Owned Enterprises in the Middle East and North Africa: Engines of Development and Competitiveness?*, OECD Publishing 2013.

⁹⁰ OECD, *Ibid.*

Decorative Stones

The Kosovo Mines and Minerals Regulations, administered by the EU Independent Commission for Mines and Minerals (ICMM) and the Ministry for Economic Development govern the decorative stone industry as it does mining and minerals. As with mining, this industry is guided by the GOK's *Mining Strategy of the Kosovo Institutions 2012-2025*. The Mining Strategy paper reported that the Kosovo Geo-database contains over 116 locations for dimensional and decorative stones but noted that additional geological research and exploration was necessary.

As investment incentives, royalty payments on production of minerals are kept low. For example, royalty on marble is 3.2 % per cubic metre extracted.⁹¹ By comparison, in Afghanistan, another fragile state which is also trying to develop its marble industry, royalty fees were reduced to 10% of gross sale value.⁹²

Reserves of marble, granite etc. were identified in a USAID report, including high quality honey yellow onyx, black marble and marble breccia, which has traditionally been sourced from Italy but similar mines in Italy are exhausted.⁹³ The USAID report concluded that the variety of colours and patterns available within close proximity to one another provides cost effective quarry development opportunities. Kosovo is also close to Europe.

Fox Marble Holdings, a company co-founded by a Kosovo citizen, is listed on the Alternative Investment Market (AIM) market of the London Stock Exchange. The company has six quarries under license and two under operating agreements in Rahovec/Orahovac, Malishevë/Mališevo, Suhogëri/Suvo Grlo and Pejë/Peć. The company reported that the quarries hold a combined volume of over 300 million cubic metres of premium quality marble and decorative stone, estimated at 16 billion EUR.⁹⁴ Fox began constructing a state of the art semi-automated processing and polishing facility in Kosovo to refine the quarried marble into slabs. The firm aims to establish itself as the industry leader in decorative stone in Kosovo and southeast Europe.

Besides Fox, other quarries focus on blasting and crushing operations. The USAID report (published before the Fox investment) found the industry to be in a primitive form of raw material extraction and in a small scale of processing capabilities and sales throughout Kosovo. Most firms are small operators who lack the financial resources and technical expertise to proceed to extract marble blocks or to expand their processing capabilities to cut and polish them. For example, Drini Company, which uses the Drini quarry for aggregates extracts, licensed its site to Fox for marble extraction for a royalty payment of 20 EUR per cubic metre.⁹⁵ The market price of a processed cubic metre of grey marble was quoted at 2,100 EUR.⁹⁶

⁹¹ http://mzhe.rks-gov.net/repository/docs/Lista_e_Rentes_Minerare-Ang.pdf, retrieved July 16, 2014.

⁹² <http://afghanenterprise.com/wp-content/uploads/2014/04/Marble-Sector-Action-Plan-4-14.pdf>, retrieved July 16, 2014.

⁹³ USAID, *Decorative and Dimensional Stone – Development Potential in Kosovo KCBS*, 2005.

⁹⁴ <http://www.thisismoney.co.uk/money/markets/article-2197562/London-listed-Fox-Marble-operating-exclusively-Kosovo.html>, retrieved July 16, 2014.

⁹⁵ <http://www.proactiveinvestors.com/companies/news/39591/fox-marble-rallies-on-new-quarry-deal-in-kosovo-39591.html>, retrieved July 16, 2014.

⁹⁶ <http://www.proactiveinvestors.com/companies/news/39639/fox-marble-looking-to-build-brand-based-on-kosovos-stone-making-heritage-39639.html>, retrieved July 16, 2014.

The international market demand for decorative stone products provides an opportunity for local processors to manufacture these products from local decorative stone resources, rather than from imported slabs at much higher costs. Some local processors are also cutting, polishing and finishing imported slabs to supply finished products to other countries.

The quality and quantity of Kosovo's deposits have already attracted foreign investment. **The entry of a well-funded company with international linkages can propel the industry to international recognition in the marketplace.** Kosovo's decorative stone industry has the potential to become an internationally competitive cluster, if the local companies upgrade. It is expected that ROI and social spillovers would be higher if the current local participants upgraded instead of the industry being dominated by foreign investors. World prices for blocks are much higher than crushed aggregate. Importantly, the value added to polished slabs is significant. Cut and polished into slabs, an eight cubic metre block could be worth between 9,000 to 24,000 EUR, based on a per square metre price of between 40 to 100 EUR.⁹⁷

It is recommended that a cluster initiative be convened to assess the needs of the industry and foster cooperation among firms so the **Kosovo brand of marble and other natural stone can be positioned and marketed internationally.** Stakeholders, including GOK ministries/agencies, municipalities, donors, entrepreneurs, training institutes, banks, etc., need to coordinate their efforts and resources to enable the growth and expansion of the cluster. The CI can produce an action plan to develop Kosovo's decorative stone cluster.

RECOMMENDATIONS:

1. Conduct reliable pre-feasibility studies and geological surveys on the quantity and quality of natural stone deposits to help facilitate domestic investments and upgrading as many of the currently licensed quarries and processing firms lack the financial means to conduct their own.
2. Offer technical assistance to improve the capacity of local technical expertise i.e. to quarrying firms to convert to wire and saw extraction, instead of blasting, and to processing firms (cutting, polishing, finishing). As the CEO of Fox Marble said, "Marble extraction is a fairly low-tech business."⁹⁸ Donors can facilitate Italian experts to provide technical assistance and training.
3. Establish a testing laboratory to certify Kosovo marble and stone in accordance with international standards.
4. Assist firms to obtain financing required for upgrading e.g. longer term financing and lease purchase for machinery, equipment and vehicles.
5. Assist vocational training institutes to establish courses on mechanical and electrical trades to repair and maintain quarry and processing equipment

Forestry

Thirty-nine percent of the land in Kosovo is forested with a high availability of primary wood and an annual value of wood products is estimated to be between 50 and 75 million EUR, resulting in a contribution of between 1.8 and 2.6% to GDP.⁹⁹ An estimated 8 to 10% of the population is es-

⁹⁷ <http://www.thisismoney.co.uk>, Ibid.

⁹⁸ Ibid.

⁹⁹ EKIS.

timated to depend on forestry and wood industries. However, illegal logging is a problem and EU certification is a hurdle. USAID's KPEP¹⁰⁰ concluded that *"The issue of ensuring that Kosovo's forests are maintained and harvested in a sustainable manner is unlikely to be resolved anytime soon because of the inability of the Kosovo Institutions to protect its forests from illegal logging."*

MAFRD, Forestry Department (FD), and Kosovo's Forestry Agency (KFA) have drafted *"Policy and Strategy for Forestry Sector Development 2010-2020"* which include development of the forestry sector. At its 2014 meeting, the Kosovo Forest Sector Think Tank¹⁰¹ reported that progress made in the sector is only satisfactory as out of the 27 activities, 21 are on-going. Current challenges in implementation are related to the delay in the adoption of the new Forest Law, the capacities for implementation, inter-institutional competition on mandates for the management of forest resources, lack of data and transfers of competencies in the process of decentralisation. Most of the effort made to date has to do with development of preliminary analysis, preparatory work and various studies, approved plans but not implemented, guidelines, identification studies and TORs for studies. It stressed that **it is urgent that these numerous plans, studies and analyses are translated into concrete implementation plans.**

The Regional Environmental Center for Central and Eastern Europe¹⁰² offered the following recommendations:

1. Increase the budget allocations for MAFRD, particularly for the forest sector, in order to implement the approved Strategy for Forestry Development 2010-2020
2. Build and maintain forest roads to ensure access to the forest and better management
3. Prepare a special action plan toward rapid reduction of illegal harvesting
4. Ensure better cooperation between donors
5. Increase investment on forest, management and development sector
6. Develop the cross-border project and regional project for sustainable forest management.

Furthermore, the capital intensive upstream processing of wood coupled with the high cost of capital in Kosovo has ceased investment in that segment of the value chain. There is an absence of wood processing activities from saw milling to manufacture of intermediate wood products such as particle boards, medium-density boards, veneers, etc. Some local micro-firms may fabricate some of these intermediate wood products such as veneer joinery.

The MAFRD strategy paper on forestry reported that the wood processing sector is fragmented and using old and obsolete equipment. It recommended the establishment of associations representing the interests of various stakeholder groups such as private forest owners, entrepreneurs and companies involved in forest operations and wood processing. Importantly, the paper stated that *"in order to ensure the implementation of development strategies, the private business community shall always be invited to participate in policy development including the compilation of concerned legislative documents."*

¹⁰⁰ USAID, *Mid-term Evaluation of the Kosovo Private Enterprise Program (KPEP)* September 2011.

¹⁰¹ <http://kosovoforests.org/wp-content/uploads/2014/04/Highlights-from-Kosovo-Forest-Think-Tank-27.02.2014.pdf>, retrieved June 28, 2014.

¹⁰² http://illegallogging.rec.org/publications/K_IL_Diagnostic_Audit_Final.pdf, retrieved June 27, 2014.

The Cluster Initiative should include the above recognized stakeholders plus research organizations and the Think Tank.

Wood Furniture and Products

The wood furniture and products industry in Kosovo is currently minimally linked to the forests. Kosovo wood furniture producers seldom use lumber from Kosovo forests, especially as solid wood furniture tends to be very expensive and therefore, needs to be very high end. These design-led specialised products tend to be purchased in the local market of production and there is minimal demand in Kosovo.

Most of the wood furniture and other products produced in Kosovo are made from imported raw materials. In 2013, imports of wood-related inputs e.g. particle boards, medium-density boards, veneers, etc. exceeded 25 million EUR while exports of wood products (primarily for kitchen and furniture) were about 1.9 million EUR. USAID's KPEP reported that wood products, notably furniture, have gained traction in regional markets, and modestly, into the EU (but they remain uncertified at present). Exports of wooden doors and windows were slightly above 380 thousand EUR in 2013. By comparison, exports of doors, windows and frames made of plastics exceeded 3.8 million EUR in 2013 and enjoyed nearly 77% growth in the last four years (CAGR 2010-2013).

This emerging cluster has several linkages established. The Association of Wood Processors has seven industry leaders and one academic. The Association has established business training and woodwork training programmes. Importantly, the Association has established Forestry and Wood Products programmes at the University of Prishtina where industry executives teach. For this cluster to continue emerging, one of its key constraints, access to capital, would need to be overcome.¹⁰³

It is recommended that a Cluster Initiative be convened that includes stakeholders i.e. companies, institutional agencies, academia, research institutions, banks, donors, etc. The CI could establish a **Kosovo Furniture Promotion Council** to specifically focus on the promotion of the furniture sector.

Tourism

Travel and Tourism is one of the leading job creators in the world.¹⁰⁴ The industry has widely dispersed linkages in terms of industrial connections and is less geographically concentrated than other industries.

Several donors have embarked on promoting tourism in areas such as Prizren and Rahovec/Orahovac Valley Wine Routes. The Medieval Monuments in Kosovo are World Heritage sites which were singled out as the marquee attractions in Kosovo when the *New York Times* included Kosovo (at number 36) on its list of "41 Places to go in 2011."¹⁰⁵ Local entrepreneurs and civil society organizations have organised a number of cultural and sporting events such as Dokufest, Anibar and Tour de Kosovo which attract local and foreign tourists. The abundance of local clusters of restaurants/cafes

¹⁰³ Interview with the Association of Wood Processors of Kosovo.

¹⁰⁴ World Economic Forum, The Travel and Tourism Competitiveness Report 2013, http://www3.weforum.org/docs/TTCR/2013/TTCR_Chapter1.5_2013.pdf, retrieved May 27, 2014

¹⁰⁵ http://www.nytimes.com/2011/01/09/travel/09where-to-go.html?pagewanted=all&_r=0, retrieved May 27, 2014.

coupled with Kosovo's extensive natural and historical attractions together form a strong basis for tourism. However, these individual initiatives have not increased the number of overall tourists.

Efforts to promote tourism would need to range from anti-litter campaigns (large scale dumping on public land and roadsides is pervasive) and general environmental clean-up to organised campaigns. The lack of an enabling environment also hinders development of this potential cluster. While cultural and sporting events may draw huge crowds of tourists during the period of the events, a more comprehensive strategy is needed to support tourism year round so that destinations and accommodation facilities can enjoy more sustainable income and not be subjected to feast or famine business.

Currently MTI's Division of Tourism is responsible for the tourism sector. A new Law on Tourism was enacted in 2013 with a view to develop the tourism industry and it provided for the establishment of a Tourism Council of Kosovo. The new law aimed to offer incentives e.g. removing the requirement of certain licenses and permits.¹⁰⁶ A key change was the removal of licenses and the mandatory categorisation of accommodations in accordance with international standards to a voluntary system. Not surprisingly, many businesses have requested the re-introduction of mandatory requirements as a voluntary system removes standards and fair competition. Standards and enforcement are especially crucial in tourism where foreign customers need to be able to rely on local and central institutions to offer them consumer protection.

As identified in the UNDP *Sector Profile on Tourism*, a challenge is the lack of reliable official data on the industry. While the Kosovo Agency of Statistics collects and provides data on resident and non-resident visitors, there is no distinction between business visitors and leisure visitors (tourists). The presence and movement of foreign workers, which is particularly large in Kosovo, distorts the true picture of foreign tourist arrivals. For example, non-resident visitors to Lipjan/Lipljan jumped from 3,000 to over 10,000¹⁰⁷, placing the municipality as the second leading destination for visitors after Prishtinë/Priština, and it would appear this is due to the presence of OSCE in the area. Another potential source of data collection is the Ministry of Immigration to ensure that all arrivals complete a form indicating their reason for arrival as well as other information. Another important source of information is customer surveys which can be collected by the various businesses.

While several tourist associations exist, it appears only the Kosovo Alternative Tourism Association (KATA) is a business association comprised of 146 members, mainly hotels, travel agencies, tour operators, transport companies and other institutions, and coordinates the Hotels' Council of Kosovo. One of its stated objectives is "fighting the susceptibility of foreign direct investments in the tourism sector." While it is understandable that a bifurcated tourism sector in which most businesses are foreign owned and local employees are poorly paid is not desirable, there are business models where FDI can play an important role in helping develop and shape tourism. Many hotel and resort properties in major tourist destinations are owned locally but managed by international chains who are very experienced in hotel management, marketing and attracting tourists. For example, Nusa Dua in Bali was once a barren stretch of beach that was developed into a prestigious resorts and convention destination when the government of Indonesia planned to create a specialised

¹⁰⁶ UNDP, *Sector Profile of Tourism*, March 2014.

¹⁰⁷ Kosovo Agency of Statistics, *Hotels Statistics*, 2013, at http://esk.rks-gov.net/publikimet/cat_view/81-hoteleria.

tourism cluster with excellent spatial planning and management systems. Importantly, international chains will bring an international standard to the local industry.

It is recommended that a Cluster Initiative be convened that includes all stakeholders i.e. companies, institutional agencies, municipalities, funding institutions, donors, educational and training institutes, civil society, etc. The CI can work closely with the Tourism Council when it is formed. The CI can play a coordinating role for donor projects and recommend new initiatives. For example, Kosovo can benefit from marketing campaigns run by international airlines such as Austrian or Turkish airline. As a starting point, the CI can conduct a more in-depth study of Kosovo's potential as a tourist destination and its competitive positioning. Iceland succeeded in a very brief period to turn a once near unknown nation into a popular hip and cool tourist destination. Kosovo has much to offer but coordinated packaging and promotion are critical.

Information and Communication Technology

To achieve competitiveness, a country needs to attain a high level of productivity based on its effective use of human resources, capital and physical assets. Information and communication technologies are strong tools to enhance competitiveness in industry and in society as a whole. **Information and Communication Technology (ICT) use and development by the government sector, private sector, and citizens are important prerequisites for attaining a high level of competitiveness.** The ICT sector offers high potential for youth employment; therefore, countries with very high unemployment among the younger population seek ways to promote their ICT sector.

Kosovo's competitive performance in the global ICT sector is difficult to measure due to the lack of systematic information on the sector. USAID's KPEP project to support ICT included promotion of call centres and business process outsourcing services targeted at the EU. The Kosovo Association of Information and Communication Technology (STIKK) published a study, *Kosovo ICT Market Analysis* in November 2013. Their research showed little growth in the sector between 2010-2013, with grim forecasts by the companies, reflecting the reduced spending by the Kosovo institutions, lack of investments in telecommunications and the decrease of purchasing power of retail buyers in Kosovo. Local ICT businesses were mainly involved in providing Internet Service, software development/programming, maintenance and repair, vendor sales, training/certification and web development. Only 2% of companies expected viable growth from mobile application development, online banking and e-commerce services, while 5% expected opportunities to grow by business process outsourcing (BPO). About 13% of companies reported having clients in Balkans (4%), Europe and elsewhere (9%).

The potential users of ICT in Kosovo e.g. institutions and private businesses are underserved and present untapped opportunities for growth. Kosovo Institutions have been the major customer consuming about 2/3 of the total ICT production with significant funds invested.¹⁰⁸

Though a local success story, 3CIS, started by an experienced returnee has emerged, this is a highly competitive global industry. 3CIS identified a lack of skills among local university graduates to "work in the market".¹⁰⁹ Several donor-funded studies have identified serious weaknesses in edu-

¹⁰⁸ Kosovo Economic Development through Quality and Networking, *Analysis of ICT Industry in Kosovo*, November 2011.

¹⁰⁹ UNDP, Sector Profile of ICT – Business Process Outsourcing and Customer Support Centres Sector, March 2014.

cation of students leading to a lack of quality university graduates, though there is availability of a small number of well educated professionals who graduated abroad.

While 3CIS is a local success story, the founders' extensive relationships developed from years spent working in the US appears to be the source of their US based contracts rather than a natural born, local emerging cluster. Without these connections and relationships (and years of expertise gained in the US) the success of 3CIS would be difficult for another local IT company to replicate.

In 2012, the Ministry of Foreign Affairs of Norway has been funding an incubator "Innovation Centre Kosovo" in Prishtina to support entrepreneurship, innovation and business development focused on information and communication technology (ICT) and in 2013 opened on in Gjakova/Đakovica. The Management Development Associates (MDA) Foundation also supports an incubator, Business Launch Pad, a business angels investor network, etc.

Several reports such as the aforementioned STIKK *Market Analysis*, USAID *ICT Country Profile for Kosovo (2013)*, EU-funded *Analysis of ICT Industry in Kosovo*, UNDP *Sector Profile of ICT (2014)*, etc, offer their findings and recommendations. As concluded by the EU report, a number of good strategies have been adopted for ICT development but not all strategies are supported by implementation plans, budgets and strong implementation mechanisms. These factors have lead to lack of focus and difficulties in the implementation of the strategies.

RECOMMENDATIONS:

Convene a Cluster Initiative of ICT firms, leaders from other CIs (potential ICT users/customers from other clusters e.g. tourism, healthcare, transportation, etc.), institutional agencies including the Prime Minister's office, donors, educational and training institutions, etc. The ICT CI can also serve as the coordination/governance body for ICT development in Kosovo tasked with prioritising strategies and action plans for implementation, etc.

There are several critical issues which the CI can prioritise and help implement solutions.

1. Skills mismatch – the CI can help develop curricula, internship programmes, scholarships, coordinate programmes between educational and training institutions, etc.
 - a. The CI can determine the optimal plan to develop a cluster-based workforce training system.
 - b. CI can facilitate private firms to link up with education and research institutions to improve innovation competencies through technology transfer, technology absorption and innovation.

- c. CI (especially donor participants) can facilitate donations of equipment from global ICT companies to educational and training institutions
 - d. Where appropriate, introduce international standards
2. Public procurement, at central and municipal levels, can make a significant contribution to the cluster
 - a. Kosovo Institutions should invest more in e-services
 - b. Awarding agencies should facilitate local partnerships with foreign firms should they be awarded institutional contracts
 - c. The procurement process needs to be transparent with avenues for protests and reviews
3. Formulate fiscal and tax policies to not only align Kosovo with the region, but to enhance attractiveness for FDI
 - a. Stimulate private sector investment in ICT through incentives, such as matching grants, tax exemption for technology acquisitions along with mechanisms to integrate international production networks.
 - b. Enact income tax holiday for start-ups, whether local or foreign. The CI could evaluate the merits of focusing on IT, i.e. computer software and hardware businesses, and exclude retail, repair, telecommunications, media, etc.
4. Attract ICT FDI Sector "Drivers:" Building an ICT industry from near infancy is no simple feat especially given the cost advantages enjoyed by India and the expertise and innovation of Silicon Valley as well as other dominant players. One giant leap down the experience curve can be achieved by the introduction of a few international ICT firms whether service providers (call centres, cloud hosting, etc.) or production houses. Service providers will look for a trainable, multilingual population, production houses will seek the same plus intellectual property protection.

Processed Foods and Beverages¹¹⁰

Exports of processed foods have increased significantly at 39% CAGR over the last four years. This growth has been propelled by non-alcoholic beverages. Non-alcoholic beverages exports are significant with more than 7 million EUR in 2013 supported by 39% CAGR (2010-2013) growth. A leading exporter is Fluidi Co. which is a licensed producer and exporter of RC Cola soft drinks with rights to four countries in the region, and Jaffa Champions fruit-based drinks. The company also markets licensed iced tea and its own brand of energy drinks

Chocolate exports exceeded 1.7 million EUR in 2013, even though growth appears to have plateaued with -0.6% CAGR 2010-2013. The leading chocolate manufacturer is Kamila Chocolate, a foreign investor targeting EU export markets. Another notable export is roasted coffee which experienced growth of 36% CAGR, reaching nearly 900 thousand EUR in 2013.

¹¹⁰ Food processing refers to the techniques and methods used to transform raw ingredients (i.e. farm products) into food for consumption. Transformation includes activities such as packaging, preservation, nutrition enhancement, flavour enhancement, toxin removal, marketing and distribution. Some major sub-sectors are baked and packaged foods, candy and chocolate, meat and dairy products, processed dairy, milk and frozen desserts, paper containers, food products machinery and specialty foods and ingredients.

While the bigger exporters are seeding a potential Processed Foods and Beverages cluster, it remains to be seen how well linkages will be formed by these entrepreneurs as their inputs are mostly imported. Naturally, they can be encouraged to source locally. New products can be developed that incorporate more local inputs. These firms can offer spill-over benefits from their food processing methods and international food safety standards. The leading export firms are producing and marketing products that cater to a broader range of consumers than local tastes.

A small part of the emerging cluster that is deeply dependent on the agricultural producers have focused on import substitution with a few exporting to the nearby region which share similar tastes. Firms such as Ask Foods and Abi&Elif are strongly anchored in the agribusiness cluster, sourcing from local growers to produce ajvar, jams, fruit preserves, pickled cabbage, etc.

A cluster initiative that includes the large exporters with the smaller firms can benefit the entire value system by facilitating market-making opportunities. The small food processors can learn from the best practices shared by the big processors through an industry promotion unit. The CI can facilitate cooperation between the big and small processors to strengthen the distribution and business networks. High ROI products should be the focus. As noted in the Agribusiness-Soft Fruits case study, it is important that Kosovo's producers, aggregators, processors, and traders/re-tailers assess the best semi-finished and finished product mix (fresh, frozen, jams, dried) to optimise Kosovo's limited agricultural land. The risk exists that foreign traders may try and relegate Kosovo's agriculture producers (which will also spillover to processors) to low value products.

Textiles and Apparel

Textiles and Apparel was the second largest industrial sector in Kosovo, after mining, with 15 SOEs, sales exceeding 35 million EUR and employment of more than 1,000 people. Today there are approximately 451 private companies, of which 90% are final product manufacturers,¹¹¹ though data from TAK indicate only 164 firms engaged in the manufacture of textiles and wearing apparel.¹¹² The majority of firms are micro, i.e. with fewer than 10 employees. The two largest firms accounted for 40% of employment.

The two leading exports are synthetic fibre yarns and jeans. Exports of synthetic fibre yarn for 2013 exceeded 7.5 million EUR, while exports for jeans in 2013 were 1.3 million EUR.

Foreign investors acquired two large, privatised firms in the sector, Remateks and Kosovatex (previously a cotton yarn producer). While both these firms are seeding a potential textile cluster, it remains to be seen how well linkages will be formed by these foreign investors.

Kosovatex manufactures jeans for well-known European brands according to their specifications and using materials selected by these customers. The company employs around 300 workers and in 2013 exported 300,000 pairs of jeans to the EU. The Dubai-based investors, Ecolog International, have built a denim manufacturing facility but other inputs are imported because they are not available locally or do not meet quality standards. The most serious constraint the company faces is a

¹¹¹ <http://www.invest-ks.org/en/Textile-and-Leather>, retrieved June 28, 2014.

¹¹² UNDP, Sector Profile of Textile Industry, March 2014.

shortage of skilled workers and therefore, it had to hire skilled foreign staff. All local hires undergo on-the-job training in specific production skills.

Remateks imports its raw materials and exports its knitting yarn, most likely to its own knitted fabric factories in Turkey. As a partner in UNDP's sheep wool value chain project,¹¹³ Remateks is also a collection centre for sheep wool which is exported to Turkey and England.

Kosovo's locational advantages of proximity to the fashion centres of Europe and access to the EU market are shared by its neighbours, most of whom have more advanced clusters. K-Tex Association of Kosovo is a member of the South-East Europe Textiles and Clothing Network (SEE), a group of six associations and clusters from Albania (CFA), Bosnia and Herzegovina (UTOK), Bulgaria (BAPIOT), Macedonia (TTA) and Serbia (FACTS), to promote the regional textile and clothing industry. UTOK has 300 member companies employing 40,000 people and exports are approximately 500 million EUR annually. Similarly, TTA, the Macedonia textile cluster association, reported annual exports exceeding USD 500 million annually with employment of over 40,000. FACTS, The Cluster fashion and Serbian Clothing industry comprise 15 companies and three academic institutions.

The DEED project can be tasked to help seek FDI for this cluster from well established Diaspora Kosovars in the fashion industry.

It is recommended that a Cluster Initiative be convened that includes stakeholders i.e. companies, institutional agencies, banks, donors, educational and training institutes, etc. The CI can determine the optimal plan to develop a cluster-based workforce training system or help micro firms develop into suppliers to the large firms. A cluster-based workforce development programme can train workers to fill actual jobs in the cluster and meet the actual skill needs of these jobs. A demand-driven approach to training can help equip workers to seek employment in multiple firms in many parts of the cluster

¹¹³ <http://www.ks.undp.org/content/kosovo/en/home/presscenter/articles/2012/09/24/sheep-farming-employment-opportunity-for-the-poor-/>, retrieved June 28, 2014.

4) KOSOVO ANALYSIS: CONCLUSION

Overall, the Kosovo's diamond is still emerging as there are many challenges in the business and political environment though firms strive to be competitive not only domestically, but also regionally.

Entrepreneurship in Kosovo

Entrepreneurs and firms are emerging from trading companies as our interviews with successful local firms revealed. These entrepreneurs are well-versed in business, experienced in export markets and can identify the needs of the market. Currently, most are family businesses and as they expand will potentially face management challenges. Some families educate their younger generation overseas and ensure they are trained in their specific industries, preferably with leading firms, while overseas. This younger generation returns to work in the family business skilled and experienced to compete internationally.

Linkages among firms are growing slowly, though privately some entrepreneurs report on a certain lack of trust among competitors. Nonetheless, trade associations in some industries are being formed, e.g. the Footwear Association, as firms begin to cooperate for common goals e.g. lobbying institutions but lack of interest in other industries remain due to lack of trust.

Linkages between firms and institutions are slowly emerging as indicated by the success of initiatives such as the Suharekë/Suvareka Business Support Centre. However, a disconnect between industry and educational institutions remains as shortage of skilled workers persist.

Kosovo has a clear opportunity to shift toward faster, private sector-led growth with its market access to the EU and to the Central European Free Trade Agreement (CEFTA) countries.

***Unleashing this potential is within country's own grasp,
because most of the current obstacles are of a policy nature.¹¹⁴***

Kosovo may not be a big place with a huge population but today, any small place can access the world market, find a particular niche and establish itself as a global manufacturing centre, especially as OEM manufacturers. For example, as OEM manufacturers, two once small and remote Chinese villages, Qiaotu and Yiwu, have become international powerhouses, producing more than two-thirds of the world's buttons and zippers, respectively.¹¹⁵

¹¹⁴ World Bank, Poverty Reduction and Economic Management Unit, *Kosovo Unlocking Growth Potential: Strategies, Policies, Actions; A Country Economic Memorandum*, April 2010.

¹¹⁵ Monga, C., "Cluster-based Industrial Parks", World Bank Policy Research Working Paper 5900, December 2011.

5) RECOMMENDATIONS

Kosovo has made strides in many areas but entrepreneurs say more has to be done to expand growth and create jobs. There are numerous studies with recommendations for private sector development and interventions are being implemented by many donor organisations that would impact cluster development. Most of these studies agree on the top priorities needed for Kosovo's economic development and the following list of priorities is derived from ECIKS:¹¹⁶

- 1) Strengthen rule of law
- 2) Strengthen economic governance
- 3) Improve education
- 4) Improve infrastructure
- 5) Utilise natural resources
- 6) Develop private sector and SMEs
- 7) Attract foreign direct investments
- 8) EU integration and regional cooperation

Following are recommendations based on this study with the hope that initiatives, whether driven by Kosovo institutions, donors, private sector, etc. could be coordinated toward joint objectives. While individually well intentioned, the large number of different initiatives and donor programmes carries the potential for conflict and redundancy. Aggressive stewardship is required to optimise these initiatives. The implementing agencies or relevant ministries impacted by the initiatives can be assisted by the relevant Cluster Initiatives to ensure coordination and optimisation of the various initiatives or programmes. The following are the more critical issues that impact cluster development, especially those clusters that are emerging in spite of the constraints listed above. It is expected that more specific recommendations will emerge from the cluster initiatives that are being recommended.

1) Convene Cluster Initiatives:

Only sustained, private sector led cluster initiatives can be sufficiently specific and persistent in their activities to achieve real improvements in cluster performance. Leadership by a committed individual is needed to keep momentum and integrate individual constituencies into a common upgrading process e.g. the CEO of Solid Shoes is the chair of the Suharekë/Suvareka Business Support Centre. The Suhareka Business Support Centre was initially supported by donors and is now membership-funded. Importantly, it includes the active participation of municipal officials.

Once clusters are organised through trade associations or other means, institutional agencies should become active participants in dialogues with cluster participants to understand local constraints to productivity and identify gaps and weaknesses in public policy.

Cluster group participants should include:

- Broad representation of cluster participants including end product producers, service providers, distributors, etc.

¹¹⁶ Economic Initiatives for Kosovo, *A New Deal for Kosovo, Creating Sustainable Economic Growth*, June 2013.

- Associated institutions such as universities, training providers, etc.
- Relevant levels of institutions (central, municipal) that are willing to improve regulatory and government programmes based on inputs from the cluster
- In Kosovo, all donors need to be represented.

Kosovo Industrial Master Plan

Full-scale in-depth studies on clusters are recommended which would inform the Cluster Initiative discussion for policies and specific actions to be taken at the central, municipal and cluster level. Some potential clusters like Leather may require technical analysis from industry experts, especially on an environmentally friendly leather cluster industrial park infrastructure. These full-scale cluster studies on identified clusters should be used to inform the preparation of a Kosovo Industrial Master Plan which would include individual cluster master plans for each cluster. Each cluster study should involve the participation of its Cluster Initiative.

Cluster Industrial Master Plans

It is recommended that each cluster initiative produces a master plan, which should be revised periodically to reflect new situations and enhanced policy capabilities. There are several ways to ensure implementation:

- (i) an action plan matrix that specifies actions and a monitoring mechanism in detail and in advance;
- (ii) a high-level monthly cluster committee chaired by a top leader which oversees progress and solves problems; and effectively mobilizes "projects" through donor assistance, and institutional budget and private cooperation to implement designated action plans.

Each particular cluster initiative would require a competent hub organization which can navigate itself through different ministries, donors and private stakeholders.

2) Organise the Implementation of National Economic Programmes Around Clusters

Economic development programmes will be more effective and efficient if they are structured so they can be implemented using the cluster model. Each cluster has different needs that a generic programme may fail to address. A cluster-based implementation approach will lead to spillover benefits for many more firms than programmes targeting a single firm or small group of firms. A cluster-based workforce training system, for example, will train workers to fill actual jobs in the cluster and meet the actual skill needs of those jobs. In a cluster-based workforce development model, workers will be equipped to seek employment in different firms instead of training programmes that subsidise training in individual firms.

Economic development agencies at the national and municipal levels should incorporate clusters into their organisational structures instead of organising solely around generic policies and programme functions. Staff should be assigned to develop expertise in particular clusters to allow for deeper information exchange and better understanding of company needs and priorities.

3) Incentives

Another dimension of cluster policy is *incentives* to spur collective investment by cluster participants in assets that benefit many cluster participants, such as university research centres, community college curricula, or testing facilities.

4) Access to Capital

The most critical barrier is access to and the high cost of capital. Lack of access to finance was widely cited as a major impediment to growth and competitiveness. Small to medium-sized companies desperately need capital to expand, add jobs and grow. These are firms with a track record but the high cost of capital severely hinders their ability to expand. While interest rates were generally considered to be high and projects typically required collateral far higher in value than the loans, donor grants to individual firms may also be distorting the market. Interviews revealed that some firms delayed necessary investments, even when they were capable, in the hope of attracting donor grants. Donor grants to individual firms can also distort competition in that particular industry as donors may be inadvertently “picking winners.”

The GOK’s “*SME Development Strategy for Kosovo*” has Strategic Goal 2: Improving SMEs’ Access to Finance. The report recognised there is little incentive for banks to lend to SMEs and recommends measures to improve SMEs access: reform of the Cadastral collateral and credit registration system enforceability of debts against the collateral. Most critical would be additional efforts to develop a fully functional capital market in Kosovo. Donor programmes can go a long way in addressing this issue. USAID’s new EMPOWER project aims to support small- to medium-sized enterprises and support job creation through workforce development.

5) Foreign Direct Investment

Kosovo needs a more meaningful and competitive strategy for its foreign investment policy and their promotion. Foreign firms can enhance many different clusters. However, Kosovo needs to be competitive in offering incentives and **providing a favourable business climate to foreign investors**. While studies already exist on the strengths and weaknesses of Kosovo to foreign investors,¹¹⁷ a study that investigates the potential of a more flexible FDI policy, e.g. one that allows flexibility on crafting the structure of individual FDI deals, would inform decision makers on whether a more competitive package of incentives is needed for foreign firms to spur job growth and enhance cluster development in Kosovo. Enhancing the business environment would go a long way in attracting FDI.

Kosovo does not have the resources to engage in an FDI bidding war with Serbia (or other neighbours) so a different approach is required. Further, the true ROI of heavy FDI incentives must be explored as such incentives are unsustainable and produce mixed results. Winning a bidding war to land a new factory may yield a net cost of 250,000 EUR per job with little or no technology transfer or true cluster contribution.

¹¹⁷ Nakije Kida, *Growth Impact and Determinants of Foreign (sic) Direct Investment in Kosovo*, Journal of Macroeconomic Dynamics Research 2013, http://manuscript.sciknow.org/uploads/jmdr/pub/jmdr_1382212551.pdf#page=1andzoom=130,30,598, retrieved April 21, 2014.

Emphasising that total value, such as a better executed cluster initiative, will yield the higher ultimate ROI for investors may be able to compete against a neighbouring country's flat per employee subsidy. A targeted case by case FDI offering (for qualified prospects) and communicating the benefits and value relies more on creative and thorough packaging of existing assets than flat subsidies or incentives.

Kosovo's FDI attraction efforts could target specific countries and their specific sectors with specific packages of benefits. With its locational advantages, Kosovo can be a manufacturing/service base for (i) EU companies seeking lower cost production with EU quality and (ii) US/Asian companies seeking access to the EU market. Kosovo needs to distinguish itself as an outsource manufacturing/service hub by connecting into regional clusters and facilitating easier expansion of such regional clusters into Kosovo. With the assistance of donors Kosovo can make a strong case to US and Asian companies seeking a manufacturing or service base to access the EU market. Many US companies have outsourced manufacturing to China and other low-cost producers but Kosovo can be just as cost-competitive and offers benefits such as just-in-time delivery, EU access, etc. Further, as concern over labour practices and environmental issues in China grows, many US companies are looking for alternate suppliers.

An important first step is a post-competitive bid analysis on recent lost deals. For example, engage with GeoX to learn what Kosovo could have done (if anything) to win the business from Serbia. Was it exclusively Serbia's per employee subsidy or were other factors at play? This exercise is necessary to gain true insight into FDI requirements from the investor's perspective.

6) Procurement

Institutional procurement policies can assist firms by being sophisticated and demanding customers and setting standards. A policy that sets preferences for local producers would help create local demand and support local companies. Importantly, procurement needs to be transparent and competitive. Kosovo's law provides priority for domestic bidders and the set criteria that the price offered by the domestic bidder is not more than 15% higher compared to the lowest price offered by foreign bidder. Acting as a demanding and sophisticated customer means institutions should set standards, quality and performance levels in addition to price considerations.

7) Data Collection and Metrics

Public policy at the cluster level should begin with the collection of *information* that identifies the existence of clusters, i.e. cluster composition, membership, employment and performance. Clusters combine industries in different parts of traditional industrial classification systems. Standard industrial classification systems obscure many products and services that are not specifically covered by the data collection systems. For example, in Kosovo, the business registration, employment, tax and trade classification systems should be aligned with each other and with international harmonised systems.

8) Cluster-based Industrial Parks

Industrial zones in general tend to be quite popular tools for economic development. While some have been successful and are well managed, others have not delivered the expected outcomes due to the choice of the location not always being optimal. While some zones were built near transport hubs, others were created as isolated geographic enclaves or in remote areas, not on the basis of an economic rationale but as a way to appease political constituencies. This increased production and transaction costs for the few firms willing to build factories there.

Cluster-based industrial parks have specialised facilities configured to the needs of specific industries and sectors. Such cluster-based industrial parks could be of various sorts depending on the particular industries to be promoted. With their specialised facilities customised to the unique needs of target industries, they may be airport-based zones to support air-based activities (fruits and vegetables or cut flower exports), agro-processing, etc. They can also have labs and testing facilities, customs bonded warehouse facilities, training facilities, maintenance and repair centres, product exhibition areas, etc. that can be shared among firms. Manufacturing, in particular can reap economies of scale through geographic concentration. By clustering together, similar firms reduce each other's costs.¹¹⁸ Clustering also helps firms lower their transaction costs and expand.

Kosovo Institutions need to play their indispensable facilitating role: provide some basic industry-specific infrastructure (electricity, water, telecommunications, etc.); coordinate the design and implementation of the investment needed and used collectively by firms in their industries (e.g. storage facilities). Privately-owned, managed and operated zones should be encouraged but they could start as public-private partnerships, with public provision of off-site infrastructure such as roads, and public-private funding of on-site facilities.

¹¹⁸ Monga, Ibid.

APPENDIX A: INTERVIEWEES

We are grateful to the following stakeholders for sharing their valuable insights:

Donors

EBRD – Anton Kobakov, Head of Office

EU Regional Development Agency (South) - Valentin F. Hoxha, Executive Director; Qazim Pirana, Project Manager;

EU Wine Route and Wine Culture Development in South Kosovo – Korab Rexhepi, Consultant

EU Trade Policy Project – Rron Dalladaku, National Trade Policy Advisor

IFC – Sagita Muco, Project Manager Kosovo IC Project

UNDP Aid for Trade – Besnik Cecelia,

Petrit Gashi, Trade Expert

USAID – Flora Arifi, Project Manager

USAID New Opportunities for Agriculture – Mark Wood, Chief of Party

Business Associations

Alliance of Kosovo Business (ABK) - Agim Shahini, President; Lumnije Ajdini, General Manager

American Chamber of Commerce - Visar Hapciu, Policy and Government Relations Manager

Kosovo Chamber of Commerce – Safet Gerxhaliu, President

Trade Unions

The Union of Independent Unions of Kosova – Haxhi Arifi, President; Alush Sejdiu, Vice-President; Dafina Mehaj, Head of Office for International Cooperation

Municipal Institutions

Municipality of Prishtinë/Priština – Dardan Sejdiu, Deputy Mayor

Municipality of Gjakovë/Đakovica – Mimoza Kusari-Lila, Mayor; Silvana Domi, Director, Department of Economic Development

National Institutions

Ministry of Finance (MoF), Kosovo Customs – Lulzim Rafuna, Director General

MoF, Tax Administration of Kosovo – Sakip Imeri, Director of Department, Taxpayer Services and Education

Ministry of Trade and Industry (MTI) – Bernard Nikaj, Minister

MTI - Adnan Hoxha, Senior Officer for the policies of industrial development and projects, Department of Industry; Igballë Rexha-Jashari, Head of the Division for Trade Policy

MTI, Investment Promotion Agency of Kosovo – Kreshnik Thaci, Senior Investment Promotion Officer

MTI - Blerim Ahmeti, Acting Director of Department of Trade

Education and Consultancy

Riinvest – Lumir Abdixhiku, Executive Director; Alban Hashani, Research Director

University for Business and Technology - Prof. Dr. Edmond Hajrizi, President

Companies

Abi & Elif – Irfan Fusha, Owner

Biopak - Bejtullah Haxhimurati, Co-owner

Galanteria Group – Muhamet Ymeri, Executive Director (Founding Member, Association of Wood Processors)

Hit Flores Dragash - Nuridin Bajram, Owner

HIT Shoes, Ferizaj - Xhevat Gashi, Owner

LAND HOLDING – Faton Maksuti, Owner

Meridian Corporation – Hakif Gashi, CEO and Chairman

NewcoFerronickeli Complex – Arten Bajrush, former Administration and Public Relations Manager

Key One – Mirco Tattini, Co-Owner; Gëzim Qurdina, Manager

Paradiso (Granite Marble Ceramics) – Alban Uka, CEO

Solid Shoes - Shefqet Kuci, Owner

StoneCastle Vineyards and Winery - Hysen Gecaj, Co-Owner

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