Micro Business Financing System and Development of Credit Lines in Albania

Prof. Dr Albert Qarri

Rector of "Ismail Qemail" University,
University of Vlora, Albania,
E mail: bertiqarri@hotmail.com,

Prof. Assoc. Dr Alba Dumi

Management Department, Economy Faculty, Tirana, Albania,
Dean of Graduated School, University of Vlora Albania
Email: besi.alba@yahoo.com

Dr. Ervin Demo

Director of Communication and Public Relation", Management Department,
Economic Faculty, University of Tirana Albania
E mail: ervindemo@gmail.com

Doi: 10.5901/mjss.2012.03.01.33

Abstract *The capacity of public administration was weak; the system, stemming from a party focused environment, was highly politicized. Corruption was pervasive in every facet of the public sector. Citizens feared public administration and did not trust it to provide even the most basic services in a fair or impartial way. The financial collapse in 1997 was a watershed event in Albania's transition from its communist past. It highlighted the problems of Albania's economic governance capacity and, from an administrative standpoint, reaffirmed and highlighted the inefficacy of a public administration, unable to enforce its laws and regulations. As the public's confidence in Albanian[1] institutions had been significantly eroded by the recent events, restoring the public's trust in the government became the main priority of the government. In order to achieve this objective the capacity of the public administration needed to be dramatically strengthened.[2] The donors concurred with this assessment. IDA, starting with the 1998 CAS, considered governance and institution building as one of the central planks of its intervention and identified the need to adopt and implement reforms to build an accountable and transparent state as the most important challenge facing the Government of Albania. Over the next several years, the Albanian Government, in partnership with donors, emphasized institutional reform and capacity building and developed a comprehensive strategy to strengthen the public institutions for more effective governance.[3]*

Key words: *Administrative system, implementing financial reforms, accountable & transparent financial public goals, administration strength micro credit lines.*

1. Introduction

This study empirically examines the impact of debt management policies on borrowing costs incurred by state governments when issuing debt in the municipal bond market. Based on positive political theory and the benefit principle of taxation, it is proposed that states that adhere to best practice debt management policies transmit signals to the credit ratings, investment community and taxpayers that the government should meet

[1] *The Project Development, Project Appraisal Document (PAD) (Report No. 2000, page 59-ALB)*
[2] *Structural Adjustment Credit (SAC & ICR Ministry of finance, Supreme Audit Institute ,year 2009, 2010*
[3] *Ida & CAS report for developing in Albania*

its obligations in a timely manner, resulting in lower debt costs. This was my entire point with temporarily nationalizing the banks. Banks are not going to lend until the bad assets are off their books. Someone is going to pay. If we nationalized, at least we shared on the upside potential. "Three Basic Principles: Using $75 to $100 billion in TARP capital and capital from private investors, the Public-Private Investment Program will generate $500 billion in purchasing power to buy legacy assets – with the potential to expand to $1 trillion over time. The Public-Private Investment Program will be designed around three basic principles: Maximizing the Impact of Each Taxpayer Dollar*:* First, by using government financing in partnership with the FDIC and Federal Reserve and co-investment with private sector investors, substantial purchasing power will be created, making the most of taxpayer resources.

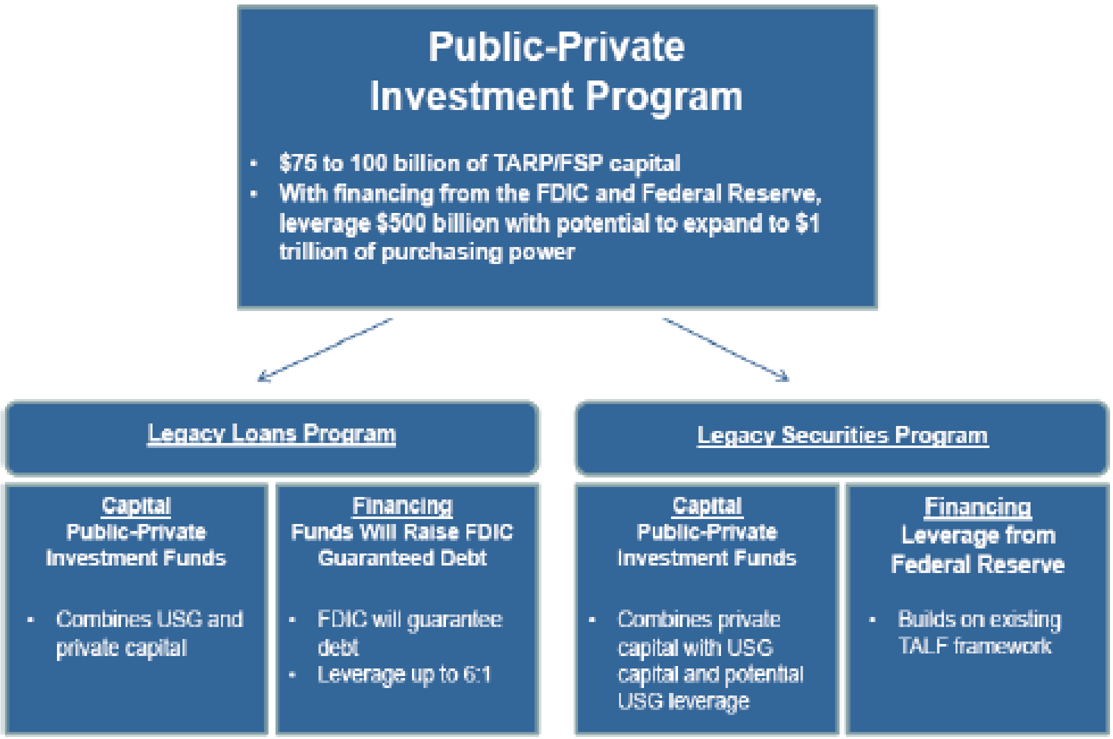
The EU remains Albania's main trading partner, providing 64.1% of Albania's imports and receiving 70.2% of exports as of September 2010. Trade with Italy and Greece, although steadily declining since 2008, continues to represent the largest share of EU trade, with a combined 40.8% of imports and 56.4% of exports as of September 2010. Other major trading partners include Turkey, China, and Germany. The impact of CEFTA in Albania's trade with member countries has been small.[4]

Shared Risk and Profits with Private Sector Participants*:* Second, the Public-Private Investment Program ensures that private sector participants invest alongside the taxpayer, with[5] the private sector investors standing to lose their entire investment in a downside scenario and the taxpayer sharing in profitable returns.

Private Sector Price Discovery*:* Third, to reduce the likelihood that the government will overpay for these assets, private sector investors competing with one another will establish the price of the loans and securities purchased under the program." The partnership and business take place worldwide, in a huge diversity of societies and between widely varying organizations. Actually, the business environment has become more complex, with expanding and deepening ties between societies and between the many organizations within those societies. Moreover, many large organizations now see themselves as truly global in scope, not rooted in any one society. T[6]he aim of this article is to present an overview of the international environment, highlighting the differing levels, from local and national, to regional and international. The discussion focuses on the main identifying features of the business organization, including ownership and decision-making structures, as they adapt in differing geographical contexts. It is emphasized that the multinational enterprise (MNE), central to international business activities, covers a variety of organizations, large and small and the growing interactions between organizations, governmental and societal players are resulting in a broader view of the business organization in society. This argument looks at varying perspectives on globalization, often argued to be the defining characteristic of our times. These are showing on the table nr 1.

[4] *TDS Albanian Europe, internet link 2010, pp 12, 34, 15*
[5] *Private Sector Price Discovery, FDIC, Geithnerr & Mozilo, Japan Bank 2010*
[6] *Albanian Governance report , year 2009*

Table 1. [1] Private Sector Price Discovery, FDIC, Geithnerr & Mozilo, Japan Bank 2010



As a result of a multi-block multivariate regression model[7] the implication of adhering to debt policies aimed at promoting transparency results in a borrowing cost savings in terms of true interest cost (TIC) of close to $8,000 for every $1,000,000 of debt issued (-.769, p<.10). However a comprehensive debt policy is not a significant indicator of borrowing costs. These results suggest a product of a pull push process between the economic forces of the bond market on one hand and politics on the other, pulling the administrative function toward efficiency in the former and democratic values of responsiveness and transparency in the latter. The problem lies in policies that respond to the bond market but virtually exclude any other community interest in policy making. It is recommended that openness in government and allowing taxpayers to understand government services are essential goals in ensuring responsible citizen oversight and providing taxpayers the opportunity to be less likely to propose restrictive initiatives or force dramatic political or management changes through the electoral process or bond referenda.

1.1 Financial Control and Cost Calculation Systems

Most enterprises are used to keeping accurate records for tax purposes, often using electronic tools, such as spreadsheets, to elaborate and present the data. However, only a few of the enterprises use the same kind of tools for cost calculation, break-even point calculation, simulation and sales forecast, etc. MS Excel has built-in formulas and templates for this type of calculations, but few SMEs make use of them. Among the interviewed enterprise owners/managers, marketing skills is the number one perceived training need. Absorbing fundamental marketing theory and practical marketing tools to be applied within their organizations is seen as crucial. In regards to sales, this skill is often confused with marketing, and in most cases the same

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[7] *The finance theory, B Ciceri, H Xhafa January 2000, Capital Cost, (RADR)& (camp) pg 323*

person responsible for marketing will also do the occasional sale activity.

On matters of public administration, the Government's strategy focused on addressing two inter-related sets of interventions: (a) strengthening public financial management, including the management of both public expenditures and revenues; and (b) strengthening human resource management. The Government worked with donors on the public financial management agenda by strengthening core public financial management units (Ministry of Finance, Supreme Audit Institute, Procurement Directorate within the Office of the Prime Minister) as well as the financial & management units within each line agency (e.g., budget departments within line Ministries). On matters relating to public sector human resource management, the reform strategy envisaged addressing this issue in two major stages: civil service reform and broader public sector human resource management reform. During the stage, the reforms aimed to create the managerial and professional nucleus required to lead any serious efforts to improve the accountability and performance of public institutions.

During the first years of the reform, the government focused[8] on improving the legislative framework to ensure that its objectives could be achieved. By 1999, and prior to the approval of the credit under review by this ICR, the Government had identified and adopted a large number of measures which provided important institutional capacity to strengthen the public administration. Supported by the Structural Adjustment Credit (SAC),[9] and Public Expenditure Support Credit, the government undertook a number of pivotal actions which defined the framework of reform. Among them, Parliament [10]revised the Civil Service Law in November 1999, and an independent Civil Service Commission (CSC)[11] was created and staffed.

The recruitment of 50 civil servants under transparent, competitive, merit-based procedures as established under the human resources management legislation was completed.

The Public Administration Reform Project (PARP),[12] under review in this ICR, was an investment credit aimed at supporting the implementation of this ambitious reform agenda.

The credit targeted governance and institution building to support both the public expenditure management and the human resource management agendas. It was complemented by a long series of policy based adjustment operations and extensive economic and sector-related work as well as related activities financed by other donors.

1.2 Original Project Development Objectives (PDO)

The Government of Albania has adopted a comprehensive policy reform program to strengthen Albania's weak institutional and governance capacity. This policy reform program is being supported by a Structural Adjustment Credit, which was approved by the Bank in June of 1999. [13] (The data are showing at the end or paper in [13] index)

The overall objective of the proposed Public Administration Reform Project is to provide required resources for technical assistance, training, goods and incremental operating costs that are needed to implement the Government's Institutional and Public Administration Reform agenda effectively. The Development Credit Agreement (DCA) states the objective of the project to be: The objective of the Project is to assist the

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The Project Development, Project Appraisal Document (PAD) (Report No. 20059-ALB)

[9] *Structural Adjustment Credit (SAC) Report 2009 , CSC Report 2010*

[10] *Albanian Parliament 2010[10] Credit report & general Albanian BANK, YEAR 2008*

, Crediting of micro-business, The Project Development, Project Appraisal Document (PAD) (Report No. 20059-ALB)

[11] *Civil Service Commission (CSC) FOR MICRO BUSINESS FINANCING*

[12] *The Project Development, Project Appraisal Document (PAD) (Report No. 20059-ALB)*

[13] *Real GDP growth (2009 est.): International Monetary Fund 2.8%, Ministry of Finance 3.3%; (2010 pp 64): International Monetary Fund 2.6%, Ministry of Finance 4.1% .)Inflation rate (2009): annual average 2.3%; (as of November 2010): 2.8%. (Albanian Institute of Statistics)*

Unemployment rate (2009): 13.75%; (as of September 2010): 13.52%. (Albanian Institute of Statistics

Borrower to improve its capacity with regard to policy formulation and coordination, and administrative performance so as to create conditions that will encourage the Department of Public Administration of the Borrower to improve their service delivery.

2. Micro Business Financing and Credit lines

Credit lines are considered as a limit granted to a customer for use within a specific period of time. Credit lines are not used as an 'extension' of a current account of the customer and can only bear debit balances. Micro businesses often use working capital to pay short term obligations as inventory or it can be also utilize for long term projects such as renovations or expansion. If working capital dips too low, a business risks running out of cash. The small loans can be used as a fast cash option to caution the periods when cash flow is not available. Cash flow is the micro business life blood and every owner's primary task is to help keep it flowing and use the cash to generate profits. The faster a business expands the more cash it will need for working capital.

2.1 Eligible Customers

Credit Lines are given mostly to Physical Professionals Persons and Micro Business customers such as shops, groceries, pharmacies, bakeries, mini-markets, small manufacturing workshops etc. The common characteristic of these businesses are that they are established on family base, limited employment (up to 5 people). For example: Tirana Bank will offer them a full range of banking services, including: personal and business deposits and loan accounts, buying and selling of foreign exchange; paying taxes, phone bills settlement etc.

Table 2. Credit Proposal for "Professional Facility" SME Product

Purpose	To cover the needs of clients Professionals for Cash Liquidity.
Min / Max Loan Amount	- Min. 1,000 EUR or equivalent ALL, USD. - Max. 10,000 EUR or equivalent ALL, USD.
Loan Security	- Personal guaranty of borrower, co-borrower or Guarantor if necessary.
Currency	EUR, ALL, USD
Interest rates	- First year fixed interest rate. ALL = Treasury Bill (12 Months) +8.5 % EUR = Euro bor (12 Months) +7.5% USD = Libor (12 Months) +7.5% Floating rate: The interest rate will be floating every 3 months, respectively at 15 March, 15 June, 15 September, and 15 December, to be linked to a national and international index (Treasury Bill / Euro bor / Libor).
Overdue Interest	3% + interest
Insurance	Not Necessarily
Max LTV	n/a

Loan period	Up to 12 months renewable (based on renewal criteria of Tirana Bank).
Repayment Method	- Quarterly payment of interest. - The principal to be renewable every year.
Grace period	Not Necessarily
Disbursement	Crediting the borrower's sight account.
Fees and commissions	- Administrative expenses 1.5% flat fee with Min 50 Euro.
Penalty fee for pre-payment	1. There is no repayment penalty, 0 fees.
Age	Min 18 years (preferably 25 years old)Max 60 years
Professions / Length of Employment	Customers – target group The loan is intended exclusive for professionals (Doctors, Pharmacist, Dentist, Lower, Notary, Authorized Financial Expert etc). The owner of the company called borrower. In the event of more than one applicant the others are called co- borrowers/s. The persons / legal entities who guarantee the loan contract are called Guarantors. Professional stability Borrower | Stability conditions

2.2 The Purpose of the Credit Lines

Used to pay for current assets such as inventory, accounts receivable and other working capital requirements; seasonal financing, contract performance, financing against existing inventory and receivables, or to purchase an existing business. These credit lines are not indented for purchases of equipment or real estate.

2.3 Ineligible or not Appropriate use of Credit Lines Proceeds

a. The borrower cannot demonstrate the ability to repay the loan
b. The business involves gambling activities, real estate investment or other speculative activities or intention to use the proceeds for an unsound business purpose, repay delinquent withholding taxes, make a change in ownership or business that will not benefit the business, refinance existing debt where the bank might sustain a loss or reimburse funds owed to an owner of the business. *The Credit Requirements (Tirana Bank example)*[14]

Tirana bank considers a variety of factors when determining if an applicant is creditworthy as follows:

a. The applicant performs active business for minimum 2 years
b. No litigation is pending against the client

[14] *References data of confidence from Tirana Bank year credit lines 2009*

c. Cash flow generated from the business
d. Management experience
e. Credit history and character.
f. The owner's equity contribution
g. The collateral offered
h. How quickly the business collects money owed for its goods and/or services, whether has a profitable history, if sales are stable or growing, how the business is positioned against its competitors, etc

2.4 Credit Department

a. Within 24 hours the Credit Proposal is presented for approval or denial.
b. Credit Department notifies the branch of the decision via fax and with a follow up duly signed Credit Proposal.[15]
c. Depending on the loan, additional information may be requested as income verification.
d. If the loan is denied the Branch contacts the applicant and provides details of why the loan is rejected.

Credit lines are actually open ended loans, with review periods usually equal to 12 months. The accounts are reviewed close to the end of their review period and the line could either be renewed for another term of 12 months, or matured.

2.4.1 Term Renewals

The fate of the credit lines, i.e. whether it will be renewed or not, as well as the limit amount assigned to the line for the new period (if renewed) will determine how the outstanding principal will be treated and how renewals will be handled. Renewals will be only for updated credit lines.

More specifically:

In case of non renewal of the credit line, the whole outstanding principal (apart from any other due items) will be due on the expiry date and payment should be effected, otherwise it will be considered overdue (i.e. in delay).

In case of renewal of the credit line, with the same or increased limit, the whole outstanding principal due date will be carried forward to the new expiry date of the credit line. E.g. in case a credit line is originally given with a review period of 12 months, which expires on the 1st of December 2006, any principal disbursed on the loan will be considered as due on the 1st of December 2006. Any repayment to the loan, reducing the outstanding balance should be taken against the principal due on that date.

If this credit line is renewed for another 12 months, the due date for the outstanding principal on the 1st of December 2006 will be shifted to the 1st of December 2007. There is no requirement to repay the whole outstanding balance of the credit line, prior to starting out the new term. In case of renewal of the credit lines, with a lower limit amount, then any outstanding principal, in excess of the new limit amount should be repaid on the review date of the line. E.g. assuming that in the above example, where the line expires on the 1st of December 2006, and the approved amount is 40.000 EUR and the outstanding principal on the expiry date is 40.000 EUR (fully- utilize). The line is renewed for another 12 months, the new term expiry date is set to the 1st of December 2007; however the limit amount for the new term is 30.000 EUR. The outstanding principal in excess of the new limit (i.e. the 10.000 EUR) should be repaid on the 1st December of 2006, otherwise it will be considered as overdue.

[15] *Referenced data "Credit department" general Albania bank,2007, 2008, 2009*

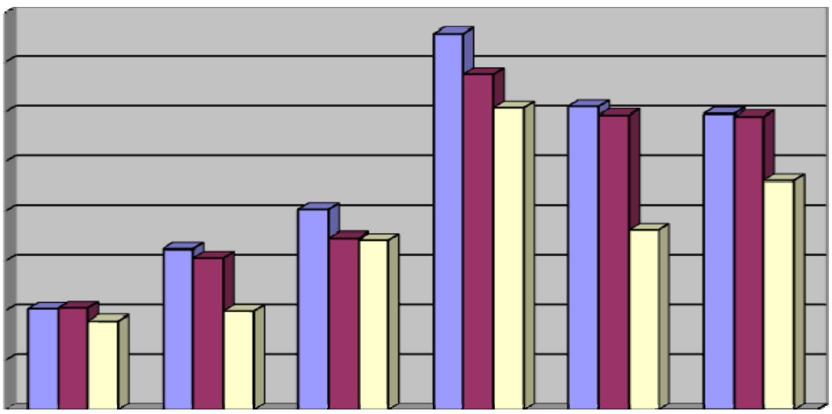
Interest Rates[16]

Interest rates are floating:

a) ALL loans 1 Year Treasury Bills rate + 5% (min 12%)
b) EUR loans EURIBOR 1 Year +6% (min 11 %)
c) USD loans LIBOR 1 Year + 6% (Min. 11 %)

The above interest rates are pegged on interest payment frequency on a 12 month basis. The interest rates are re-pegged to the base rate value of the renewal date.
The margins are negotiable and can vary according to the agreement with the customer.
This Albanian reform allows banks to better evaluate the creditworthiness of potential borrowers, facilitating access to credit for firms and individuals. Albania also strengthened investor protection. A new company law requires that disinterested shareholders approve transactions between interested parties and obligates those parties to disclose all information on the transaction to the public. The law also reinforces directors' duties and requires directors, when found liable, to pay damages and return profits to the company. A new bankruptcy law approved during 2008 provides a more efficient framework for closing a business.
Despite good progress in those areas, Albania needs to do more to improve its ranking in other indicators. In addition, much remains to be done because the report doesn't measure other important indicators that have significant impact on the business climate like corruption, infrastructure and the efficiency of the public administration.

Table 3. Interest rates (ALL loans, EUR loans, EURIBOR, USD loans). The payment frequency on 12 month and indicators of loans are confidentially data.



2.4.2 Re-Payment Schedule

The type of schedule for credit lines depends on the type of the Credit line. More specifically: There is no specifically assigned due date for the principal, the customer can repay the outstanding principal at any time (fully or partially) within the term of the line, so that the funds are once more available for re-use. In case no repayment is done for the whole term of the line, then the outstanding balance is considered as due on the expiry date of the line (depending on whether the line is renewed or not). This is very similar to the above; it is contracted that the total of the outstanding balance should be repaid on the expiry date of the line.

[16] *Repayment schedule Libor per year report, December 2006, 2007*

2.4.3 Decreasing Lines

These are the only cases, where there are specific repayments scheduled within the term of the line. Decreasing lines are those, where there is a scheduled decrease of the limit amount within the term of the loan. In case of non-payment, then the amount is should be considered as overdue and delinquency processing should take place. A line can shift from one type to another, especially between a random repayment and a decreasing line type. E.g. it might start as a random repayment line, however in the middle of the term, a decrease to the limit might be considered and scheduled, which will turn it to a decreasing line. On renewal, it might be renewed with the same approved limit, so that it will once more be considered a random repayment line.

3. Payments and Interest Rate

Apart from the interest payments, the customer can freely *repay the outstanding balance* of his loan (this is not considered as an early repayment), so that he can re-put the available balance of his account. When such repayments are made to credit lines (and if no other due items exist), the total amount should be taken against the outstanding principal. No interest accruals are to be paid by the repayment amount. A margin of 3% over the regular interest is charged on overdue principal and interest. When the maximum amount charged within the term is reached by a disbursement, further disbursements within that term are no more chargeable. In case, there is an increase of the limit within the term of the line, then the maximum amount that can be charged within the term is also increased by the same percentage (1% or 0, 3%) on the increase amount and subsequent disbursements will be charged up to the new admin fee total amount. The fee should be posted to the repayment account after the disbursement credit, as a separate posting. The above depends on the type of the credit line, as explained in the previous chapter, with the decreasing lines being the exception where scheduled repayments exist.

3.1 Collaterals

Any type of Bank's accepted collateral can be assigned to credit lines. It is rather common, that such lines are given under a first rank mortgage security in favor of Albanian Bank (commercial premises take the preference or residential premises can be accepted as well), which generally have to be: owned by borrower or co-borrower, easily marketable and preferably divisible. The LTV (loan to commercial value of offered real estate) will not be higher than 50%. For example for a shop of 50.000 EUR commercial value the maximum loan will be 25.000 EUR.

The appraisal of mortgage: will be done from the branches according to the standards procedure and the appraisal reports have to be signed from branch managers.

1. Non-life securities: Property insurance for 100 % of commercial value
The core set of measures of impacts on institutional performance to monitor intermediate institutional impacts is indicated in the PAD. It includes an extensive list of indicators, some of which were intended to help the Government focus attention on the longer-term objectives of its reform effort, and to capture the more immediate and concrete progress.

2. *Policy and Public Expenditure Management*: aggregate fiscal discipline including inflation rate, revenue predictability, and fiscal aggregates; strategic prioritization including policy volatility, delays in auditing, and deviation from functional appropriations and operational efficiency including representative deviation by spending units at sector level, and transparent, competitive procurement Public Sector Human Resource Management: fiscally sound pay and employment practices including the number of civil and public servants

in comparison with international practices, and fiscal weight of public employment in comparison with international practice; competitive and non-arbitrary remuneration including civil service pay (vertical and horizontal compression), and comparisons with the private sector; and human resource management based on rules, performance and fairness including rule credibility, and limited incidence of political appointees in the civil service project was complemented by several other investment operations, including health, education, social services, land development, agriculture services.

3. *The objective of putting two sets of reforms* under the umbrella of a single project was to improve the odds of collaboration between the two central agencies leading each of these reforms; i.e., MOF and DOPA. Yet experience with these sets of arrangements seems to indicate that engendering the needed collaboration in practice is quite difficult and rarely materializes solely on the basis of project coordination. Instead, including public expenditure reforms and public administration reform in the same investment instrument only added complexity to project implementation. It also increased the need for disparate skills within the supervision team. In this context it is important to note that the Bank tends to make standard allocations for supervision notwithstanding the project's complexity.

However, these measures would have significantly delayed Board presentation of the project and there were merits perceived to have the investment project approved at the same time as the SAC as leverage from the SAC helped spur the Government to move on key preparation elements. Given this strategic choice to go ahead with Board presentation despite the inadequate preparation of the Treasury System component, the project's implementation timeframe should have been extended to take into account the system's incomplete design.

Conclusions

Bank of Albania assesses that the difficult situation the international financial markets are going through, augments the risk for the Albanian financial system. Due to certain factors related to the characteristics of the local financial activity, such a difficult situation in the international markets is not expected to impose a real and considerable impact on the internal financial market. However, the situation in the financial international markets remains unstable, thus its impact on the internal financial market could change. For that reason, it is needed that the financial institutions and the regulative authorities of the country, follow and analyse carefully these events.

As factors that presently safeguard the Albanian financial system from the un-favorite events occurring in the international financial markets, we can mention as follows:

a) the quite well financial situation of the system and particularly of the banking sector;
b) the absence of the similar and sophisticated financial products, whose value was recently shocked throughout the international financial markets;
c) the rather low levels of the need for financing in the international financial markets from the Albanian financial institutions, and particularly from the banking sector, as there is a lot of space to provide for its financial needs by the internal sources;
d) the rather restricted direct and indirect exposure of the Albanian financial institutions, and particularly of banks, in other institutions and financial products, whose value is negatively impacted by the difficulties of liquidity in the international financial markets;
e) the limited exposure and financially affordable of the European banking groups that operate in Albania, versus "sub-prime" loans financing scheme of the United States of America;
f) The well financial performance demonstrated in these last years by the financial institutions and by the European banking groups that has built on a better financial protection, through the standart of the necessary reserves and the sufficient of the activity to absorb such shocks.

The financial sector in Albania has in general been spared from the global financial turmoil, primarily due to the low amount of loans in relation to total deposits. Also the lack of a housing/construction bubble has minimized pressure on the banks. However, a significant reduction in bank deposits took place in the fall of September 2008 as individuals withdraw their money due to fear from losing their savings. Since October 2008 deposits dropped by about 15% and during 2009 they were below their top level. After summer 2009 there has been a stable increase in bank deposits and by the end of 2009 they reached their pre-crisis level. Lower deposits created some liquidity issues but banks were well equipped to face the situation. Banks have increased their equity capital to better face the situation and also BOA has an active monitoring program to ensure enough liquidity in the banking sector. The financial sector is totally dominated by commercial banks funded with private capital. Currently, 16 banks are operating in the country – two domestically owned banks and 14 foreign or joint ventures. The degree of market concentration remains fairly high as the five largest banks dominate the market with about 75 percent of total assets. The performance of the financial sector in channel savings towards productive investment has substantially improved, but still remains weak in comparison to Western standards.

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