



The missing element of enlargement: SMEs, competitiveness and convergence in the Western Balkans

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journals.sagepub.com/home/euv**Peter Hefe¹** and **Katerina Jakimovska¹**

Abstract

This article argues that small and medium-sized enterprises (SMEs) are the missing link between EU enlargement, economic convergence and Europe's competitiveness agenda in the Western Balkans. While enlargement debates have focused mainly on geopolitics, rule of law and institutional preparedness, the capacity of firms to benefit from integration remains underexplored. SMEs dominate the region's economies yet face cumulative constraints: limited access to finance, fragmented markets, regulatory burdens, skills shortages, weak digitalisation, insufficient representation and growing sustainability pressures. Existing EU support instruments, including the Instrument for Pre-Accession Assistance III, the Growth Plan, the Western Balkans Investment Framework and European Investment Bank-backed lending, have mobilised significant resources but remain insufficiently targeted to firm-level productivity and absorptive capacity. Europe needs a more strategic SME policy that links enlargement to single-market readiness, value-chain integration, brain-drain prevention and EU strategic autonomy. Strengthening Western Balkan SMEs is essential for making enlargement economically tangible, socially legitimate and geopolitically resilient in concrete practice.

Keywords

Western Balkans, SME, Enlargement, Competitiveness, EU, Single market

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Introduction

The debate on EU enlargement has been focused predominantly on geopolitics, rule-of-law standards and institutional capacities, in both the EU and the candidate countries. Significantly less attention has been paid to a more substantive and decisive question: to what extent are companies in those countries already prepared for and benefiting from integration? Here small and medium-sized enterprises (SMEs) deserve attention, as they are an important channel through which integration becomes tangible and translates into investments, jobs, growth, tax revenues and local development. Factors such as access to finance and to the market, the development of adequate skills, meeting standards and coping with compliance will decide the success and public acceptance of the next round of enlargement.

In a world increasingly contending for resources, power and influence, Europe's economic integration with its immediate neighbourhood is of key importance. The Western Balkans region will either become an integral part of the EU's productive base, helping to diversify Europe's supply and value chains, or remain structurally vulnerable, open to (geo)political influence from external actors. SMEs form, as the Western Balkans Investment Framework (WBIF) puts it, 'the backbone of the Western Balkan economies and are the stepping stone to their economic convergence and path towards the [*sic*] EU accession' (WBIF 2024).

Across the seven economies in the region (Albania, Bosnia and Herzegovina, Croatia, North Macedonia, Montenegro, Serbia and Kosovo), SMEs account for between 99.2% and 99.9% of all enterprises and generate roughly 73% of employment (OECD 2026). Yet labour productivity (GDP per person) in the region varies between €15,000 and €25,000—less than half of the EU average of €52,000. As long as firms in the region are unable to compete in the EU market, to scale up, and to attract and retain talent and capital, it will become increasingly difficult to meet the objective of convergence.

This article argues that, beyond attracting foreign direct investment, the Western Balkans' competitiveness can only be achieved through a more targeted and comprehensive strategy for SME development. This not only matters in terms of convergence but directly serves the EU's strategic interests. The Draghi report (2024) highlighted the need for EU-wide industrial renewal, supply-chain diversification and the reduction of strategic dependencies. The Western Balkans, geographically located in the centre of continental Europe and surrounded by EU member states but institutionally outside the single market, represent an underused asset. Integrating the region's SMEs into EU value chains, digital networks and sustainable transition frameworks could advance both EU strategic autonomy and regional convergence.

Why SMEs matter

The success of Europe's unique socio-economic model ('social market economy') depends on a landscape of economic actors, diverse in size, products and services, and

spatial allocation. SMEs, representing 98% of all European companies, serve as the backbone of employment, local development, entrepreneurial activities, and political legitimacy and stability. This is true for both Europe as a whole and the Western Balkans.

According to OECD statistics, SMEs in the Western Balkans account for 99% of firms, generate 65% of value added and employ roughly 75% of the workforce. However, a closer look at the structure of Western Balkan SMEs reveals significant differences between them and those in more advanced economies in Western and Central Europe. We find in the Western Balkans a larger number of microenterprises—so that for the region we should speak of ‘micro, small and medium-sized enterprises’ or ‘MSMEs’. These have low capitalisation and limited capacity for innovation and integration into larger, transnational supply chains. Many of them are located outside the capitals and the few major industrial centres. They are often family-run and concentrated in small manufacturing, agri-food, tourism and trade. These specifics characterise the current shortcomings. However, they also strongly indicate that (economic) policy interventions in favour of MSMEs should aim to strengthen their role as key economic actors in the region and as indispensable agents in the integration process. The very few large companies, and those embedded in foreign value chains, are better positioned to adapt. But even for them, many obstacles remain.

These structural weaknesses largely limit opportunities for rapid productivity growth, which often occurs through integration into wider value chains and ‘trickle-down effects’ such as skill and technological upgrading and capital influx.

The crucial role of MSMEs, therefore, lies not only in their mere number or employment capacities. They determine whether the necessary economic convergence during the enlargement process becomes a tangible benefit for all citizens; they achieve this by embedding all groups within the area’s societies and regions into a diverse economic landscape. So far, the conditions have produced a dual-track economy, in which internationally connected firms have moved ahead faster than smaller domestic firms.

Beyond pure economic logic, successful integration will contribute massively to the overall political legitimacy of the enlargement project. Massive demographic and regional imbalances are already creating a powder keg made up of Euroscepticism and the vulnerability of the political and party systems to corruption and foreign influence.

Support architecture

While this article is intended to point out the weaknesses of the entrepreneurial landscape and make the case for more targeted support, it should be noted that the EU and the candidate countries have indicated their willingness to address the situation. The EU’s institutional support for SMEs in the Western Balkans has grown substantially over the past decade, combining EU pre-accession instruments, multilateral development bank financing and regional cooperation mechanisms. The following section describes this framework and its strengths and weaknesses. A gap analysis of what already exists and what remains to be done will be the basis for our final recommendations.

The EU pre-accession framework: promise and performance

The principal EU financial instrument for candidate and potential candidate countries is the Instrument for Pre-Accession Assistance (IPA III), in effect from 2021 to 2027. It allocates approximately €14.2 billion across the Western Balkans and Türkiye. Within IPA III, support for private-sector development and SME competitiveness is channelled through the WBIF, which blends grants and loans for infrastructure and business development. The framework has mobilised significant capital across both public- and private-sector investment. By March 2026 the WBIF had contributed €4.3 billion to public-sector projects, leveraging €15.9 billion in total public investment, and €885 million to private-sector support, mobilising €8.4 billion in additional private investment—a combined total of €24.3 billion (WBIF 2026). The framework has so far supported more than 390,000 MSMEs across the region (WBIF 2026).

In response to the limitations and slower economic growth despite the IPA instruments, the European Commission stepped in with a new programme in November 2023. This is the Growth Plan for the Western Balkans, a four-pillar strategy explicitly designed to accelerate socio-economic convergence by bringing some benefits of EU membership to the region before formal accession (European Commission 2023). The Plan's centre-piece is the Reform and Growth Facility, a €6 billion package (€2 billion in grants, €4 billion in concessional loans) for 2024–7, with payments and availability conditional on proven reform progress. The actions aimed at integration into the single market cover goods, services, workers, payment systems, transport, energy decarbonisation and digital infrastructure. These measures are structurally significant for SMEs, as they lower the costs of cross-border transactions and begin to extend the logic of the EU's internal market to the region before full accession, resulting in gradual integration. As convergence stood at 41.4% at the time of the announcement in 2024, the EU admitted that genuine advances are needed to boost growth and bring it closer to that of the single market and the EU average in economic performance.

The Growth Plan is primarily a macro-fiscal and infrastructure instrument, though it formally includes private-sector development and the business environment (European Commission 2024). Its reform conditionality focuses on the rule of law, governance and macroeconomic fundamentals. SMEs appear to be incidental beneficiaries of broader fiscal and regulatory reforms more than direct targets of a firm-level policy. The programme did not include specific SME productivity benchmarks, the scaling up of conditionality or dedicated access-to-risk-capital steps among the conditions of payment (OECD 2026). One major gap lies in its fragmented policy frameworks.

The European Investment Bank: the bank that lends—and the market that does not

The European Investment Bank (EIB) has been the single most consequential external financier of SMEs in the region. Since 2008, the EIB has channelled credit to more than 28,400 firms across Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia

through intermediary banks under favourable terms (EIB 2023; see also *EuropaWire* 2023). The results of this intermediated lending are striking: firms that received EIB-backed loans recorded a 15% increase in employment growth compared to comparable non-beneficiary firms, equivalent to roughly 15 additional jobs per €1 million lent (Bending et al. 2024, 12). By 2025, annual commitments stood at €822 million, mobilising over €1.5 billion in new investments (EIB 2026). The European Investment Fund has expanded its instruments through the Western Balkans Enterprise Development & Innovation Facility's Guarantee for SME Resilience, now expected to unlock €885 million, supporting tens of thousands of small businesses across the region (Directorate-General for Enlargement and Eastern Neighbourhood 2025). Around 20% of SMEs across the region are credit-constrained—rejected for loans, offered less than what is requested or deterred from applying—and by 2024 nearly half identified a lack of access to finance as a major or moderate obstacle (OECD 2026). Banks dominate the financial landscape, comprising roughly 90% of total financial assets in most economies of the Western Balkans six (WB6: Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia and Serbia), compared to 50% in the euro area (OECD 2024). Domestic credit guarantee portfolios typically amount to around 0.1% of GDP, compared to 1% in the EU—too small to shift banks' risk perceptions for SME lending (OECD 2026) in a market in which no other domestic substitute exists at a meaningful scale.

The regional cooperation architecture: building a single market without being in one

The Regional Cooperation Council (RCC) coordinates the political economy of regional economic integration through the Common Regional Market (CRM). The CRM 2.0 Action Plan (2025–8) extends the logic of free movement of goods, services, capital and skilled labour within the WB6 to create a regional single market in preparation for EU accession. The RCC estimates that a supportive regional environment, if fully integrated, could add up to 2% to annual GDP growth, attract 6.5% more investment, increase job growth by 1% per year, and boost SME productivity by between 5% and 10% (RCC 2024b).

However, the OECD's conclusion remains unambiguous, even in 2026, that the current pace of structural transformation is too slow to close the productivity and convergence gap within a reasonable timeframe (OECD 2026). Three structural deficits account for much of this gap. First, the persistence of large informal economies—estimated at between 25% and 33% of GDP—has depressed the demand for formal credit and distorted competition. According to the RCC's Balkan Barometer Business Survey taken in 2024, unfair competition from the informal and grey economy ranks as the single most cited obstacle to doing business (RCC 2024a). Second, for SMEs to operate at scale, better regional coherence is required. But instead of this, one finds a number of fragmented policy frameworks, due to the WB6's varying institutional capacities, the complex institutional architecture within Bosnia and Herzegovina and antagonisms between the entities, the unresolved status of Kosovo and the political volatility in certain governments. Third, a deepening demographic and human capital crisis is undermining the long-term viability of the SME sector.

Main bottlenecks for SMEs

As outlined in the section above, SMEs in the Western Balkans face several severe constraints that limit their capacity to contribute to successful convergence, and these are structural, financial, institutional and organisational. Fatally, these challenges (often) reinforce each other: limited financial resources reduce the ability to invest in aligning with European standards, digitalisation and sustainable upgrading; low skill levels, both of the management and the workforce, constrain the use of EU programmes and productivity gains; fragmented markets limit scale and expansion beyond local and regional markets; and administrative burdens ‘lock’ many firms into local or informal business models—and none of these informal networks will easily fade away.

Access to finance

Access to finance remains one of the most persistent constraints on SME development in the Western Balkans. Many firms depend heavily on bank lending, as other capital market options are beyond their reach. This comes with larger collateral requirements due to high perceived risk, limited credit histories and insufficient equity capital. This is particularly problematic for microenterprises, startups, innovation-oriented companies, and women- or youth-led enterprises. To prepare SMEs for EU integration, significant upfront investment is also needed to fund compliance with standards and certification requirements, product testing, digital systems, cybersecurity, energy efficiency, staff training and the ability to apply for EU-funded projects. As Kos and Cormann (2026) have pointed out, many SMEs struggle with co-funding requirements, long payment cycles, and limited access to credit for intangible investments such as innovation, advisory services or compliance capacity. This creates a paradoxical situation: while, in principle, sufficient instruments exist (see the section above), many SMEs cannot use them because they lack the financial capacity to access them. The EIB’s 2024 activity report on the Western Balkans shows slight improvements, including access to more favourable and targeted SME financing, but better transmission mechanisms between financial institutions and smaller firms remain underdeveloped (EIB 2025).

Fragmented markets and limited scaling options

The small size of Western Balkan domestic markets—their intraregional trade volume accounts for only €15.34 billion (CEFTA 2026), which equals 0.085% of the European single market—limits SME growth. Many firms operate in narrow local or national markets, which restricts investment incentives, productivity gains and export readiness. Fragmentation also reduces specialisation and delays adaptation to new demands, which makes it harder to expand into the EU single market. Yet, as the CRM Action Plan 2025–8 (RCC 2024c) shows, implementation is still sluggish: reducing non-tariff barriers, simplifying customs procedures, recognising qualifications and certificates, and improving cross-border logistics are all yet to be realised. Without further achievements, fully fledged integration into the single market would find many SMEs too small, too local and too weakly networked to survive in a much more competitive environment.

Regulatory and administrative burdens

The complex regulatory environment of the EU creates significant adjustment costs for SMEs: product safety, food standards, environmental compliance, procurement, competition, digital regulation and sustainability-related requirements—all of this requires significant capabilities at the level of firms. Larger firms can rely on specialist in-house and external expertise; SMEs often cannot. Kos and Cormann (2026) point to an important distinction: information on EU rules and funding may exist, but access hurdles are (too) high, as this information is fragmented, technical and poorly targeted. Firms are aware of EU standards but not what they mean for, for example, packaging, traceability, documentation, certification, digital reporting or supply-chain management. Any attempts on the EU level towards administrative simplification are therefore not only a governance issue; they also immediately impact competitiveness, not only within the EU but also in the candidate countries.

Skills shortages and managerial capacity

No analysis of SME competitiveness could be complete without addressing the issue of brain drain. From 2015 to 2023 the working-age population declined by more than 10% on average across the Western Balkans—five times the rate of decline in the EU—with recent censuses in North Macedonia, Albania and Kosovo prompting substantial downward revisions to official population figures (Ayerst et al. 2025). The annual cost in lost education investment and foregone GDP growth is estimated at between €840 million and €3 billion (Westminster Foundation for Democracy, as cited in Icoski 2022). A third of Montenegro's citizens, over 213,000 people, lived outside the country (Statistical Office of Montenegro 2025). In 2021 the North Macedonia census recorded a 36% reduction in the youth population over two decades. In Serbia, the emigration of high-skilled workers costs the economy approximately 1% of GDP annually (Zavisa 2025). The 2024 Balkan Barometer Business Opinion survey found that labour force shortages and brain drain were the two most prevalent obstacles to doing business across the WB6, even surmounting access to finance, which had dominated in previous years (RCC 2024a).

The EU's enlargement progress reports have treated brain drain as an adjacent concern, not as a core enlargement variable (Jansen et al. 2024). This represents a significant and inexcusable analytical blind spot. The Commission's own framework notes emigration as a factor exacerbating skills shortages but rarely integrates brain-drain prevention as a structural pillar of the pre-accession process. Yet without a skilled labour base, both the upgrading—whether digital or green—of SMEs and value-chain integration are impossible. A company that cannot recruit a qualified software developer, an environmental compliance officer or a logistics manager cannot participate in the high-value supply chains that are a prerequisite for EU single market integration.

Labour markets are marked by large-scale emigration, ageing, skills mismatches and weak vocational systems. EU integration adds another layer of complexity: firms need not only production skills, but also regulatory literacy, project-management capacity,

foreign-language competence and knowledge of EU funding procedures. As Hefele (2026) highlighted, the digitalisation of SME operations is particularly severely restricted by skills shortages, from basic digital literacy to advanced information and communication technology expertise. This constitutes a persistent constraint on SME transformation. Management capacity is decisive, since digital and organisational change needs to be developed inside the organisation and cannot be completely outsourced to consultants or providers. In micro and small firms, owners often combine operational, financial, human resource and strategic functions in a single person. Even where support schemes exist, firms may lack the time and expertise to identify opportunities, prepare applications and absorb advisory support.

Innovation and digitalisation gaps

Digitalisation is a major challenge for enterprises striving to be competitive. But contrary to common understanding, it is not only about purchasing software or hardware. Many SMEs adopt basic digital tools—websites, accounting software, online communication or e-commerce—but do not take more advanced steps such as transforming workflows, using sophisticated data management or rethinking business models. The OECD notes that, although digital adoption accelerated during the pandemic, SMEs in the region still lag behind their EU peers in more advanced technologies such as cloud computing, artificial intelligence and big data (OECD 2022)—and even among Western European SMEs, the uptake is still comparatively low (Hefele 2026). Many SMEs digitalise only superficially, using selected tools without undertaking deeper organisational transformation. Digitalisation (if it happens at all) is more a matter of operational optimisation than a strategic reorientation in value creation. For Western Balkan SMEs, digitalisation is a key component in their successful EU integration: from supporting traceability and automating customs procedures to supply-chain management, procurement, certification and reporting as well as eliminating systemic vulnerabilities (cybersecurity). The European Bank for Reconstruction and Development and the EU's joint Go Digital in the Western Balkans programme, established in 2025, acknowledges these gaps. This initiative combines loans, grants and technical assistance to support investments in digitalisation, automation and green technologies (Press and Information Team of the Delegation to Bosnia and Herzegovina 2025).

Weak interest representation and limited public–private dialogue

SMEs often lack effective channels to participate in and influence policy design and implementation. Larger companies, foreign investors and well-established business associations are more likely to participate in consultations, while smaller firms, regional businesses and sector-specific associations remain underrepresented. This is already a structural disadvantage on the regional and national level. Effective representation becomes almost impossible on the European level. However, enlargement-related reforms are largely decided in Brussels and shape the business environment (directly or indirectly) in which Western Balkan SMEs must operate. Most SMEs—and even their local- and regional-interest associations—lack the staff, procedural knowledge, language

capacity and networks needed to participate meaningfully in EU-level consultations and national reform debates. Further, representation is often concentrated among capital-based or well-resourced actors, while regional and sectoral voices remain weaker (Kos and Cormann 2026). If SME needs are not heard early, regulatory alignments will be insufficiently designed and sequenced, and may impose costs, even before support mechanisms are in place. Public–private dialogue is weakly institutionalised; occasional consultations are insufficient.

Green transition and sustainability pressures

As the EU is undergoing a major transformation towards a more sustainable future, SMEs face growing pressure to adapt. Driven by new EU standards, customer expectations and value-chain requirements, the demand for energy efficiency, emissions reduction, waste reduction, sustainable packaging, traceability and environmental documentation has dramatically increased. For SMEs, this can be an opportunity, but in most cases, it is a massive burden. Many firms (small and large) perceive sustainability primarily as compliance rather than as a source of innovation or competitiveness. Hefele and Chikh M'hamed (2026) hint at a paradox: although EU policy links the green and digital transitions, many SMEs lack the skills, finance and technology to use digital tools for environmental optimisation. The EIB Investment Survey 2024 shows that already, among EU firms, energy costs, regulation and finance gaps remain major investment obstacles. This suggests that Western Balkan SMEs will need especially targeted support to manage the green transition under pre-accession conditions (EIB 2024).

In sum, the transformation and adaptation challenges of Western Balkan SMEs are cumulative. They result from an interplay of finance, scale, regulation, skills, digitalisation, representation and sustainability pressures. Existing mechanisms often fall short because they address only parts of the problem and are not aligned with or adapted to SMEs. SMEs can only become drivers of convergence if support is targeted to the realities of SMEs and designed around usability, absorptive capacity and practical preparedness for the single market.

Strategic opportunities and policy direction

Against the structural challenges of the SME sector in the Western Balkans, the existing support architecture and mechanisms for Western Balkan SMEs are not inadequate in design. The real obstacles lie in a lack of resources during implementation, fragmentation in delivery and insufficient alignment with the EU's own emerging strategic priorities.

Previous enlargement rounds offer an instructive reference model. The PHARE programme (MWH Consortium 2007) proved most effective when it combined SME-specific financial instruments with complementary institution-building: this took place in trade facilitation agencies, regional development agencies and business support networks. In Czechia and Poland, PHARE-supported regional development agencies matched EU technical standards with export-readiness programmes for SMEs,

contributing to a substantial increase in intra-EU trade after accession (EUR-Lex 2006). Estonia's embrace of e-government reduced compliance costs for SMEs, attracted digital investment and used the accession process as a forcing function for digital transformation. The Berlin Process, the Digital Agenda for the Western Balkans and the CRM 2.0's digital chapter offer similar policy windows that offer comparable advantages.

The EU's own competitiveness agenda creates the strongest strategic argument for the successful integration of the Western Balkans. Mario Draghi's report identifies three pillars: closing the innovation gap, decarbonising industry and reducing strategic dependencies (Draghi 2024). The Western Balkans, geographically aligned, euro-compliant and on an accession path, are the natural beneficiaries of the near-shoring logic that follows (RCC 2024d). The EU Competitiveness Compass (European Commission 2025) reinforces this position: without competitive, digitally capable firms in candidate economies, the EU's supply-chain resilience strategy has a structural gap on its own doorstep.

Five recommendations

1. SME productivity, export share, digital adoption and green compliance should be incorporated into annual progress reports with the same rigour as judicial reform: the OECD SME Policy Index already provides the methodology.
2. The Reform and Growth Agenda should establish a dedicated SME competitiveness window of not less than 15% of the grant envelope, prioritising micro enterprises.
3. European Investment Fund equity instruments should be scaled to all six Western Balkan economies by 2028.
4. Brain-drain prevention and diaspora engagement should be part of the Reform Agenda conditions, with enhanced allocation for countries demonstrating coherent talent-retention strategies. A circular economy strategy should help the region to deter or mitigate brain drain.
5. Politically most significant, the EU institutions and the Berlin Process should explicitly frame Western Balkan SME integration as a component of the EU's strategic autonomy. The region is not only a beneficiary of EU policy but a strategic resource for European competitiveness in an era of geopolitical fragmentation.

As the case of the Western Balkans shows, SMEs are the missing link between enlargement policy and economic convergence. If SMEs cannot access and use the support architecture, enlargement will remain macroeconomic and politically fragile.

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