

SMEs and Enterprises, Represent Potential Employment and Economic Growth in Emerging Economies in Albanian Development

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Doi: 10.50901/mjss.2012.v3n11p63

Abstract: Small and medium-sized enterprises (SMEs) are the backbone of all economies and are a key source of economic growth, dynamism and flexibility in advanced industrialized countries, as well as in emerging and developing economies. SMEs constitute the dominant form of business organization, accounting for over 95% and up to 99% of enterprises depending on the country. They are responsible for between 60-70% net job creations in OECD countries. Small businesses are particularly important for bringing innovative products or techniques to the market. Financing is necessary to help them set up and expand their operations, develop new products, and invest in new staff or production facilities. Many small businesses start out as an idea from one or two people, who invest their own money and probably turn to family and friends for financial help in return for a share in the business. But if they are successful, there comes a time for all developing SMEs when they need new investment to expand or innovate further. That is where they often run into problems, because they find it much harder than larger businesses to obtain financing from banks, capital markets or other suppliers of credit. This "financing gap" is all the more important in a fast-changing knowledge-based economy because of the speed of innovation. Innovative SMEs with high growth potential, many of them in high-technology sectors, have played a pivotal role in raising productivity and maintaining competitiveness in recent years. If SMEs cannot find the financing they need, brilliant ideas may fall by the wayside and this represents a loss in potential growth for the economy.

Key words: SME developing programs, financial help, innovations, raising productivity, financing gap

1. Introduction to management and types of SMEs

Since the late 1990s, Albanian Government has undertaken several structural reforms, involving land reform, financial market liberalization and privatization. During this time, almost all Small and Medium-sized Enterprises (SME) have been privatized and significant progress has been made in the privatization of strategic sectors, like telecommunications and banking. The banking sector has gradually increased the amount and quality of loans and financial services to SME-s. (Angjeli A, 2011)

The Government has adopted a new bankruptcy law and established a new Agency for supporting the deposit insurance scheme. Moreover, on October 2002 a new Law on SME-s was adopted, followed by a broader strategy on SME-s, which subsequently led to the establishment of the Agency for SME Development in June 2003. The "bag" vacuum cleaner and the "wind-up" radio or flashlight which need no batteries are now common household items, but nearly failed to see the light of day because their inventors could not find financial backing to transform their ideas into production. The difficulties that SMEs encounter when trying to access financing can be due to an incomplete range of financial products and services, regulatory rigidities or gaps in the legal framework, lack of information on both the bank's and the SME's side. Banks may avoid providing financing to certain types of SMEs, in particular, start ups and very young

firms that typically lack sufficient collateral, or firms whose activities offer the possibilities of high returns but at a substantial risk of loss. (MOE Report 2010)

1.1 What are the obstacles to SME access to financing?

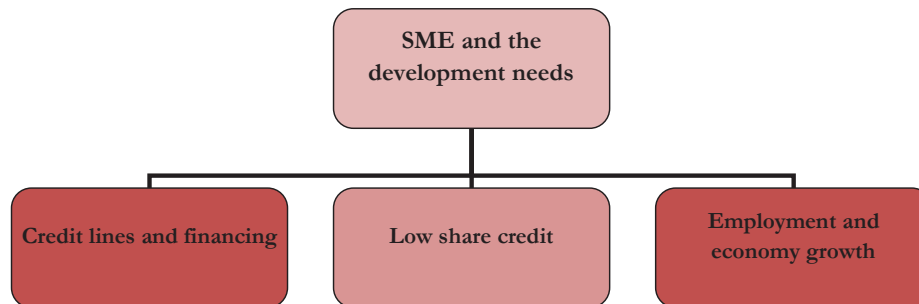
The paper contents five sections which describes the main barriers of small and medium enterprises in Albania to growth in the first section. The second section is focused on the main economic feature and the characteristics of the market size in Albania. The discussion is followed in the third and fourth section aiming to shed light on the implementation of the competition law and policy in Central and East European countries and presents some of the issues faced by the Albanian reforms. The final remarks indicates the main issues that should be considered in assessing the level of the enforcement of the competition law and policy. (Dumi A, JERM USA 2012)

SMEs tend by their very nature to show a far more volatile pattern of growth and earnings, with greater fluctuations, than larger companies. Their survival rate is lower than for larger companies – one analyst found that manufacturing firms with fewer than 20 employees were five times more likely to fail in a given year than larger firms. Thus, SMEs are at a particularly severe disadvantage when trying to obtain financing relative to larger and more established firms. It can also be difficult for potential creditors or investors to distinguish the financial situation of the company from that of its owners. If there are two cars in the driveway, can one or both be considered part of the company's assets? If the owner dies, is there someone to take over the business, or will it die with him or her? If entrepreneurs cannot gain access to finance through the regular system, they may not start up a business or simply go out of business, a potential loss to the economy.

Albania has entered a new phase of economic reforms for a better future and the prosperity of the country. The country's development is linked to the strengthening and enhancement of the private sector, which is one of the strongest pillars for ensuring the successful integration of Albania into the European Union. (Sykja B, 2011 MOE Report)

The Government is committed to create a better climate for business and is guided by the motto "Albania is the most attractive country for new investments" But the other danger is that they will abandon the formal system altogether and operate in the informal economy, sidestepping taxes and regulations, and thus not making a full contribution to economic growth and job creation. In most countries, commercial banks are the main source of finance for SMEs (Figure 1), so if the SME sector is to flourish it must have access to bank credit.

Figure 1. Commercial banks, the main source of finance for SMEs



2 Literature Review and Hypotheses

2.1 Data from Albanian SMEs

The Program for the Development of SME-s in Albania is greatly helping local businesses, especially SME-s which make-up 95 percent of all companies in the Albanian market. In one way or another, they end up in the environment resources that may be a combination of air, land and water resources. The overall SME financing gap is particularly pressing in non-OECD countries, since the bulk of them report a widespread shortage of financing for all categories of SMEs. Micro-credit and micro-finance schemes play an important role in developing countries and efforts should be made to boost their effectiveness and diffusion. Any provision of official funding should respect the principle of risk sharing, so official funds should only be committed in partnership with funds from entrepreneurs, banks, businesses or universities. Governments

should also look at whether government- technical support can be used generate the emergence of business angels and to make the existing business angel systems operate more efficiently.

This Program is of particular importance for the Ministry of Economy, Trade and Energy and the Albanian Government, more generally, because it potentiates the fast-paced development of the country's economy. (Source MOE, Albania 2011)

The Program consists of three components:

2.5 million Euro for the development of the Guarantee Fund which helps SME-s obtain loans when they lack collateral;

1.7 million Euro grant for technical assistance aimed at capacity building for the Program's implementation and, more generally, for the initiation of SME-s in the domestic financial market.

25 million Euros of soft loans for the line of credit of SME-s.

Even though SMEs account for a large share of enterprises, and represent potential employment and economic growth in emerging economies, they receive a very low share of credit. Indeed, most of them are denied any access to formal financial markets. The characteristics of the banking system in emerging markets frequently inhibit SME lending.

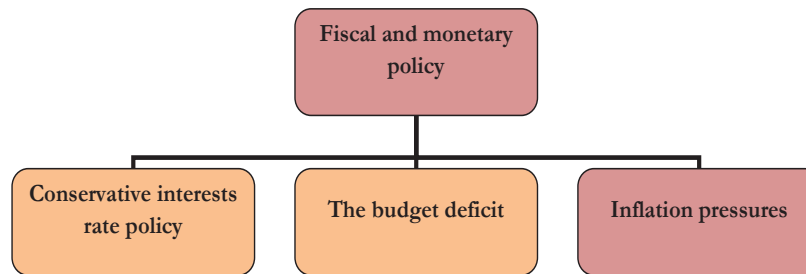
2.2 Literature and Development concept

The economic growth was also stimulated by the rapid increase of business loans. Loans for the private sector ranged from 6.4 percent of the GDP in 2002 to 37.4 percent of GDP in 2009, meanwhile the annual growth rate varied from 41 percent to 74.9 percent (the highest reached in 2005). During 2009 the bank insecurity and the hesitation of businesses noted a growth of loans of only 12.1 percent. Chart 2 below provides a comparison of the economic growth in Albania and other South Eastern Europe Countries (Sicignano A, 2011 DIDC in Albania)

2.1.1 Monetary policy and Albanian budget deficit

One of the key aspects of economic policy in Albania has been the tight fiscal and monetary policy. The budget deficit has been declined from 9 percent of GDP in 2000 to 6.6 percent in 2002. In addition, Bank of Albania has played a conservative interests rate policy by keeping its key interest rate well above CPI. Figure 2 shows that in 1996 and especially 1997 the economy lost its momentum, reflected also in the increase of CPI (end of period) by 22.7percent.

Figure 2. In 1996 and especially 1997 the economy lost its momentum, reflected also in the increase of CPI



H1. Governments should also act to improve awareness among entrepreneurs of the range of financing options available to them from officials, private investors and banks.

General Business Development: The ambition and comprehensive macroeconomic program undertaken by Albanian Government after 1997 yielded quick results in macroeconomic stability followed also by increasing real GDP at satisfactory rates. Over the period 1998-2002, contribution of private sector in GDP growth is obvious. In the Report this is demonstrated by increasing share of service sector (where dominate private firms) to GDP formation, as well as in increasing the number of employment in private enterprises compared with those in public enterprises especially in construction and trade sectors. Private sector's contribution to GDP became more important.

SME-s contribution in economic growth

The assessment of business development based on Structural Business Surveys of INSTAT over the period 1998-2002 revealed the following peculiarities in SME-s development: 1. Business development for small and medium size enterprises have been quite satisfactory. In particularly the very good performance the SME-s sector has shown in construction and transport sectors. 2. Small and medium size enterprises in industry and construction are the main generators of employment growth in comparison with other non-agricultural sectors. 3. Over the 1998-2002 period labor productivity for small and medium size enterprises have been almost doubled. Increasing the volume of investments for small and in particular for medium size enterprises during the 2002 year is an indication that SME-s will increase their impact on economic growth and employment in general. Government measures to promote SMEs should be carefully focused, aimed at making markets work efficiently and at providing incentives for the private sector to assume an active role in SME finance. Where necessary, banking systems should be reformed in line with market-based principles.

H2. Policy makers need to ensure that the tax system does not inadvertently place SMEs at a disadvantage.

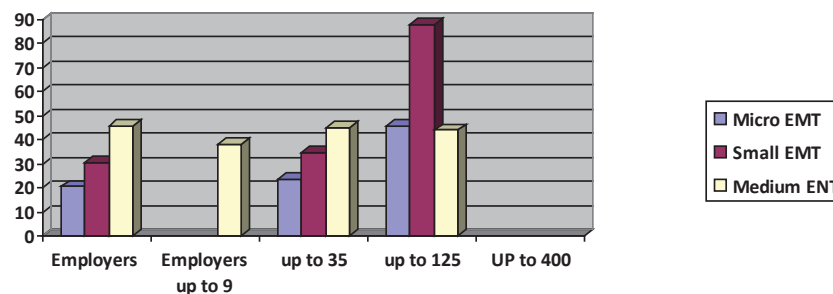
They should also review the legal, tax and regulatory framework to ensure that it encourages the development of venture capital. At the same time, national policies should encourage diverse forms of institutional savings and institutional investors should be regulated flexibly. The market for corporate control should be allowed to function efficiently for both domestic and foreign entities

3. Methodology and Research Goal

SME Financing from Financial Institutions

Traditionally, however, financial institutions in Albania have been cautious with lending to SME groups because of high default rates and risks associated with the sector. Few banks have therefore developed an explicit policy for SME target groups taking the particular requirements and needs into consideration, e.g. developing earmarked financial products and appropriate credit management systems. Only few banks have SME specific loan products, and many of these are donor funded. Few banking institutions have SME desks or departments. SMEs play an important role in all economies and are key generators of employment, earnings and economic growth stimulators. According to an OECD study on countries that belong to this group (OECD), SMEs employ more than half of the work force, meanwhile in European Union countries they make up 99 percent of all enterprises. Furthermore, 99 percent of these enterprises in EU countries are micro-firms with less than 10 employees. (Global Financial Stability Report, October 2008).

Graph 1. *The distribution of working force in three types of SMEs*



In Albania, small and medium enterprises represent 99.6 percent of all registered business entities. In 2008, the SME sector provided 72.9 percent of the GDP and employed 71.4 percent of all active work forces. The SME activities in Albania are focused in the local market and very few work in the export sector. For the others, lending to micro and small businesses is simply transacted by credit officers from corporate finance departments of the bank who generally apply the same appraisal and lending principles to SMEs. None of the commercial banks have any specialized training for credit officers in proven SME lending techniques, and most credit officers do not have any prior SME specific experience. (Annual Report, 2009)

Why SME Credit Schemes Have Been Ineffective? We have concluded that SME financing in Albania has generally not been effective. What are the reasons?

The key missing factors are: 1. Adequacy of the institutional framework 2. Legal and Regulatory -Framework 3. SME Managerial Capacity and Lack of Training 4. Adequacy of Development in progress of Institutional-Framework.

Among the resources needed for the production of goods and services, there are many things that set capital apart from the other inputs. Assets such as equipment and land provide benefits that derive from their physical characteristics. (Annual Report, 2001) Unfortunately we cannot say the same thing about the financial resources used to run a business. The acquisition of financial resources leads to contractual obligations. Here are some examples:

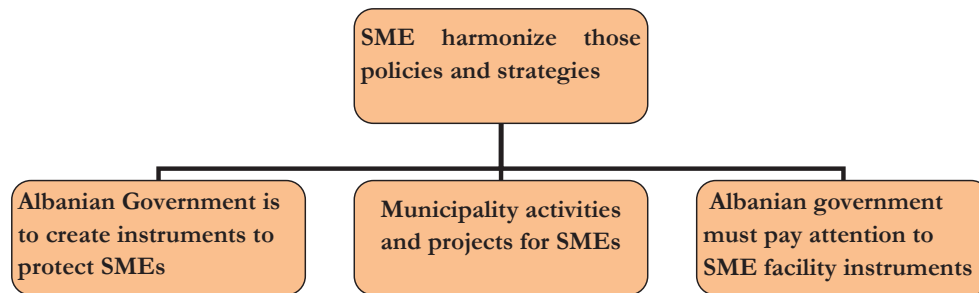
1. When a bank lends money to a business, the loan generates a contractual obligation between the borrower and the business. Under the loan contract, the lender is entitled to receive specified payments of principal and interest during the term of the loan. If the business is a sole proprietorship or partnership, the owners of the business are personally liable. If the loan is to a corporation, the corporate entity is liable. 2. An investment in the shares of a business is also a contractual relationship. Shareholders are entitled to share in any earnings which are distributed as dividends. In addition, shareholders are entitled to their pro rata share of the net assets of the company upon liquidation

4. Findings of this paper research

From the above, we conclude as follows:

- There is a strong demand for the government to elaborate and implement policies and strategies for financing SMEs as well as for developing and improving financial institutions and financial instruments;
- There is a need to harmonize those policies and strategies as well as the instruments for implementing them
- The legal framework plays an important role in the creation and successful operation of SMEs and should encourage a simplification of the procedures involved in the creation, financing, training and other aspects of the SME sector;
- In Albania, banks do not pay sufficient attention to the development of SMEs. The role of Governments should be to open the dialogue and to create instruments together with the banks to promote the financial aspects of successful SME development;
- There is a great need for improving different aspects of financial services for SMEs such as seed money, leasing, venture capital, and investment funding. There is a lack of long-term loans; interest rates are still high, etc.

Fig. 3. Promotion of SME's development in all regions of Albania



Promotion of SME-s to increase the number of employees, as well as eliminating the phenomena of hiding the real number of employees (informality) and informal economy. The coordination and monitoring of the programs related to the European Charter of Small Business remain as very important objectives.

5. Conclusions and Recommendations

The analysis regarding the overall business environment in Albania leads us to the following conclusions:

1. The economic program undertaken by the Albanian Government at the end of 1997 allowed the economy to bounce back at the same rate as before the 97' crisis. The strong economic performance continued in 2000 and 2001. GDP

growth declined in the fourth quarter of 2001. This slowdown, which continued also in 2002, was mainly related to power shortages and the slowdown in the world economy after September 11.

2. Albania, in the last 5 years, has followed a tight fiscal and monetary policy. The budget deficit has declined from 9 percent of GDP in 2000 to 6.6 percent in 2002. In addition, the Central Bank of Albania has played an active interest rate policy by keeping its key interest rate well above CPI. Inflation pressures were kept under control in 1998 and CPI has moved in the narrow band of -1 to 4 percent in recent years. Interest rates applied by commercial banks for credits in Lek have decreased in the last 3 years.

3. After 1999, employment in private firms increased much faster than in public firms. This can be explained by the acceleration of the privatization reform in Albania in early 2000, which was followed by an increase in the share of employment in the private firms in the industrial sector by about 9 percent in 2002. On 2010 the development of SMEs are with 45% more than 2008

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