ASSESSING THE FINANCIAL AND FINANCING CONDITIONS OF ALBANIAN SMES

by

Filip Ruxho, PhD Candidate
European University of Tirana, Albania
Doctoral School
E-mail: routzio@gmail.com

Abstract

The purpose of this paper is to analyze the financial and financing conditions for organizations in the context of Albania. This paper investigates the financial aspect of targeted businesses and is presented to evaluate the relationships of the SMEs with banks and the terms for financial requirements when aiming to develop their business. Also, to discover and analyze the activities that Albanian SMEs would prefer to invest in the coming years and the funding type required for these activities. The instrument used was a questionnaire of 50 items and the participants where Albanian organizations (N = 163) from different sectors of the economy. Data were analyzed using IBM SPSS Statistics 20. Findings show that the three main areas in which Albanian companies intend to develop their business are: (i) Increase annual turnover by opening new markets; (ii) Develop and market new products/ services; (iii) To develop staffing skills. Anyway, the interest to invest and to develop seems to vary widely based on the sector. Other data show that only 21.3% of businesses have requested financial capital to run their business over the last year, while only 14.5% of these businesses now have a bank loan or plans to apply for over next year. Regarding the relationship with banks, it seems that a considerable majority has a neutral relationship, leaving no room for interpretation; however, 30.5% claim to have good relations.

Keywords: *Albanian SMEs, fundings, debpt, equity, business development*

Introduction

The strategic economic importance of the small business sector has been widely accepted among economists and policymakers. According to official statistics in European Union countries, enterprises with up to 250 employees- classified as SMEs, have the greatest impact on job creation. In the European Union, more than 80% of new jobs have been opened in the small and medium business. In addition to acknowledging the importance of this business, the European Commission is trying to reduce to a maximum the bureaucratic restrictions and to undertake a number of measures to integrate them into a single market, hence the same conditions in all countries.

Is generally accepted that small businesses do not generate as much money as large corporations (Brown 2016), but in any case, are a key part and major contributors to the power of local economies. First, small businesses pose new job opportunities and serve as building blocks of corporate firms (Edmiston, 2007). Small businesses also contribute to local economies by bringing growth and innovation to the community in which the business is built. Small businesses stimulate economic growth by offering employment opportunities to those who may not be employable by corporations (Brown 2016). They attract talent that invents new products or implements new solutions to existing ideas. Large businesses often depend on small, because the latter perform some business functions through outsourcing.

Europe is the world's largest market, this continent offers many business opportunities, but the competition is very strong. If a business strives to become successful it must be well prepared before facing buyers. In total, the Western Balkans in 2016 had 1.3% of the total marketed in Europe (European Commission, 2017). However, the individual contribution of states was very low: Albania (0.12%), the Republic of Macedonia (0.24%), Bosnia and Herzegovina (0.26%), Montenegro (0.03%), Kosovo (0.03%) and Serbia (0.59%).

Small and Medium Enterprises (SMEs) play an important role in all economies and are key generators of employment, earnings, and economic growth stimulators. In Albania, small and medium enterprises represent 99.6% of all registered business entities and are the main source in providing employment (Spahiu & Kapaj, 2016). Since 1998, the Albanian economy has experienced rapid and sustainable economic growth and unlike other Balkan countries and many European Union countries, it has positively increased growth during the global economic crisis (albeit with significant reductions in recent years) during 2009-2010. Up to nowadays, the impact of the crisis has been felt mainly in reducing the level of remittances and trade.

Albania's performance and challenges in the European integration process is a field of high interest to many scholars (Abazi, 2013; Laci & Hysa, 2015; Spaho, 2012; Turan & Bala, 2014). Membership in the European Union has been the national key and strategic target of Albania since the early 1990s. Albania's EU integration challenges are different and do not necessarily only relate to the country's progress in consolidating democracy, rule of law, and market economy. Albania has been a potential candidate for being part of the EU membership since 2009, later in June 2014, the European Council granted Albania candidate status. This country has to accomplish five key priorities for the opening of accession negotiations in order to get the membership status of EU (European Commission, 2016). These five key priorities generally have to do with overcoming previous political polarization, the well-functioning of the juridical and political system, reducing the level of corruption, the intellectual property law, etc. Albania will need to put more efforts on the overall preparations for implementing the EU acquis (European Commission, 2016).

It is important to mention that Albania has also made modest progress in developing a functioning market economy (Dima, 2018). Some progress has been made in improving the budget balance, fighting informality and reforming the electricity sector. It is quite evident that Albania’s economy had an accelerated growth and improvement in the market situation, but anyway, the unemployment is still high. The public debt continues to be high, meanwhile, the investments are still continuing. The financial sector is generally stable, but the bank sector is still burdened with bad loans and credit is growing slowly. The ongoing justice reform is expected to have a material impact on the business environment (European Commission, 2016).

One of the main challenges facing Albanian SMEs remains the business funding. Although in recent years the burden of receiving external financing, mainly bank/ financial institution credit has decreased, Albanian SMEs continue to be very concerned about the long, difficult and very bureaucratic administrative procedure of lending procedures. The key issue with regard to SMEs is collateral because the conditions required to be met by collateral to be considered as good and acceptable collateral are serious for SMEs.

Usually, banks require that collateral is in the form of a real estate, or collateral may be in the form of bank deposit. Therefore, since most Albanian SMEs can hardly reach a reasonable profit margin, they should earn enough profits to own different properties and bank deposits to act as collateral for a bank loan, in most cases many excellent business ideas do not become true due to lack of collateral (Berhani & Hysa, 2013). Moreover, Albanian SMEs find the number of forms that are required to be met by too much excessive and wasteful time.

Literature review

Albania has been a successful development story in many respects. Over the last two decades, the country has made galloping moves to establish a credible multiparty democracy and market economy and is rapidly integrating into the international and European community. Since 1998, the Albanian economy has experienced rapid and sustainable economic growth and unlike other Balkan countries and many European Union countries, it has positively increased the growth rate even during the global economic crisis (although with significant reductions in recent years) during 2009-2010. Up to nowadays, the impact of the crisis has been felt mainly in reducing the level of remittances and trade.

Although there were signs of recovery and gradual expected growth, Albania's economic growth remains below its pre-crisis level. In the early 2000s, Albania was one of the fastest growing economies in Europe, enjoying real annual growth rates of 5% to 6%, largely driven by flying remittances by migrant workers abroad that boosted economic growth. The turnover of SMEs was growing at two-digit annual rates. The rapid economic expansion was cut off by the global economic crisis of 2008-2010. Between 2009 and 2011, both growth rates of GDP and SMEs were halved. The growth of the country further suffered from the Eurozone crisis, particularly in Italy and neighboring Greece, reaching the lowest level of 1.1% in 2013. Thanks to the increase in domestic demand supported by sound fiscal policy and structural reforms, growth grew again In 2014, the economy is estimated to have risen between 2.5 and 2.75 percent in 2015. High barriers to external economic shocks, however, create a disadvantageous climate for investment and future development of the sector of SMEs. Although it began as a financial sector crisis, it quickly expanded globally, the global financial crisis has taken on the features of a profound and comprehensive economic crisis. It is clear that the financial figures show a sluggish decline in Albania's performance, resulting in unemployment, high informality, stable inflation and critical remittances.

In Albania, sectors such as manufacturing, construction and services felt a high liquidity need, and many of them declared bankruptcy. From a political point of view, Albania's true situation has faded and defended by governments, implying that the European crisis is not and will not affect the country's economy. It should be said that by 2009, even from international institutions like the World Bank, Albania’s economy was immune and created the idea of a stable and strong economy, neglecting the fact of growing large public debt and stocks which later indicated that short-term decisions were not enough. In the coming years, Albania was affected by all the Balkan states by the crisis in reducing foreign investment and unsustainable macroeconomic policies.

Experts tend to say that this delayed result was due to small economies and the stable banking system.

According to the World Bank (2015) report for Southeast Europe, small economies are the ones that are most vulnerable to the euro crisis. Foreign factors are determinant for the economic growth of the region, including the recovery of external demand, especially in Europe and the stabilization of international energy prices at current levels. In fact, after a decade with high rates of economic growth, the region of Southeast Europe was severely affected by the economic and fiscal crisis. The economic activity of this region suffers from a weak domestic demand, from high unemployment and from banking systems loaded with many non-performing loans.

Structural challenges continue to be the answer to finding growth in the countries of Southeast Europe. The model should initially be based on the integration of the regional economy into a more intelligent and more comprehensive economy, which exceeds the boundaries that today share regions. Beyond the way how it was born or spread, the crisis prompted the implementation of some special policies that were unprecedented at the national and international level.

Nowadays, the developed world is dealing with the analysis of the successes of the unconventional instrument, as is the quantitative easing. The Federal Reserve, the Bank of England and more recently the European Central Bank are trumpeting the success of this instrument into a world that is still financially troubled, which, according to its cycles, marks a growth, or even a major decline. The crisis showed that market players were not prepared to manage the system they had created themselves (European Investment Bank, 2016).

The country's banking sector is the main channel for SME financing, accounting for more than 88% of total supply. It's healthy, profitable and well-capitalized, although the high level of NPLs remains a concern. There are some guarantee schemes for SMEs in Albania, some of which have been created too late. Although new guarantee schemes have the potential to improve SME access to finance, their success will depend greatly on how they are managed efficiently (European Investment Bank, 2016). Non-banking financing is on the rise but still plays a modest role in SME financing. Risk capital has been available in Albania for twenty years, but the investment portfolio is very small. Clients' deposits are the main source of funding, with IFR borrowings playing a small role and requiring them to be low, given the high banking sector liquidity and falling interest rates on deposits.

There is a moderate financing gap for loans in Albania, as banks are more conservative due to higher levels of NPL (Vasiljev, 2017). Since lending is largely based on collateral, the gap is higher in rural areas, with very poor farming and there is a huge financing gap for people in remote mountainous areas (European Investment Bank, 2016). With a low credit to deposit ratio and high liquidity, banks have a reduced need for additional borrowings. Financing is not a priority even for non-bank financial institutions (OECD, 2014). Added funding would be more needed to help raise awareness among SMEs of the benefits and principles of an equal investment or the quality. While potential risk capital requirements are high, especially among starters in the IT sector, the capital investment gap is estimated to be large. The largest option for IFIs is a well-designed component of technical assistance that will be included in a financing package.

Access to financial resources and its impact on business development

Funding is one of the most important functions of any business. Not only is it a good indicator of the overall health of the company but also plays an important role in managing business growth (Parker, 2012). If growth is attributed to greater market capitalization and a growing employee, a new location, a new product or a service offering or a new demographic funding, is the possibility of these opportunities (World Bank, 2015).

Companies are funded in one of two ways: Debt *or* Equity. Debt financing includes traditional business loans as well as short-term loans that can be used to finance the cost of an item or venture, such as equipment. In any case, debt financing requires some sort of planned payment, usually per month. By contrast, equity financing is the financing provided in return for a property interest in the company. Funding may be in the form of shares, bonds or private investors.

However, any kind of funding has its own unique characteristics and can affect different operations. Debt financing is a cash flow. Not only does it present a fixed settlement obligation, but repayment must come at certain intervals at certain amounts, regardless of the company's excess or profits. Equity funding, on the other hand, does not require the same type of payment, regular payments, in many cases, some levels of management interest have decreased in exchange for prior funding (Parker, 2012).

Because debt and equity finance have such diverse effects, companies seek to find a specific balance or an optimal level of funding (UNCTAD, 2014). The idea is to use sufficient debt to finance various business ventures without exposing the company to very large debts but to use a small amount of debt to maintain the proper ownership interest within the company. For this purpose, some financial formulas, such as the weighted average cost of capital, or WACC, the capital asset price model, or CAPM, may be used, inter alia. These are used to decide what financial impact would be to obtain a kind of financing, and what would be the optimal distribution of the company's financing.

Distribution of funding is a serious concern, while growth can only be financed to some extent only through revenue from the company, most companies receive funding to prevent their financial loss (Piper & Weinhold, 1982). A company with a high amount of debt can become over-leveraged, which means they have high fixed costs in terms of funding and, as such, unsustainable. Therefore, keeping a minimum funding can strengthen a company's financial health.

Large amounts of business finance can create a series of problems for a company. On the one hand, if the company has a lot of debt, its access to financing may be limited, perhaps before the company had a chance to complete its growth strategy. In addition, if a company has a high amount of debt and income suddenly stalls, such as in a recession, it may leave the business unable to meet its obligations (Unctad, 2014). On the other hand, if a company is constantly relying on fundraising, it can find that a certain amount of decision-making authority is lost, a factor that can hinder growth strategies as much as the lack of funds.

A more effective and sustainable approach to development would directly address financial market shortages, without causing adverse effects of incentives. Most redistributive policies create margins for work and survival, though the economic magnitude of these disincentive effects is subject to intense debate (Sanfey & Zeh, 2012). As Demirgüç-Kunt and Levine (2007) argue, these tensions disappear when they focus on financial sector reforms. Reducing financial imperfections to expand individual opportunities creates positive, non-negative, stimulating effects. Therefore, these arguments are highly in line with modern development theories but emphasize the implementation of financial sector reforms that promote financial inclusion at the core of the development agenda.

Addressing financial sector imperfections may appeal to a wider range of philosophical perspectives than redistributive policies, while the latter is directly related to the reconciliation results, while more functional financial systems serve to equalize the opportunities (Unctad 2014). Extensive empirical evidence suggests a significant and powerful relationship between the financial depth and the growth. The latest micro-testimony using firm-level databases suggests that the most financially viable financial systems.

Objectives of the study

The overall purpose of this study is to examine the financial aspect of Albanian SMEs. This study is mainly of research and exploration nature that aims to reveal the financial aspect of targeted businesses and is presented to evaluate:

(i) Evaluating SME Relationships with Banks and Financial Resources Requirements in Business Development.
(ii) Discover the activities that Albanian SMEs would invest in the coming years and the funding type required for these activities.
(iii) The importance of financing business and other financial resources in case of refusal by banking institutions.

Methods

Albanian companies from different sectors of the economy where the target group selected for this study; the sectors were selected based on the current percentage of their contribution to the economy. For the sample selection was followed a non-probabilistic approach but was used an intentional selection, which is the most common technique of sample selection (Marshall, 1996). This might include the development of a variable model that can influence the individuals' contribution and may be based on the researchers' practical knowledge, available literature, and the study itself. The sample size (N=163) was 163 different SMEs distributed in different sectors (Construction industry 7%, Trade 32%, Hospitality & Tourism 34%, Manufacturing industry 6%, Information and Technology 4% and Services & others 17%).

Data Analysis and Results

Funding is a business function that uses figures and analytic tools to help managers make better decisions. There are many reasons why you should understand and evaluate the financial aspects of a business. For owners and managers, understanding the financial aspects is essential for making good decisions that go ahead. Potential investors can also take care of a company's financial aspects as a means of gaining knowledge to help predict future performance. In this study, information about the company's annual turnover in the last year, regarding the increase or decrease of this turnover compared to the previous year, was also asked for financial capital. An important element of this section was the investigation about the activities they would invest if they would find financial capital for next year.

The table below reflects the classification of the total number of participating companies (N = 160, missing value = 3) depending on the annual turnover (Euro) where three main intervals are used, based on the European Commission's suggestion for the Small Business Classification criteria secondary school.

Table 2. Information on annual turnover of the participants

Annual Turnover (Euro)	Frequency (N)	Percentage
Below 2 million	101	63.1%
2-10 million	44	27.5%
10-50 million	15	9.4%

Meanwhile, 59.7% of these businesses (N = 95) had an increase in annual turnover compared to the earlier year and 15.1% decline compared to the previous year. However, 25.2% of respondents had the same level of turnover compared to the earlier year. In total, 12.9% of the respondents claim to have 10% increase, meanwhile, 5.5% of the respondents had a 5% increase, and only a very small part (1.2%) had an increase of up to 40%. On the other hand, 3.7% of respondents had a drop of 2% and 2.5% of Albanian companies had a decrease of 3%.

Regarding how companies perceive their relationship with banks, the answers are as per the table below.

Table 3. Information about the participant's relationship with banks

Relationship with banks	Frequency (N)	Percentage
Very good	30	19.9%
Good	46	30.5%
Neither good nor bad	47	31.1%
Weak	2	1.3%
Very weak	1	0.7%
Does not apply	25	16.6%

Other data show that only 21.3% of businesses (N = 160) have requested financial capital to run their business over the last year, while only 14.5% of these businesses (N = 159) now have a bank loan or yes plans to take over next year.

The table below shows the information about the activities that companies would invest if they find financial capital, data on the industry sector, and an analysis of activities with the highest percentage.

Table 4. Information about the activities that companies would invest in

Industries	CS*	PL/ B	I/ RO	PME	R & D	TDP	BOB	M
Civil construction industry	16.7%	33.3%	25%	50%	0%	8.3%	0%	0%
Trade	18.8%	6.3%	12.5%	29.2%	6.3%	8.3%	18.8%	10.4%
Hospitality & Tourism	10.7%	17.9%	69.6%	0%	0%	3.6%	21.4%	3.6%
Services	15.4%	7.7%	23.1%	46.2%	15.4%	0%	23.1%	15.4%

Manufacturing	0%	20%	20%	70%	0%	30%	0%	20%
Information and Technology	14.3%	0%	0%	0%	42.9%	71.4%	0%	14.3%
Others	13.3%	20%	26.7%	20%	6.7%	13.3%	20%	26.7%

* ***Note:*** *Fields of activity are coded in the following way: CS-Cash flow; PL/ B- Purchase of land or buildings; I/ RO-Improvement or reconstruction of the object; PME- Purchase of machinery and equipment; R & D- Research & Development; TDP - Training and development of personnel; BOB- To buy another business; M- Marketing.*

Some of the most important results show that as regards the construction industry, the area of activity to which 50% of them would like to invest is in the purchase of machinery and equipment, followed by the purchase of land and buildings (33.3%) and third in improvement or reconstruction facility (25%). In the trade sector, it is also important to purchase machinery and equipment (29.2%), followed by buying another business and cash flow at 18.8% of respondents.

The Hotel and Tourism Sector is interesting as to how 69.6% respond to the improvement or reconstruction activity of the facility, followed by the intention to buy another business (21.4%) and thirdly to purchase land or buildings (17.9%). The three areas where the services sector would want to invest are the purchase of machinery and equipment (46.2%), improvement or reconstruction of the facility (23.1%) and purchase of another business (23.1%). Purchase of machinery and equipment is also the preferred sector of the production and processing sector (70%) followed by potential investment in training and employees development (30%). Information and Technology prefer 71.4% to invest in personnel training and development, followed by Research & Development (42.9%).

Conclusions

The financial aspect of the participating companies is largely at a turnover below € 2 million (63.1%) and 59.7% of businesses have increased compared to the previous year. Therefore, it can be said that participating companies meet the criterion of being small and medium-sized businesses according to European standards and have been growing in circulation, which can be seen as a success indicator. Regarding the relationship with banks, it seems that a considerable majority prefers to say that there is a neutral relationship, leaving no room for interpretation; however, 30.5% claim to have good relations.

The interest to invest and to develop seems to vary widely based on the sector. The construction industry prefers to invest in the purchase of machinery and equipment while Hospitality & Tourism prefer to invest in the improvement or reconstruction of the facility. The purchase of equipment and machinery also prefers to invest in the Trade, Service and Production and Processing sectors. Only the Information and Technology sector seems to have a high interest in investing in personnel training and development alongside the search for development. It seems that in general, the most neglected areas are: marketing, training and employees development, cash flow and other business buying. In a future study, the reasons why they prefer these activities can be analyzed and if they think they have invested enough in some other activities.

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