

NAVIGATING CHALLENGES: THE IMPACT OF EXTERNAL FACTORS ON SME PROFITABILITY

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Abstract: This study aims to examine the influence of some of the external environmental factors such as corruption (CO), tough competition (TC), informal economy (IE), law enforcement (LE), and tax evasion (TE) on the profitability of SMEs measured by the net profit of SMEs. To examine the influence of these factors, the study has adopted the quantitative approach to evaluate the data gathered through the online form from 336 respondents via a random selection sample. To achieve this objective, the data analysis was carried out by applying the multinomial regression model to evaluate the influence of external factors on the net profit according to the input of the managers or entrepreneurs. Econometric results revealed that CO and TC have a significant positive influence on the net profit of SMEs, whilst the IE has a negative influence. TE and LE showed surprising results as they did not provide a significant impact. Understanding factors that influence net profit can provide entrepreneurs with more insight into issues affecting the future of their business. Increased profitability offers greater opportunities for SMEs to become more competitive and pushes them toward growth and development. In terms of bringing new value and

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originality, the study provides new evidence through an econometric approach, which delivers answers through empirical evidence and will instigate constructive debate and discussion between researchers.

Keywords: SMEs; Entrepreneurs; External environment; Net profit; Development.

JEL Codes: F43, G21, K23.

1. Introduction

Small and Medium Enterprises (SMEs) are recognized as the backbone of the economic development of emerging and advanced countries. The significant contribution of SMEs to the entire economy validates the enormous number of these businesses in each country and the percentage of employment they include. Within 2023 inside the EU27, some 40.3 million SMEs in the nonfinancial business division hired 88.8 million employees and created 1,259.8 billion € in value added (European Commission, 2023). According to the 2023 yearly report from the Kosovo Agency of Statistics, the total number of active businesses in Kosovo is 81,692 of which 99% are SMEs. When it comes to analyzing the history of today's top businesses, each of them started as a small business. There is a probability that growth will lead to the success of a business. However, large businesses may run into financial difficulties that may lead to insolvency. Thus, not every business needs nor can advance into a large firm with billions of dollars of revenues and thousands of workforce members. Regardless, even small businesses search for new customers, sales increase, and higher profitability. Businesses may obtain funding for growth by attracting additional investments, lending additional funds from creditors, or reinvesting earnings. Each of the aforementioned scenarios requires the business to be financially stable (Dlabay and Burrow, 2008, p. 68). Definitions of SMEs differ across countries; however, the majority of governments recognize employment, turnover, and capitalization as significant measures (Mazzarol and Rebound, 2017). Hence, in this spirit, Bartlett and Bukvic (2001) discover two distinct perspectives about the core obstacles that hinder progress. The first perspective is the "finance-first" philosophy which predicts that the fundamental barriers to SME growth are attributed to financial restrictions, which could be addressed by ensuring the availability of subsidized or low-cost loans through the creation of credit guarantee institutions, micro-credit systems, or perhaps setting up venture capital resources. The second perspective, which they affectionately named the "institutional" approach asserts that non-financial impediments are the fundamental barrier to growth, including unfair competition, corruption, etc. Business growth is a prominent theme within academic research on entrepreneurship, strategic

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management, and industrial organization, among others as well. In recognition of an individual entrepreneurial business, growth is evidence of the return on the entrepreneur's investment and self-actualization (Gancarczyk & Zabala-Iturriagoitia, 2015). Therefore, this working paper aims to examine the entrepreneur's perception of the influence of external environmental factors on their SMEs' net profit. Academic arguments for business environment and performance go in both directions, on one hand, the business environment enhances SME's performance, on the other hand, it also impedes its operation. More specifically, the purpose of this investigation is to respond to the main research questions of this study on whether corruption (CO), taugt competition (TC), informal economy (IE), law enforcement (LE), and tax evasion (TE) influence the net profit of SMEs. The study employed a quantitative research paradigm with a cross-sectional design to gather data from owner-managers of SMEs (production, commerce, and services) in seven regions of Kosovo. This enabled the authors to accomplish the main and specific objectives stated previously. The research paper evaluated each parameter independently via the logistic approach. It should be emphasized that numerous authors employ the logistic approach to obtain accurate conclusions when working with this type of data, accordingly, we constructed the model following the studies performed by Quintero Sepúlveda and Zúñiga Collazos (2023).

An extensive review of relevant studies conducted by different researchers all over the world shows that several studies were conducted to examine various factors that influence the net profit of businesses. However, potential factors that influence the net profit of SMEs were previously tested separately and not combined in a single study. Moreover, the previous research on the external environment determinants–performance nexus has analyzed mostly advanced economies. Consequently, the discoveries may have limited use in emerging economies in Southeast European Countries. This region has been dealing with a lot of economic, social, legislative, and political challenges on its path to joining the European Union family. Therefore, conducting additional research on the influence of environment external factors on the business environment or business performance is important in this instance. Furthermore, it motivates us to undertake this research and contribute to the existing literature by providing evidence of the interaction across CO, TC, IE, LE, TE, and SME performance measured by the net profit. The remaining sections of this research paper are described as follows. Section 2, provides a detailed review of relevant literature in the context of the variables included in the research, which defines the academic foundation of potential drivers of SME performance. Section 3, describes the data and methodology used ranging from overall to specific. Section 4, displays the observed outcomes and discusses the findings. Finally, section 5,

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offers important conclusions in the context of improving policies that facilitate SME growth.

2. Literature review and hypothesis development

Literature provides a progressive acknowledgment of the importance of SMEs to both social and economic development on a worldwide level. The significance of this business model is not that it is unique to a given country or region but rather that at the international level, this represents the most common business structure and a major driver of economic growth. When it comes to GDP, employment creation, and overall economic growth, SMEs remain crucial, regardless of whether a country is emerging or industrialized (Gomez, Perez, and Arbelo, 2018). SMEs are becoming the driving force that accelerates economic development, as their activities are exclusively made possible by a globalized international market. The majority of industrialized countries witnessed a transformation in production philosophy in the late 20th century as a result of these initiatives; small businesses appeared, promoting innovation and individuality in comparison to the globalization and standardization advocated by multinational conglomerates (Demiri, Tmava, and Durguti, 2021). Knowing the importance of the net profit as a key factor for SMEs' growth and development is very important to analyze determinants that might influence the net profit of SMEs.

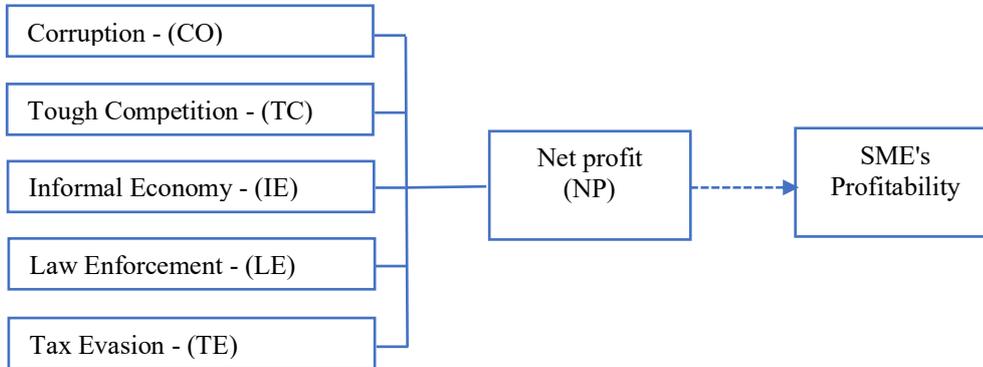
2.1. Net profit

Historically, researchers were interested in examining how well companies perform overall, but in the modern era of digitization and globalization, the subject of business performance has taken the spotlight. Therefore, employing various approaches and variables to address determinants of business performance, essentially the entire study has concentrated on three clusters as follows. Following, researchers (Mazdeh, Moradi, and Mazdeh, 2011) examined the influence of the business's strategy, while (Chang, Hughes, and Hotho, 2011) examined the organizational structure and internal business environment, whilst researchers (Tan and Liu, 2014) examined the external business environment. The first cluster outlook is concentrated on groups external to the organization that impinge on its daily operations, which comprises consumers, competitors, suppliers, government regulations, and regulatory authorities. The second cluster outlook addresses the characteristics of external variables, namely complexities, creativity, and sustainability (De Jong, Phan, and van Ees, 2011). The third cluster outlook encompasses managerial perceptions of environmental characteristics, highlighted by (Durguti and Krasniqi, 2023).

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For any business, financial management is a crucial aspect of success. One of the key factors that helps businesses manage their finances effectively is understanding and monitoring their net profit. Net profit serves as an indicator of a business's financial health and profitability. To measure the SMEs' performance, through the data collected, we analyzed whether CO, TC, IE, LE, and TE affected the NP of SMEs. In light of the aforementioned research review and our set of hypotheses, we propose the following conceptual framework.



Graph 1: Conceptual framework of the study

Source: Authors' compilations

2.2. Corruption

Corruption (CO) is an enemy affecting economies worldwide and its destructive influence is abundantly obvious. It distresses markets and competition, produces animosity among the citizens of a country, erodes the rule of law, degrades government legality, and destabilizes the integrity of SMEs (Burger and Holland, 2006). By analyzing the extent of interaction between the shadow economy, corruption, and taxes in 25 high-financially developed countries and 30 low-financially developed countries, Oanh et al. (2024) provide evidence that corruption has a positive impact, while the shadow economy and taxes exert a negative influence. From a psychological perspective, corruption has been addressed by Borlea et al. (2019) by analyzing corruption levels in an economy, which can be explained by factors such as culture, tax morale, trust, religion, or even happiness. Their findings emphasize that tax morale, trust in the legal system, and happiness are considered significant determinants of corrupt behavior. CO throughout SMEs has garnered increased scrutiny in the recent past because limited research has been oriented toward identifying if corruption negatively or positively affects SMEs by either throwing sand or greasing the wheels of commerce. The adverse effect of CO

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on business and a country's economic progress is an integral topic for both academics and legislators. Additionally, there is convincing proof that corruption affects business growth (Colonnelli and Prem, 2022), as well as business-enhancing initiatives such as innovation (Xu et al. 2017). A different perspective contends that CO is beneficial considering it speeds up an otherwise slow and unresponsive bureaucracy (Dreher and Gassebner, 2013). Nevertheless, a significant proportion of research highlights that corruption is harmful (Amin and Motta, 2023). In light of the previous examination, we put forward the following hypothesis.

H1. Corruption significantly affects the SME's net profit.

2.3. Tough competition

Tough competition (TC) between SMEs that perform precisely the same activities, which in reality are several, is a vital component in enhancing the quality and at the same time requires special attention. As emphasized by Ademosu and Morakinyo (2021), in modern economies, entrepreneurship serves as a key driver on the one hand; however, on the other hand, it is extremely challenging and competitive for individuals to manage their businesses and generate income. To overcome this challenge, entrepreneurial structures must possess adequate knowledge aligned with labor market demands while also embracing innovations offered by the digitalization process. A competitive strategy empowers the business to obtain a competitive advantage over its competitors. Multiple studies have revealed that a business that has competency across multiple functional domains, will be better equipped to remain competitive in the market (Suraji and Suraji, 2020). The most important factor that may successfully influence the overall degree of productivity of an SME is the intensity of competition you confront in the market. If there's an elevated level of competitiveness in the market, obviously the profits of individual business entities will automatically be lower. Additionally, as small businesses tend to encounter strong competition from pre-existing leaders in the field, it will require additional effort to carve a niche for your brand and stand a class apart (Media, 2017). Following the previous examination, we put forward the following hypothesis.

H2. Tough competition significantly affects the SME's net profit.

2.4. Informal economy

Informal economy (IE) was often described by such acronyms as the grey economy, the black economy, the shadow economy, and the underground economy. Consequently, it covers concepts comprising as tax evasion, informal employment, and under-declaration of salaries of employees (Onah et al. 2024; Skenderi, Islami, and Mulolli, 2017). It is claimed that over one-half of all enterprises globally operate on an unregistered basis (Acs et al., 2013), and an even higher proportion of the uncalculated number of official enterprises under-reporting sales is included

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(Williams and Bezeredi, 2018). Hence ignoring entrepreneurship in the unregulated industry is to neglect a significant proportion of entrepreneurship around the entire world. On the other side, it is reported that these unregulated businesses represent unfair competition for official businesses and have adverse effects on the business operations of formal businesses (Williams and Bezeredi, 2018).

Although IE helps businesses sidestep certain costs, it may also impede access to certain opportunities offered to formal businesses, including better access to credit, increased opportunities to engage with large firms and government contracts, reduced harassment by law enforcement agencies and municipal officials, and access to broader training and support programs. A considerable amount of the initial evidence that formalization may lead to more rapid growth came from evidence that formal businesses tend to grow faster than informal sector firms. Based on the above discussion we propose the following hypothesis.

H3. The informal economy significantly affects the SME's net profit.

2.5. Law enforcement

The media, representatives of parliament, and law enforcement (LE) bodies call upon businesses to be more mindful of society, and businesses do seem to respond to this request. Increasingly, ethical standards as well as risk and compliance departments are arising, and employees are trained to enable businesses to conduct their business in a more ethical manner, or at least to be able to market themselves as ethical, mindful of the environment, or socially conscient (Peeters, Denkers, and Huisman, 2020). Regulations or norms imposed by the government and enforced by certain threats of consequences typically incorporate a cost or penalty applied to business and they are commonly referred to as regulations (Edmore, 2017). Additionally, Castro (2012) notes that regulating strategies differ substantially from country to country and even from industry to industry. Considering the variety they possess, regulations can be described using several additional categories: statutes, constitutions, legislation, norms, rules, and other similar terms (Edmore, 2017). One of the prerequisites to obtaining an ideal business environment requires a sustainable legislative context and LE. Particularly for SMEs, that are unable to afford the financial resources for sound legal assistance, legal risk has turned into one of the most serious business concerns (Virglerova, Conte, Amoah, and Massaro, 2020). After considering the previous discourse we propose the following hypothesis.

H4. Law enforcement significantly affects the SME's net profit.

2.6. Tax evasion

ax evasion (TE) and its continuous avoidance have drawn the attention of regulatory authorities, and both of these phenomena are probably as old as taxation itself. Whenever and wherever the authorities decide to impose taxes, both individuals and businesses always strive to discover avenues to avoid paying them. TE is considered

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an extremely serious issue that demands immediate action from authorities, legislators, and other stakeholders. Promoting taxpayer compliance, strengthening tax enforcement mechanisms, and addressing the underlying economic and social factors that contribute to TE, are a variety of measures that are capable of mitigating the negative effects of tax evasion and guaranteeing that governments have the resources they need to provide essential public services (Al-Rahamneh and Bidin, 2022).

The strand of research that studies the interaction between tax evasion and the cost of debt has indicated the existence of two opposing influences (Hasan et al., 2014). On one hand, by cutting income tax expenses, businesses improve their after-tax cash flows, which may cause them to require less debt, thereby strengthening their credit quality, decreasing their default risk, and hence lowering their cost of debt. On the other hand, investigations additionally emphasized the consequences on the risk exposure of financing providers, including shareholders and debt holders, associated with TE activities (Sánchez-Ballesta and Yagüe, 2023). In light of the information provided in the previous discussion, we put forward the following hypothesis.

H5. Tax evasion significantly affects the SME's net profit.

3. Research method

3.1. Study sample

The research surveyed SME owners and managers throughout seven geographical regions of Kosovo using a cross-sectional strategy to gather data. The requirements for methods to evaluate data inspired employing a rule of thumb to determine the study's sample size. As stated by Hair Jr. Black, Babin, and Anderson (2010), factor loadings of ± 0.5 or above are deemed appropriate and sufficient when a sample size of 120 respondents is chosen. Regarding models based on econometrics, it is recommended to gather 15-20 observations per variable or predictor (Hair Jr. et al. 2010). Based on this information, our study administered 556 questionnaires using the Internet interface. To ensure each of the SMEs was given equal importance, the sample was stratified using a random methodology, with the three fundamental criteria being SME size, activity, and region. The overall number of responses received from SME owners and managers was 516. Afterward, using the logical control technique to ensure that the questionnaires were filled out correctly, 336 were retained for final analysis, while the remaining 180 were eliminated.

Additionally, the test known as the chi-square is employed by the equation modeling techniques to quantify the model's robustness and fit. The information for the current research was collected within the three months from September to December 2023. In light of both of these assumptions, we concluded that 336 questionnaires are an

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adequate number to acquire for our study since the sample size was determined within the criteria highlighted by the aforementioned authors. The design of the questionnaire is constructed across three layers, starting with the overall data, proceeding with the challenges and barriers faced by SMEs, and finally, the section that ends with the question "What are their assessments/perceptions for the net profit of 2024 compared to the year 2023?". The gathered responses and data analysis have been structured according to the Likert scale (from "strongly disagree" = 1 to "strongly agree" = 5) for nearly every one of the questions, and in particular for their perception of the predicted net profit for the year 2024.

3.2. Measurements and selection of variables

The research endeavor relied on the logistic econometric approach (multinomial regression) to measure owners' or managers' predictions regarding the net profit for 2024, specifically whether it is expected to be higher than the period of 2023. To measure the influence of the abovementioned factors CO, TC, TE, IE, as well as LE as described previously. The respondents were asked to express their agreement or disagreement with the questions reflected in the structured questionnaire with a 5-point Likert scale.

Whenever considering strategies to set up the criterion based on perception or historical data to measure the performance of SMEs, it is important to emphasize that further study is needed in this domain. Those who advocate applying quantitative approaches for measuring SMEs' performance have pointed out previous research by Ndeye, Abdul Razak, Nagayev, and Ng (2018), and Sam Ahinful, Danquah Boakye, and Osei Bempah (2023) that focused on different accounting indicators. However, indicators based on accounting or time series data have been criticized in retrospect as being unable to measure future performance and failing to take into account differences in risk-taking and SME behaviors (Ramanathan, 2018). Additionally, supporters of qualitative approaches have examined how factors such as the education level of female entrepreneurs and the firm's age influence the growth of SMEs (Avdullahi and Fejza-Ademi, 2020); another study addressed the influence of education, training, and consultancy services (Krasniqi, Jashari and Mehmeti, 2022). Meanwhile leveraging the capacity of sustainability to confront crises for start-ups in the context of Romania was steered by (Dragomir, Zamfirache, Albu, and Foris, 2023); and finally, the treatment of innovation capacities and strategies in SMEs performance was evaluated by (Quintero Sepúlveda and Zúñiga Collazos, 2023). Therefore, evaluating the above-mentioned issues and the nature of the data provided, the study was designed in line with the qualitative approach for predicting what is expected based on the owners or managers regarding the net profit for the year 2024.

3.3. Data analysis approach

The working paper employed a multinomial regression approach to quantify the net profit of the owner's or managers' perceptions of SMEs in Kosovo. The derivation and development of this approach is a result of the collected data, which in our case is categorical (or nominal) and the dependent variable has three rankings (ranking 1, 2, and 3). The use of econometric approaches to evaluate the highlighted determinants is diverse, as various authors aim to assess the effects of different determinants on a dependent variable. In this context, Bazrkar et al. (2024), by applying a sample of 250 questionnaires distributed to senior and middle managers, utilized the structural equation modeling (SEM) approach through the SMART PLS software. In cases where we are dealing with binary data and the dependent variable has two ranks, the approaches that provide more accurate estimates are considered the logit or probit approaches, but if the dependent variable has more than two ranks, then the most preferred approach is multinomial regression (Osborne, 2017). Since most research has employed an identical approach, there is additional justification to adopt the applied approach. By analyzing the parameters that affect the effectiveness of SMEs, Krasniqi et al. (2022) employed the multinomial regression approach. Hence, our research employs the multinomial regression approach to more accurately evaluate the parameters, beginning with the dependent variable's conditioning (due to its three ranks). Since very few models provide these interpretations, the multinomial regression approach has the unique advantage of being able to calculate interpretable coefficients that establish the correlation between the perceived net profit and other parameters that influence it. Additionally, the fact that they are substantially more adaptable than standard logistic functions is another advantage. As demonstrated by equation 1, the overall equation can be represented mathematically.

$$ML_r = (Y = 1|X) = \varphi(X^t\beta) + \varepsilon_i$$

Where: ML_r - the approaching prospect, φ – indicates the variance constants, whereas β – indicates the parameters. By replacing this equation with our actual instance, then we compose the following mathematical expression:

$$\begin{aligned} NP_i(NP_{i,k}) &= NP_i(NP_i = k)|x_i \\ &= \beta_1 CO_i + \beta_2 TC_i + \beta_3 TE_i + \beta_4 IE_i + \beta_5 TE_i + \varphi + \varepsilon_i \end{aligned}$$

4. Empirical results

4.1. Descriptive statistics

Considering the mean value and standard deviation (SD), this descriptive information evaluated the answers provided for each topic. Through a 5-point Likert scale, which considers responses ranging from "strongly agree" to "strongly disagree," we can express the respondents' level of agreement or disagreement for each response. In other words, a greater mean value signifies that more respondents agreed to provide the same answer, and a lower value indicates vice versa. The SD also displays the degree to which the responses varied from each other, thus the greater the SD score directed the more dissimilarity there was in the responses.

Table 1 Descriptive statistics

Variables	Obs	Mean	SD	Min	Max
NP	336	1.750	0.826	1.000	3.000
CO	336	3.770	1.281	1.000	5.000
TC	336	3.700	1.170	1.000	5.000
TE	336	3.390	1.239	1.000	5.000
IE	336	3.690	1.260	1.000	5.000
LE	336	3.030	1.248	1.000	5.000

Source: author's view

Pursuing the descriptive information presented in Table 1, the mean value of the predicted net profit for 2024 is 1.750, with an SD of 0.826. Furthermore, corruption, tough competition, tax evasion, the shadow economy, and law enforcement collectively have a mean value between 3.770, 3.700, 3.390, and 3.690, as well as 3.700 with an SD ranging from 1.281 to 1.248. Based on the outcomes of the mean reported by the business owners or managers, it is evident that most of the responses are above the mean, considering the 5-point Likert scale. The SD outcomes, on the other side, reveal the extent to which respondents' opinions on the dependent and independent variables skew toward themselves.

4.2. Correlation analysis

Moreover, correlation scrutiny was performed to identify the degree of interaction between the dependent as well as independent variables. As confirmed in Table 2, the examination yielded a moderately negative interplay among every variable and predicted net profit, with corruption having the greatest magnitude at -0.158. The obtained result offers us more convincing evidence that the applied data have not encountered any issues with multicollinearity since no coefficient has a value greater than 0.75 ($\beta \geq 0.75$). Gujarati (2004) achieved this conclusion by stressing that if any

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coefficient surpasses this limit, then it can be assumed that the data have such difficulties.

Table 2 Correlation analysis

	NP	CO	TC	TE	IE	LE	VIF
NP	1.000						2.548
CO	-0.158	1.000					1.079
TC	-0.129	0.132	1.000				2.048
TE	-0.084	0.676	0.113	1.000			2.168
IE	-0.119	0.704	0.023	0.599	1.000		1.189
LE	-0.010	0.255	0.249	0.305	0.105	1.000	

Source: author's view

However, to eradicate this dilemma, we have also completed the VIF analysis, obtaining evidence that no variable has an individual value greater than ($\beta \geq 5$) and that in our instance the highest value is corruption with 2.548. Wooldridge (2012) offered evidence that in scenarios where the results of this examination have the value ($\beta \leq 5$), it is regarded as an acceptable result as each coefficient is within the threshold and the model is presumed to be stable.

4.3. Model fitting

The subsequent part presents supplementary justifications concerning the establishment of this methodology to evaluate several additional specific components of the net profit of SMEs in Kosovo instance. To enhance confidence in the stability and sustainability of the proposed technique, we employed principal component analysis (PCA). To determine whether the data is fitting for this research, the initial stage is to execute KMO & Bartlett's test. This measure is presented in the third part of Table 4 and has a value of 0.713. According to the overarching concept, this assessment uses results within the range of 0 and 1. Within this range of values, an outcome above 0.5 is regarded as acceptable, while an outcome above 0.7 indicates a high level of adaptability (Kaiser & Meyer, 1974).

Table 3 Principal component analysis

Component matrix ^a	1	2	3
NP			0.897
CO	0.892		
TC		0.798	
TE	0.853		
IE	0.817		
LE		0.779	0.519

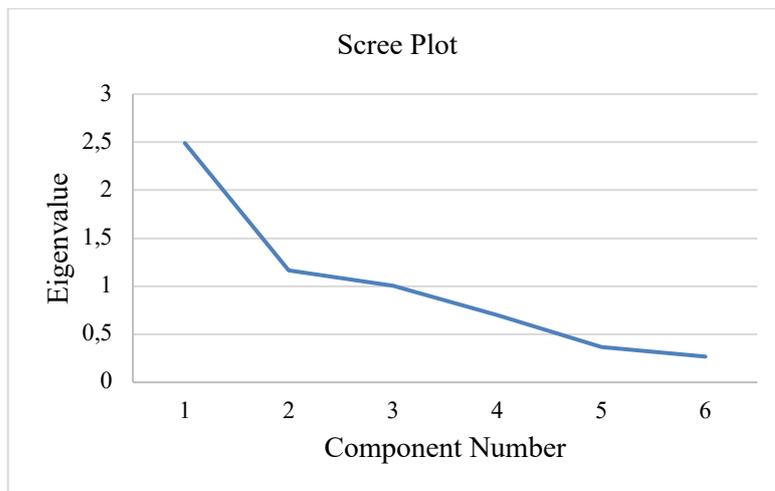
Note: Extraction Method: PCA, - a. 3 components extracted.

Source: author's view

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Furthermore, bearing in mind this argumentation, we conclude that it is appropriate to proceed further with additional analyses. Additionally, to evaluate the hypothesis regarding the homogeneity of the correlation matrix, we employed Bartlett's test. The outcome of this examination rejects the null hypothesis and supports the alternative hypothesis, as indicated by the significant value ($\rho = 0.000$). The Bartlett test is considered appropriate when its output is less than or equal to $\rho < 0.05$ (Bartlett, 1954). Table 3 reveals that net profit positively correlates with corruption, fiscal evasion, and the informal economy in the first component. In the second component, there is a high degree of positive correlation between tough competition and law enforcement. Finally, the third component is strongly related to law enforcement. Moreover, Graph 2 provides a full-screen PCA analysis, which supports the argument regarding the selection of components. The analysis confirms that each of the three components has values greater than 1.



Graph 2: PCA plot

Source: Authors' compilations

Additionally, to the analysis outlined above to provide further evidence that relies on Chi-square for model fitting, it turned out to have a value of 41.631 with $\rho = 0.000$, offering us substantial evidence that the specification of the model is adequate. To explain the degree of variance within the variables included in the model, the Pseudo R-square value has a coefficient of 0.068, which relies on McFadden an estimation that observes the variance, which is founded on the predicted probability. Based on the outcomes of this estimation, reflecting numerous

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research, it is suggested that the higher its coefficient, the more favorable its fitted model (Pituch and Stevens, 2015). Indeed, about this evaluator, it is important to emphasize that there is no consensus among scientists about the way of its interpretation. Within our specific scenario, we will proceed according to the conclusions of Menard (2011) who proposes that evaluation and interpretation can be performed in those cases when the dependent variable has more than two categories (and in the present instance, the predicted variable is ranked in three categories). Nevertheless, we contend that each of these preliminary tests provides significant evidence of the soundness of the model.

Table 4 Empirical outcomes

	Model fitting criteria			
	-2 Log-Likelihood	Chi-square	df	Sig.
<i>Intercept only</i>	599.314			
<i>Finale</i>	575.676	23.639	10	0.009

<i>Higher NP than 2024</i>		β	SD	df	Sig	OR
	Intercept	-1.066	0.618	1	0.084	
	CO	0.309	0.170	1	0.009	1.362
	TC	0.278	0.122	1	0.022	1.321
	IE	0.100	0.157	1	0.528	1.105
	LE	-0.171	0.128	1	0.083	0.843
	TE	-0.062	0.164	1	0.706	0.940

Other information on the model

Pseudo R-Square	Cox and Snell	0.068				
	Nagelkerke	0.078				
	McFadden	0.034				
KMO & Bartlett's						
Kaiser-Meyer-Olkin		0.713				
Bartlett's Test of Sphericity		530.812			0.000	

Source: author's view

4.4. Findings and Interpretation

Following our model, displayed in Table 4, the findings validated that CO positively influences the Net Profit of SMEs. This argument is based on the coefficient ($\beta = 0.309$, with probability $\rho = 0.009$) which is statistically significant at the 1% confidence. The empirical evidence reported here points out that a unit increase in CO leads to a 1.362 (odd ratios) unit increase in Net Profit. Within a similar vein, several studies that focused on particular businesses have found that corruption boosts their profitability (Imran, Rehman, and Khan, 2019), and also improves the growth of firms (Vial and Hanoteau, 2010). Moreover, the results we have discovered are contradictory with those of the author (Dreher and Gassebner, 2013) who defends the position that paying bribes by SME owners/managers to government officials results in a decrease in profit as a result of unfulfilled business agreements. As stated by Dreher and Gassebner (2013), there is a counterpoint that argues CO can be advantageous since it makes bureaucracies more responsive and agile. Additionally, the result confirms our first hypothesis (H1) that Corruption significantly affects SMEs' net profit.

The second hypothesis (H2) was used to measure the influence of TC on NP. The multinomial regression analysis shows a β value of 0.278 and an ρ - value of 0.022, which means that the discoveries confirm the second hypothesis. The results revealed that TC has a positive influence on NP. Consistent with (Moyo, 2018), we discover that when businesses are motivated to innovate by competition, it leads to more effective deployment of resources and an increase in production itself. Businesses are forced to compete aggressively in a competitive market, which in turn makes them offer better products at better pricing. Competitiveness mitigates inefficiencies by decreasing disagreements within the organization and boosting quality monitoring. Moreover, it inspires additional alternatives for customers, eliminating inconsistencies and the potential for CO and rent-seeking. The Schumpeterian paradigm also argues that competition impedes business expansion (Tuyet and Ninh, 2023). The results we obtained do not correspond in line with the study results of (Gimmon and Aiche, 2021) which indicate that having few competitors encounters an advantageous and substantial influence on growth.

Similarly, the third hypothesis (H3) was utilized to test the influence of IE on NP. The multinomial regression analysis shows a β value of -0.316 and an ρ - value of 0.028, which means that the results confirm the third hypothesis. Based on the results revealed, IE influences negatively the NP of SMEs. The empirical evidence reported here points out that an increase in IE leads to a proportional decrease in Net Profit. Our discoveries are in line with the outcomes conducted by (Skenderi, Islami, and Mulolli, 2017) which confirm that the IE is an obstacle to SME development. Furthermore, the fourth hypothesis (H4) explored the influence of LE on NP. This

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relationship has a β value of -0.062 and a ρ - value of 0.706 which confirms that the influence of LE on NP is not significant. Hence, we rejected the null hypothesis and accepted the alternative one that the LE exerts no profound effect on NP. As stated by (Peeters, Denkers, and Huisman, 2020), the news media, lawmakers, and law enforcement authorities call upon businesses to be socially conscious, and businesses do seem to be reacting to this appeal. Our discoveries do not correspond with the discoveries of Gomez (2016) which imply that the rule of law tends to increase the performance of businesses since equally the investor activity and businesses' expanding activity are boosted under a secure and predictable legal environment.

The last hypothesis (H5) explored the impact of TE on NP. This relationship has a β value of -0.100 and a ρ - value of 0.528 which confirms that the influence of TE on NP is not significant. Thus, we reject the null hypothesis. Our discoveries are not in conjunction with (e.g., Lim, 2011, Hasan et al., 2014) discoveries that by reducing income tax expenses, companies increase their after-tax cash flows, which may lead them to require less debt, therefore strengthening their credit quality, reducing their default risk and consequently lowering their cost of debt.

5. Conclusions

This paper examines the influence of some of the determinants of the external environment such as CO, TC, IE, LE, and TE on the net profit of SMEs. To our knowledge, this is one of the first papers to do so, because many other researchers have analyzed these variables separately. To explore the effect of independent variables on dependent variables we used multinomial regression analysis. From the outcomes revealed we conclude that corruption, tough competition, and the informal economy have a significant influence on the net profit of SMEs, while, law enforcement and tax evasion have no significant influence on SMEs profitability. The discoveries are valuable to developing countries' SMEs and policymakers. Therefore, based on the results of this research, several recommendations and policy implications can be considered which are summarized as follows. First, entrepreneurs must be aware that corruption and tough competition have a positive influence on their business profitability, while, the informal economy has a negative influence on their business profitability.

The straightforward association between competition and performance demonstrates that the government must dedicate greater emphasis on ensuring competition at the appropriate level. The government needs to develop more effective regulations to preserve the high level of competition. If competitiveness in the market remains lower than what is considered ideal, it is necessary to reduce entry barriers to motivate and inspire the founding of new businesses. Moreover, the government

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could modify and augment anti-corruption laws and regulations to promote a more advantageous economic environment. Additionally, we exclusively studied Kosovan businesses due to our restricted ability in data collection. To validate what we discovered in the current study we encourage other research incorporating data from other transition economies. Despite these limitations, the present investigation nonetheless incorporates contributions to the existing literature.

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