

The Role of Small Medium Enterprises on Albania Economy Challenges of Their Development: Case of Korca Region

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Abstract: *The study analyzes trends in development of SMEs and their impact on the national economy. This study serves as an important instrument for the formulation of the best government policies in promoting SME development in Albania and in particular in the region of Korca. The paper deals with the analytical aspects of the problems that business and financial lending institutions face. The paper treats theoretically the role and importance of SME sector on the national economy and various financing alternatives for the business.*

The main objectives of this study are: a) analysis of the role of SMEs in national economy, b) presentation of the current situation of SME financing and external financing resources as barriers to business development, c) identify financial needs of SMEs and their financial problems, d) review the current situation of lending to small businesses, such as; how much SMEs are investing during last years, what are the former resources, what are the difficulties for financing SME from the view of banks or non-banks, which are the sectors of economy that financial institutes prefer more, e) how many banks and foundations lend and what is the situation in different sectors such as trade, manufacturing, transport and service f) the challenges of SMEs development and the prospects of funding to businesses in Albania and in particular in the region of Korca.

Keywords: *SME, Financing, Regional development, Loans, Financial institutes.*

1. INTRODUCTION

SMEs are important to almost all economies in the world, but especially to those in developing countries and, within that broad category, especially to those with major employment and income distribution challenges.

Small and medium-sized enterprises (SMEs) are a very heterogeneous group of businesses usually operating in the service, trade, transport, and manufacturing sectors. Some are dynamic, innovative, and growth-oriented while others are satisfied to remain small and perhaps family owned. SMEs usually operate in the formal sector of the economy and employ mainly wage-earning workers.

In terms of organizational structure, SMEs are, on average, considerably more complicated than microenterprise, which involve largely the self-employed, sometimes accompanied on the job by a few family workers and hence usually having under- five workers.

The SME sector also plays a key dynamic role in generating growth, especially pro-poor growth. Nearly all developing economies have large micro enterprise sectors that, like the SME sector itself, are highly heterogeneous in many respects--the goods or services produced the entrepreneurial capacity of the owner, and the potential for growth, etc.

Many are survivalist in character but others have dynamic potential. In most countries for which such data are available it appears that most small firms began their lives as microenterprises and then grew. Thus the SME sector is to a considerable extent the place where successful micro enterprises wind up, through a process which is at least in part one of survival and growth of the fittest. This positive selection process will of course be less prominent if for policy or other reasons it is hard to operate SMEs in a given country.

SMEs tend to use medium-sophistication technology, which is approximately consistent with the factor endowment ratios in most developing countries. Many firms "grow into" or "grow out of" the SME size range, with both of these transitions having something positive to be said for them.

The frequency with which SMEs manifest a capacity to grow fast and to innovate has, partly as the other side of the same coin, higher failure and exit rates than do large firms.

In part this reflects a “survival of the fittest” process in which firms lacking strong entrepreneurial skills or simply in bad market niches do not survive. Few estimates have been made of the sort of deadweight loss associated with firm failure and the extent to which it lowers the average efficiency in resource utilization of the SME sector as a whole. The issue is complicated, since sometimes failure is a factor contributing to the longer run development of entrepreneurial capacity, since some of the physical capital of failing firms is not wasted but purchased and used by other firms, etc.

Even short of actual exit, many small firms suffer significant shrinkage at certain points in their lives, with negative implications for the job security of their employees. The costs of such insecurity are hard to tote up and the difference with large firms is one of degree.

Getting the most from the SME sector requires better support systems, either from government or collective action by the SMEs themselves, than those required by larger firms. This is essentially because some needs of SMEs are in effect public goods while the parallel needs of larger firms can be effectively handled privately. The implication is that in countries with governments of limited competence the SME sector will not perform to its real potential.

Considering the developments of global financial markets in recent years, it is done this study, to present a complete approach of the role that SMEs have in the national economy, the problems of financing their activities and the challenges of small businesses development. The paper is a product not only theoretical, but it is based on different website navigation, as well as ongoing research and studies that are made in Korca region and beyond.

As we mentioned above, small medium enterprises have a significant role in the national economy. So, the government, the financial and nonfinancial institutions must support the opportunities of financing the development of SMEs.

In order to provide quality information on current activities of SMEs and those planned for credit and their attitudes on the opportunities and barriers of lending, it is designed a questionnaire to several private ventures and financing institutions in the region of Korca. This study includes the key members in financing small businesses such as the micro-credit institutions and commercial banks. After the detailed analysis that is presented on the survey, about needs, resources and difficulties in financing the small enterprises, it is found that 60% of businesses have declared in favor of long-term loans, while the majority of commercial banks and other financial institutions prefer short-term loans. Furthermore, 44% of other financial institutions, loans were given to individuals while 41% of bank loans were given to large businesses. Also by studying the situation in the region of Korca, it resulted on high rate of interest which must be constantly negotiated among financial institutions and borrowers, because it is considered the most difficult key in the application for loans by the small businesses.

At the end, the study concludes with the results from the research as well as recommendations for supporting small business development and creation of various facilities for the reduction of financial problems.

2. LITERATURE REVIEW

It is important to emphasize the importance of small enterprises in our economy. There has been a great contribution of micro and small enterprises toward the economic growth. A first step in evaluating this contribution is the correlation between the size of the SME sector and the economic growth of the country. However, this approach is static and does not account for the dynamic evolution of industries. Therefore, for most policy interventions, the size of the SME sector is treated as a secondary interest. However, with greater interest is considered the questions on whether the business environment supports dynamism among SMEs, by facilitating creation of new ones and growth of them, in order to contribute on economic growth. In previous researches, one of the key areas of SME research is that of Ayyagari and Maksimovic (2008), who identified that lack on understanding the small firms have a niche and play a dynamic role such in a significant proportion of big businesses in the importance of their contribution toward the growth of the industry. The authors used a sample of 100 countries and 27 industries in the manufacturing sector, in order to examine the

growth rates of different industries across countries with different levels of institutional development and doing business environment. Beck et al. (2006) measure an industry's composition of small firms relative to large firms by looking at the share of employment in firms with less than 20 employees in the United States. Thus, they identified each industry's "technological" firm size in a relatively frictionless market, such as the US, and assumed that the technological firm size of each industry should be constant across countries. These studies found that industries naturally composed of small firms for technological reasons grow faster than large firm industries in economies with better doing business environments. This suggested that a good business environment boosts the growth of small firm dominated industries more than large-firm dominated industries. Also, Ayyagari and Maksimovic looked at a detailed breakdown of the different business environment characteristics. They found that the less onerous regulation have a large impact on small firm growth by following the listed characteristics, such as: starting and closing a business, dealing with licenses, employee hiring and firing decisions, exporting and importing of goods, paying taxes, protecting investors and obtaining credit etc. So, the result was that a good business environment has a disproportionately large impact on the growth of small firm dominated.

Also, based on the above studies, other studies are conducted in Albania from business organizations in collaboration with the International Labour Organization (ILO). ILO and Albania Business Organization conducted some research, in order to identify the problems and the barriers faced by SMEs, by finding solutions to their further improvement.

The study aimed the collection and analyses of data, problems and obstacles encountered for the efficient development of the Albanian entrepreneurship, which hamper the growth of competitiveness of the Albanian economy. The study is designed to identify / build appropriate indicators to measure the perceptions of business to these factors.

Moreover, the study addresses the internal factors of government and business, by looking to the impact that companies have brought to the effectiveness of legal and administrative barriers toward the lack of reforms for developing the economy. The data are collected by using a selected methodology approved by the ILO, hence through interviews with stakeholders. Private sector development is considered as the main factor of economic growth. The trend of industrial development and production of small and medium enterprises (SMEs) is of the most importance. Based on this approach, the designed questionnaire is used as a guide for further continuation of providing an overall assessment of the industrial sector and services, including the manufacturing sector in Albania and making recommendations for stakeholders to improve their business performance.

3. THE IMPORTANCE OF SME SECTOR ON THE NATIONAL ECONOMY

During the years of transition, SMEs have played a very important role in the economy so the Albanian government has always pay attention to their development as a catalyst for rapid increases in domestic production and employment. Strong and dynamic development of private sector is considered a priority of the government since in the beginning of economic reforms. SMEs are important to the local economy as they constitute the majority of businesses in Albania. Thus government policies are focused on SMEs by developing the private sector. Also SMEs sector is the most viable sector of the economy.

In terms of employment, the SME sector covers about 58% of employment in the private sector Most of employees are in the trade sector, followed by the service sector and industrial one. "Micro" enterprises are 92% of total number of business and they give the main contribute to employment of 34%.

Many times SMEs are seen as a source of innovation at the aggregate level because they are flexible, dynamic and sensitive to changes in demand in comparison to larger companies. By taking in consideration the political and economic conditions of Albania, SMEs are not only dominant in the economy but they have the ability to be a dynamic force in the country's economic development. SMEs specifically contribute as an integral part of economic structure as they are suppliers of the major enterprises and contribute to foreign competition of these firms.

3.1. The Economic Situation of Small Businesses and the Problems Associated With Lending

Development of the SME sector is considered the most effective key for economies in transition, which generates sustainable growth, employment and poverty reduction. During the last three years, Albania has experienced a 6% increase on SME sector and certainly it has an important contribution on this process. The contribution of the SMEs sector is estimated at 64% of gross domestic product (GDP) and 66% of employment in the private sector. SME sector has known a constant increase during the transition period.

According to their size, about 91.95% of total enterprises have 1-4 employees. The main part of them, 62 percent have only the owner. While small businesses (5-20 employees) make up about 4.26% of the enterprises, 3.04% are medium enterprises (21-80 employees) and only 0.75% of enterprises have more than 80 employees, but their contribution to employment is very significant, about 42%. Regarding geographical distribution of businesses in Albania, about 50% of active enterprises are concentrated in the districts of Tirana, Durres by employing 57% of employees of private sector about 69% of enterprises with foreign capital are concentrated in the prefecture of Tirana, about 5% in Korca, about 5% in Shkodra and 3% in Vllore. The sector of trade and service which covers about 73.5% of businesses, there are employed 45.2% of private sector employees.

Furthermore in the Region of Korca, we have particularly:

Table1. Number of active entities in Korca Region 2010-2014

Years	Number of entities
2010	8133
2011	7252
2012	7029
2013	8261
2014	8627

In Korca region the enterprises with 1-4 employees occupy 94% of total enterprises, 2.8% of active enterprises are with 5-20 employees, while medium enterprises with 21-80 employees count only 2.6% of active enterprises in the region of Korca.

According to data obtained from Regional Directorate of Taxation (2014), the number of entities with turnover below 8 million ALL are 7871 subjects. Also, after the study that we made in the Korca Region we note that the sectors with greatest number and weight are trade and services followed by transport and production sector. The number of businesses is increased significantly from year to year, which reflects the growth of private entrepreneurship and business management skills.

3.2. Problems Related to Financial Institutions and SMEs in the Framework of Funding

3.2.1. The Financial Problems Identified by SMEs

Although the level of SME financing has increased, it is still insufficient to promote a rapid development of economy. In order to improve the climate of SME financing, some measures have been taken during the recent years mainly to the introduction of credit guarantee schemes for SMEs. The guarantee funds in Albania have been applied by several special projects (USAID) by supporting small businesses. Nevertheless the guarantee funds have been limited to support the financing of certain areas and categories of SMEs, excluding the majority of SMEs.

The main problems identified by small businesses include:

- Facing difficulties, to obtain loans from the banking sector and credit costs are estimated as relatively high.
- Banks conditions are not favorable and the collateral specifically requested fluctuates at the level 120% -150%.
- The loan interest is also seen as a problem by businesses as they assess higher rates and in those cases when a loan is required for investment in machinery and equipment, for a medium term period.
- New businesses have little chance to take loans from financial institutions. Almost no bank that operates in Korca district provides credit for new businesses as they set as a condition for a business to have an activity for about one year, before asking for credit consequently a business should have an experience in the market and should be successful.

- Albanian business continues to suffer from "no proper taxation system, created by the infrastructure challenges, government inefficiencies and tense political situation and a general attitude toward a not reliable judicial system and finally a black economy where 75% of transactions are carried out of financial system in order to avoid investigation by the state. Moreover one of the current problems affecting the small businesses is the global crisis, through less opportunities and development.
- Another problem has to do with the culture and the traditionalism of Albanian owners. About 65% of them are not willing to share ownership of their business among other stockholders because they want to take their own decisions, managing the work processes of financing by themselves.
- Many businesses have chosen not to use other financial instruments because of their malfunction. Bank loan is seen the best way compared to other alternatives because other alternatives have many gaps and uncertainties for the relevant legislation (financial leasing).
- Another reason that businesses have declared is the lack of other opportunities for them to make the right choice. An expansion of financial instruments in the Albanian financial market would create another climate, where businesses may choose the proper instruments that fits better to their requirements.

3.2.2. The Demand for Loans and the Problems of Financing

Lending is known as one of the most important activities of banks.

- A critical issue faced by the banks is the execution of the collateral on mortgages, if the borrower is not repaying the loan. So the borrower must have a greater attention towards the assessment of the pledged assets.
- Businesses that have no stable income, or have frequent changes in the level of income, represent difficulties on the loan payoff.
- Also difficulties represent and the businesses that do not provide a full picture of their financial position, or the information available for verification is not complete. Thus this fact is one of the primary factors that affect the decisions of banks to lend or not, since there exists a transparent relationship among the borrowers and the bank. So the principle of client credibility is broken and it creates no possibility for fund financing.
- The real estate assets remain the most preferred form as a guarantee for loans provided by banking institutions. However many businesses do not meet the requirements for the amount of collateral required by the bank. Especially SMEs have difficulties on benefiting the required amount of funds because of the lack of collateral.
- Sometimes many businesses apply for loans even if they do not have the certain purpose, on how to use the borrowed funds. In these cases the banks do not want to invest in unfeasible projects and not real ones, because the financing projects can be very risky. Financial institutions express interest only on projects of profitable companies, because in this way companies can recover the investment and the interest payments.
- More over it has been a request for funds from unlicensed businesses. This category of business proves that our country still has businesses that operate informally, but also testifies the needs for financial resources by young entrepreneurs.

However we must emphasize the fact that none of the banks that operate in Korca district could support the new ventures in terms of supporting their financial terms since the beginning of the activity.

4. A DETAILED ANALYSIS OF NEEDS, RESOURCES AND DIFFICULTIES IN FINANCING THE BUSINESS

In the survey were provided detailed and qualitative information about the sources of financing the SME-s the problems which they faced the financing alternatives that financial institutions offer etc. The table below shows the results of the main issues dealt in the survey conducted.

* In terms of securing funding sources for starting a business the responses showed that 58% of respondents have started their activities only with personal savings (see tab.2), about 25% of businesses have received prior by relatives, a small part of them (7%) have been unable to obtain loans from the micro credit institutions and a very small percentage (only 5%) have taken loans from banks.

Table2. Initial financing resources for SMEs

Funding resources	Sectors				
	Production	Transport	Trade	Service	Total
	%	%	%	%	%
Personal savings	45	70	55	61	58
Money from relatives	27	20	30	22	25
Short-term bank loans	0	0	0	0	0
Long-term bank loans	27	0	0	0	5
Funds from financial institutions	0	0	5	17	7
Money in the informal market	0	10	10	0	5
TOTAL	100	100	100	100	100

We saw a lack of support from banks toward new businesses.

Meanwhile, new transport businesses have started with personal savings (70%) and also long-term loans are used mainly from the production sector and not at all by the service sector.

*Another issue is the annual invested amount that these businesses have made in the last five years (see Fig.1) and the results show that businesses from the production sector about 36% invested from 1,000,000 to 5,000,000 ALL. Businesses from the transport sector about 70% of them invested from 0 to 200,000 ALL and the other sectors have invested from 200,000 to 500,000 ALL.

The investment from the trade sector varies from 200,000 to 500,000 ALL (about 30% of businesses) and 25% of them invested from 500,000 to 1,000,000 ALL. Businesses from the service sector made more investments in amounts from 0 to 200,000 ALL (about 33% of businesses), however a considerable part of them have made investments in amounts from one million to five million ALL, about 22% of them, which are conducted by the small enterprises (55%) and the “micro” enterprises(25%).

Furthermore 78% of enterprises surveyed, invested in total from 0 ALL to 1,000,000 ALL. These invested amounts reflect in reality the real needs of businesses for their development.

*Businesses were asked whether they would turn to bank to take a loan for further financing their activities, many of them responded positively.

About 73% of the interviewers from the production sector responded positively to the question if they would turn to a bank when they will carry out other investments. The remaining of 27% did not think to apply in a bank when they carry out further investments. This is because they believe that loans are very expensive. 80% of businesses from the transport sector responded positively to the question for accepting bank loans. Some of them said that they have applied to other micro financial institutions and 20% of them did not think to apply for bank loans.

In the trade sector, about 70% of businesses, agreed to refer banks in the future. About 25% of them disagreed to turn to bank loans and a inconsiderable part of them did not answer if the they will address or not toward a bank in the future. The majority part of service sector, about 67% of them, agreed to take the loan from the bank.

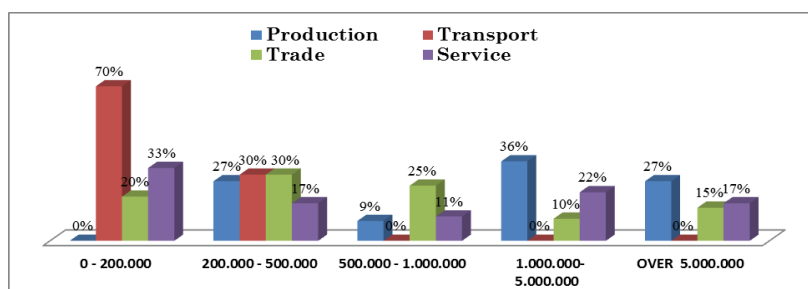


Fig1. Investments made from SMEs in the last 5 years

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As conclusion, the main part of total businesses surveyed, about 71 %,have the opinion that in the near future will see the banks as a mean of financing their activities while 27% of businesses do not think that the banks are good alternatives for investment. Sectors that support more the thought of taking loan from the bank are those of trade and services, without sidelining the two other sectors of the economy.

*The survey resulted that the majority of businesses think that if they will be financed with bank loans, their financial situation, will be improved more. With this opinion agreed almost 59% of respondents. A small part, over 14%, felt that the financial situation will improve much after taking the loan. Another part, 20% of them, show up their opinion that the financial situation will not change or has not changed after receiving the loan. About 7% felt that obtaining a loan may aggravate the financial situation of their business.

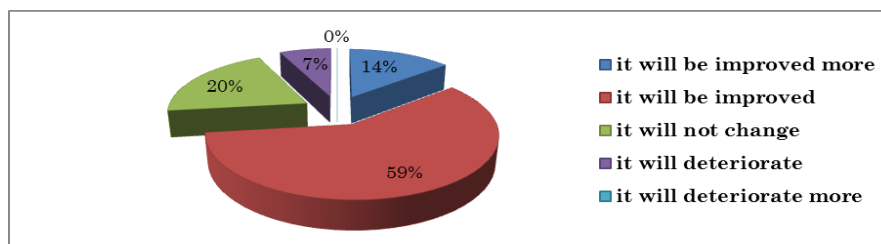


Fig2. Change of financial situation after using the loan

*By seeing the results we can understand that from three types of loans that banks offer ,about 60% of transport sector businesses have declared that they prefer loans more than one year while 64% of respondents from the production sector prefer long-term loans ,while service sector and trade sector, respectively 61% and 55%, prefer long-term loans too. Long-term loans are easier for creditors to settle out, because they have longer time to pay back the borrowed money.

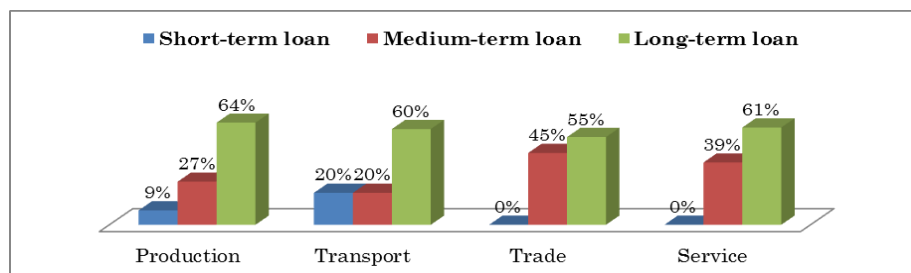


Fig3. The preferred loans by businesses

*Considering the field of credit (see table 3), there are a number of barriers which affect the access to credit by businesses such as:

- High interest rates
- Long and bureaucratic procedure of loan processing
- Small amount of loans, insufficient for business needs
- Businesses have sufficient revenues to meet their increased activity
- Businesses can provide funds easily with low cost in the informal market

These barriers reduce significantly the amount of credit from banks or from other financial institutions.

Each of the barriers in the survey, received a rating from 1-5 by each respondent, given 1 to that point which business considered as the most important one and 5 for the less important point in obtaining a loan. The results obtained from the survey are presented in table 3. Referring to the estimates, these obstacles are ranked according to this importance:

- High interest rates
- Business provides sufficient revenues to meet the increased activity in the future, by not asking for loans

- Long and bureaucratic procedures in the loan process
- Providing funds and with low cost in the informal market
- Small amount of loans, insufficient for their needs

Table3. *Assessment of barriers to obtain loans in order of importance*

LOAN BARRIERS (valuation in time)	VALUATION				
	1	2	3	4	5
1.High interest rates	73%	14%	10%	3%	0%
2.Long and bureaucratic procedures	8%	31%	36%	22%	3%
3.Small amount of loans ,insufficient for business needs	0%	15%	17%	20%	48%
4.Businesses have sufficient revenues to meet their increased activity	15%	29%	22%	19%	15%
5. Provides funds easily in informal market	3%	12%	15%	36%	34%
TOTAL	100%	100%	100%	100%	100%

* On the focus of credit extension by financial institutions, the total responses of the survey, consisted on the tendency of credit extended by banks, which differs from that accorded by the financial foundations. Respectively were taken the following detailed results by sector borrowed money to the bank and non- bank financial institutions.

Table4. *Loans extended by banks and foundations*

CREDITED SECTORS	CREDIT OF BANKS	CREDIT OF FOUNDATION
INDIVIDUALS	14%	44%
FAMILIES	19%	30%
SMALL BUSINESSES	26%	26%
LARGE BUSINESSES	41%	0%
TOTAL	100%	100%

Loans extended by banks are in greater amount toward big businesses than toward small ones. Credit allocated by foundations, or otherwise called non-bank credit institutions; most of the voice for business credit extended is toward small businesses compared to big ones. This is because these institutions are specialized for granting microcredit and the main part of credit is given for consumers and families.

4.1. Development Prospects and Financial Support Activities for SMEs in the Region of Korca

Studying the financial situation in Korca, results that the banking sector is expected to provide a greater grassroots support to young businesses. Mainly, service sector and trade sector are tending to finance their businesses in the future with microcredit. Long-term credits will remain the most preferred by businesses. Also, small businesses are expected to frequent banks more, in accordance with their expansion.

The main obstacle for taking loans with "high interest rates" and "long bureaucratic procedures" will be the main focus of the funding policies of the foundations and banks, toward the reduction of them.

Despite expectations for future support of new businesses and those in development, big businesses and existing ones remain the preferred for non-banking sector, because they carry a lower credit risk.

5. CONCLUSIONS AND RECOMMENDATIONS

- Many times SMEs are seen as a source of innovation at the aggregate level because they are flexible, dynamic and sensitive to changes in demand in comparison to larger companies.
- Preference for short-term loan, come as a result of low level of risk and a better credited monitoring possibility for a better loan.
- Activities such as trade and services have been the most favorite ones for credit.
- New businesses or small ones that do not offer sufficient guarantees to banks, only find funding opportunities to microfinance institutions.
- Funding of SMEs is it sad to be one of the main obstacles of growth and development. Economic stability is essential on improving the access of SMEs' financing and on the creation of a friendly business environment. From the survey, we can conclude that, the improvement of business's

financing needs: (i) the increase of credit level, (ii) the reduction of credit cost, (iii) the strengthening of cooperation between businesses and financial institutions. High transaction costs are one of the most important barriers for their development, so the reduction of these costs would encourage the expansion of SMEs and in particular the expansion of micro enterprises.

- The tense political climate in the country reflected uncertainty and pessimism to SMEs for their performance in the future.
- Interest rates for new investors are much higher than for those that have an experience or are larger, because small investors are considered with high risk.
- In addition to banks' expansion of micro-credit schemes and non-bank financial institutions is another development that has led to an increase for lending to small businesses.
- Strengthening the governmental institutions to local levels for supporting the businesses will create better relations between state and business.
- Banks should reduce the interest rates, in order to attract more clients. Through low interest rate will be influenced the reduction of the borrowing cost in the economy and this will bring an increase in the volume of credit expansion.
- Introduction of an informative campaign for banks and businesses, for various options available as a pledge, such as the "inventory" which is not practiced much.
- Legal solution through the creation and operation of the Administrative Court, which would entail the removal of barriers identified by businesses as barriers in additional costs to business.
- More generally, it may be that small firms will play a larger role in technological advance in the context of the information revolution and the rising role of services than was earlier the case under the dominance of manufacturing.
- It is necessary to support the activities for creation of components between local banks and financial organizations, government / donators and foreign banks for the establishment of credit lines for SME borrowings and especially for manufacturing enterprises, agriculture and agro-industrial, tourism etc.
- Monitoring the development of SMEs. Since SMEs are the most viable sector in the economy, it should be efforts toward their development and creation of various facilities, such as incentives in the tax system.

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