

LACK OF FINANCIAL INTERMEDIARIES AS A DECISIVE BARRIER TO ENTREPRENEURSHIP IN ALBANIA

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Abstract

The aim of this paper is to examine financial intermediaries in Albania, paying special attention to the Albanian banking system. Our questionnaire research (226 out of 350 questionnaires collected) concluded that bureaucratic procedures are a real impediment to credit activities in Albania while the lack of financial resources also seems to be a decisive obstacle to business start-ups or expansion of their activities. A planned strategy of training programs to improve management skills must be realistically implemented. The training programs should emphasize upgrading of management/entrepreneurial skills and the collaboration of domestic enterprises with foreign ones. Technical assistance with a clear and straightforward strategy should be initiated to help the enterprises become more competitive. Moreover, strategies and government intentions to reduce bureaucracy and corruption must also be considered. Finally, new credit lines for short-term loans for working capital or for long-term loans for new investment projects must be introduced.

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1. Introduction

A two-tier banking system was formally established in Albania in 1991. Commercial banks such as the Saving Bank of Albania (SBA) (established in 1991), the National Commercial Bank of Albania (NCBA) (established in January 1993) and the Rural Commercial Bank (RBC) (established in October 1993) were to provide a whole range of services under the supervision of the Bank of Albania. (<http://www.bankofalbania.org>).

According to Grashov (2002), in the last ten years of transition (1992-2002), Albania's banking system remained fragile and ineffective. The banking sector rarely functioned effectively in terms of domestic financial intermediation. The absence of a formal financial sector and an inadequate regulatory and supervisory framework contributed to the development of pyramid schemes.

However, nowadays (mid 2004), there are sixteen licensed commercial banks as part of the second tier (the Bank of Albania (BoA) is fulfilling the function of a central bank (one tier)). Four of them are Greek banks/branches, three of them come from a Muslim/Islamic country (Saudi Arabia, Malaysia and Kuwait), three from Germany, three from Romania, another three from the USA, and one from the region of Kosovo. Furthermore, there are two joint ventures (Italian and Arabian funds) and two new domestic banks which were licensed during the period of March-August 2003 (the Credins Bank and the Popular Bank). Actually, it is expected that these two banks will provide further incentives in crediting schemes not only for short-term loans for working capital but also for long-term loans for new investment projects. Finally, there have been two successful privatisation deals (Austrian and Turkish acquisitions in the Savings Bank of Albania and the Commercial Bank of Albania respectively).

The remaining contents of this paper are as follows: in Section 2, we present a review of the literature on financial intermediaries in Albania. In Section 3, we present our findings from the questionnaire survey conducted in 2003 in Albania. Finally, our conclusions can be found in Section 4.

2. Financial Intermediaries in Albania: Results from other surveys

The Albanian financial system, in contrast to that of other transition countries, did not include a "laissez-faire" period in its financial policy. The "laissez-faire" policy permitted by other transitional economies was the cause of the failure of their large state-owned banks. The typical clients of Albanian banks are private micro or small enterprises, undercapitalised, not quite stable and without strong relations with banks (Grashov, 2002).

The Albanian banking system underwent a major restructuring process in 1996 when real efforts began towards a legal privatization process. In the beginning of the reforms, two laws regulated the structure and functioning of the banking system: Law

8075 “On the Banking System” and Law 8076 “On the Bank of Albania” (Erhart, M., 1998). Another reform from that period was Law No. 8365, dated 02-07-1998: “On the banks in the Republic of Albania”. Many regulations are introduced each year to fill gaps in legislation on the functioning of the Albanian banking system.

Notwithstanding the unfavorable conditions of the Albanian economy, the banking system is enlarged every year through an increase in the number of private banks. This is accomplished through the privatization process and the restructuring of the state banks, through the expansion of the banking network, through improvements in banking legislation, through the growth of available credit and finally, through the supply of other new products offered in the banking market.

Despite the development of the Albanian banking system and Albania’s impressive performance macro-economically, two unexpected crises during 1991-2003 left a distinct mark on the economy. The first financial crisis occurred in 1997 when over ten pyramid schemes collapsed one after the other. Thus, 1997 is known in Albania as the year of crisis. As mentioned, this crisis was a result of the pyramid schemes (so called bubbles) and it was not related to the banking system. The second financial crisis, in March 2002, shook the banking world as Albania had appeared to be, once again, enjoying macro-economic stability. It was caused by the panic in the banking sector as a result of depositors’ withdrawal (confidentiality crisis-the banking panic-liquidity crisis) (Cani, Sh. and Haderi, S., 2002).

To put it in a nutshell, the Albanian banking system during the transition process had serious problems due to the following factors:

- (i) its role as financial intermediary was limited.
- (ii) there was a gap between a good evaluation of the credit system/schemes and the management risk associated with it (between 1992-1998 the Albanian banking system was reported to have huge amounts of “bad loans” in its credit portfolios).
- (iii) the exchange ratio was calculated but its risk was not calculated in real terms.
- (iv) the accounting system was “a product” of socialist/communist mentality and was not in conformity with international laws and legislation.
- (v) there were inexperienced bankers, lack of banking entrepreneurship and lack of managerial skills. The first bank entrepreneurs/managers were selected by citizens for their devotion to a certain political party (political reasons) and not for their qualifications, managerial skills and performance in management (Cani, Sh. and Haderi, S., 2002).

In Albania, the non-banking institutions have an inconsiderable market share of about 5% of the total financial market. The insurance market, pension funds and the stock exchange are still in their infancy, while mutual funds are non-existent. Thus it is evident that the banking system still plays a major role in the Albanian financial market (Ibrahimi and Salko, 2001).

The capital market is a hot issue and its development is a necessity and a challenge for all the transition countries, providing funds not only to the corporate sector, but much more to the entire business sector (Kawalec and Kluza, 2000; Gomel, 2002).

Although in the transition countries there is evidence of a large amount of cash in the hands of the population, it is not effectively dispersed in the right channels of the economy to promote business expansions and economic growth. The cash-economy is mostly a base for the informal economy and fiscal evasion, and creates incentives for widespread corruption.

In the opinion of Kawalec and Kluza (2000), the main reasons for the slow development of the capital market are:

- The minimal protection given to the interests of the minority and portfolio shareholders. Public companies lack transparency.
- Lack of confidence in the stock exchange.
- Lack of managerial skills. Many managers still do not really appreciate how the capital market functions and its significant role in the development of the market economy.
- The Stock Exchange was not used by the government as an instrument in the privatization process.
- Residual shares of formerly state owned companies are not sold through the Stock Exchange.
- The tax regime is not favorable to investors in corporate securities.

With this in mind, we can partially explain the problems that transition countries face, in their attempt to determine the right policies for their further development. A developed capital market will give direct assistance to SMEs, since an extra, advanced financing tool will be offered to the market. Demekas *et al.* (2002) stated that the development of a capital market is essential, while a decisive goal in the medium term for all the transition countries in Europe is to gain considerable foreign technical assistance.

In the opinion of the authors of this paper, the answer to the question, “How can capital markets play an effective role in business financing?” has two components: (a) Satisfactory pension fund reform and even the privatization of some strategic state-controlled institutions, that will create opportunities for capital market development and (b) Regional cooperation among countries in order to ensure stability, self-management, and a cross-border business network are necessary steps.

In Albania, nowadays, there is one state bank, (the Central Bank of Albania) and 16 private commercial banks (see Table 1).

Until 1996, three state-owned banks operated in Albania: the National Commercial Bank (NCB), the Savings Bank of Albania and the Agriculture Bank. Two of them were privatized in 1997 and 2003 respectively and the third went bankrupt in 1997:

- The National Commercial Bank (NCB) of Albania (the second-largest bank in the country) was privatized by the Kent Bank of Turkey together with the IFC and EBRD in October 2000. Although on 25th April 1999, the Kent Bank was declared the main owner, the privatisation process was completed in October 2000. The Kent Bank bought a 60% stake in NCB, with EBRD and IFC each receiving 20% (EBRD, 2001). This privatization deal was an excellent example of cooperation among the Albanian government and various institutions and organizations such as the IMF, the World Bank, the EBRD and IFC. The IMF played an important role in setting policy priorities and the timeframe for the privatisation process. The World Bank provided the resources for restructuring the National Commercial Bank (in late 1996, twenty-two of NCB's poorly performing branches were transferred to the Savings Bank, leaving the bank with ten main branches. In three years (1997-99) the staff numbers were gradually reduced to one third, from 1236 to 477. The EBRD and the IFC helped with the marketing of assets and inspired confidence in potential investors from their participation in the privatization deal. Finally, in 1998, another part of NCB's financial restructuring program was initiated in order to clean up NCB's bad loan portfolio. An amount of over 70 million USD was transferred to the Bank Asset Resolution Trust (bad loans agency).
- The Savings Bank of Albania, the largest bank in the country was bought in December, 2003 for 126 million USD by the Reiffeisen Bank-Austrian Bank. In 2004, the Albanian news media reported that the Reiffeisen Bank would accelerate the transformation process of the entire Albanian banking system by giving more credit to customers, expanding corporate banking, offering favourable exchange rates between currencies, etc.
- The Agricultural Bank, as stated earlier, went bankrupt in 1997. It was the only Albanian bank to declare bankruptcy from 1991-2003.

The above three banks formed GROUP I-G1 of the state banks in the Albanian banking system. Today, G1 no longer exists, as there are no state banks in the Albanian banking system.

In 1992, another group of banks, a group of joint venture banks, was established with the name GROUP II-G2:

- The Albanian-Italian Bank (foreign participation and Albanian participation).
- The Arab-Islamic Bank (foreign participation and Albanian participation).

From 1993 onwards, Group III-G3 was established, comprising the private banks in Albania. It is important to emphasize that in the two year period (2002-2003), two Albanian banks (100% Albanian capital) were licensed. This is evidence that local entrepreneurs are investing in the banking sector.

It is also essential to emphasize that there is strong participation of Greek banks in the Albanian banking system (the Piraeus Group, Alpha Bank, the National Bank of Greece and the Commercial Bank of Greece) due to the presence of hundreds of Greek entrepreneurs in the country, the geographical proximity of the two countries, the absence of local competition and western investment interest, and – finally - the existence of minorities. At the same time, the Malaysian Bank, the Arab-Islamic Bank and the Credit Bank of Albania (Kuwaiti Bank) focus on providing services to Albanian Muslims. From the banker's point of view, it is important to mention that these banks show great interest in the construction and trade activity of the country and for this reason their credit portfolio is geared to these sectors of the economy.

There is thus a considerable number of banks for such a small country. The reason for this is the unsatisfied demands in the Albanian banking market that are not met by the licensed banks. The Savings Bank of Albania (65% market share) was not given any credit from 1997 onwards because of its heavy portfolio of bad loans while at the same time other banks in Albania were very strict in their credit policy and also highly bureaucratic. Thus there was keen demand not only for credits and investments but also for other services to be provided by the banks. These reasons explain the new licenses given recently to two Albanian (local-private) banks and the keen interest of the Austrian Bank (the Reiffeisen Bank) in investing in the Albanian banking system.

Notwithstanding the striking positive developments in the Albanian banking system, the overall financial system is still fragile. The development of the banking system and public confidence are connected with the privatization process of state banks, the growth of bank competition, the developments in the transaction process (e.g. REUTERS, RTGS- Real Time Gross Settlement System), the development in real terms and the political stability of the country.

The transition to a market economy needs a sound banking system, a crucial factor in attracting foreign investors as well. Foreign direct investment in the banking sector plays a significant role in the transition countries since experience has shown that countries around the world in which FDI has concentrated have enjoyed accelerated economic growth, easier integration into world markets and less painful structural reform. [Bitzenis A., 2004]

3. Performance of Financial Intermediaries in Albania: our questionnaire results

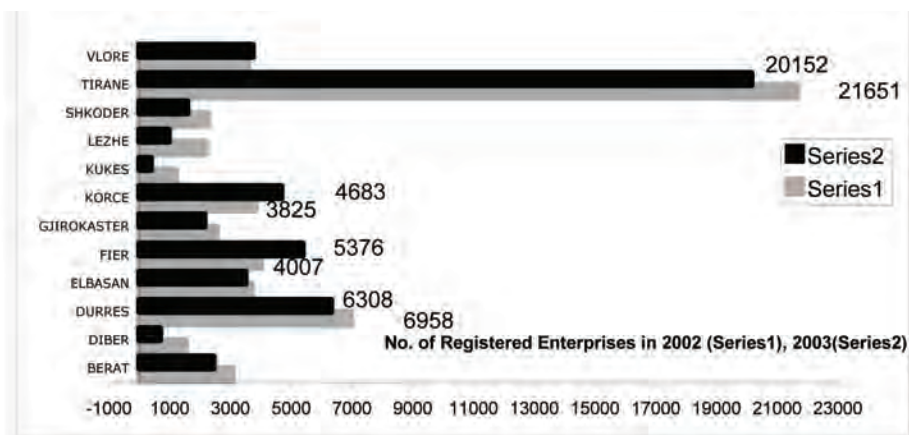
3.1 Research Methodology

The aim of this empirical research was to illustrate qualitative research regarding the financing problems, the performance of financial intermediaries in Albania, and the sources of finance of entrepreneurs in Albania.

The applied methodology was based on a survey using interview and questionnaire techniques. The sample was determined on a stratified basis (Probability-Random sampling) involving the random selection of elements from various strata of the population (growth areas/cities of Albania) to make the sample more representative. This method reduces error sampling as it makes the sample match the population in some important aspect, thus making it more representative.

We formulated a strategy of distributing the questionnaires among the most developed cities of Albania (Tirana (the capital of Albania), Durrës, Fieri, Vlora, Korça, Lushnjë, Elbasan, Erseka, Saranda, Berati, and Gjirokastra). As a result, we received feedback from 226 out of the 350 companies contacted (64.5% response rate). However, as Babbie, E. (1990) observed, the main disadvantages of probability sampling are that it can be relatively expensive and the researcher has no guarantee that all randomly chosen subjects will participate in the study. Thus, our responses from the selected strata were not distributed proportionally among the selected strata (cities). This is actually the limitation of this study. We gathered 133 completed questionnaires from Fieri and 93 questionnaires from other cities in Albania. The reason for our biased success in Fieri can be explained by the access to an online database of companies in the area of Fieri. Moreover, the selection of Fieri is because it is a significant city/region in Albania. For example, for the years 2002-3, Fieri was ranked third in its significant number of registered enterprises (Figure 1).

Figure 1. Registered enterprises by prefectures in Albania (2002-3)



Source: INSTAT "Indicators by Prefectures", Business Register 2002-2003.

Furthermore, Fieri is well known for its agriculture, trade, agro-industrial services and petroleum industry, thus making it a good area for observations based on future growth potential. Moreover, many enterprises from Fieri have moved to Tirana over the last few years. In order to overcome and avoid biased results and biased analysis, a two-group study (Fieri and other cities) was prepared.

Participants in the questionnaire survey were entrepreneurs or Chief Executive Officers (CEOs) of Albanian enterprises (or somebody else in these positions). All the companies were interviewed through either face-to-face interviews or phone (or even online) interviews. The companies were asked multiple choice or open-ended questions eliciting descriptive information about their enterprises as well as their opinion of problems they faced when they started their business or encountered in other phases of their business activity.

The main strategy developed was to collect questionnaires “on the spot”. Interestingly, the questionnaires left to be completed later on (according to respondent preference) were never returned.

3.2 Analysis and Discussion of the Results

With Question 1 (Section III in our questionnaire), which deals with the number of banks and type of transactions and relationships that the enterprise is engaged in, we examined the extent of relations between companies and different banks. The results of Question 1 can be found in Table 2.

Table 2. Transactions and Relationships with banks

	No bank	One bank	Two banks	More than two banks	Total
Fieri	26	49	42	16	133
Other cities	8	37	18	30	93
Total	34	86	60	46	226

It was discovered that 86/226 (38%) out of the 226 participants had negotiations with one bank, (60/226) 27% with two banks, another (46/226) 20% with more than two banks, while (34/226) 15% did not have contacts with banks at all. In 90% of the cases where participants chose to negotiate with one bank, the Savings Bank of Albania (the biggest formerly state-owned bank in the time-period of our survey, now owned by an Austrian bank) proved to be their preference. Generally their transactions were primarily in the form of obligations to the Taxation Office, disbursement schemes and pension funds, and, to a lesser degree, common bank transactions like credit lines, deposits, accounts, etc.

The results of the second question (Section III in our questionnaire) deal with the preference of enterprises in Albania regarding domestic versus foreign banks (Table 3).

Table 3. Domestic versus Foreign Banks

	Albanian banks	Foreign banks	Both banks	None	Total
Fieri	46	50	22	15	133
Other cities	29	29	19	16	93
Total	75	79	41	31	226

There is only a slight difference in the percentage of enterprises with a preference for domestic (Albanian) banks (75/226, 33%) from those with a preference for foreign banks (79/226, 35%). 18% (41/226) of the participants in the sub-sample chose both domestic and foreign banks, while 14% did not establish commercial transactions with banks. At this point it is worth pointing out that the Savings Bank of Albania in mid 2003 (a period in which the survey was conducted) was a state-owned bank, holding 65% of the Albanian market share. Thus, the high percentage of preference of the Albanians for domestic banks was an expected outcome. The sample with a preference for “Albanian banks” remarked, “We choose Albanian banks because we trust in them and because we are used to transactions with these banks”. The sample with a preference for “foreign banks” commented, “These banks are quick, very efficient, not bureaucratic and give more credit”. The “Both banks” category contained those participants who chose for each business deal the bank that offered special trade conditions and the best professional staff. They held the belief that operating with more than one bank grants them advantageous opportunities to compare the products and services of each and to choose the better of the two.

Table 4 contains the results of Question 3 (Section III in our questionnaire). These results are related to the length (duration) of the procedures involved in securing approval for a credit line.

Table 4. The length of procedures for a credit line

	“No Credit”	Yes				Total “yes”	Total
		One week	Two weeks	One month	More than one month		
Fieri	101	3	1	12	15	41	133
Other cities	52	1	10	17	14	42	93
Total	153	4	11	29	29	82	226

The category “No-credit” comprised a significant 68% of the total observations (153/226). This may indicate that many Albanian enterprises use the informal market to address their capital needs. As for the time required to secure a credit line for companies using different banks, we found that of the 82 companies using a credit line, 58/82 companies (71%) declared that “the procedure is long and lasts one or even

more than one month". We should emphasize that 27% of the 153 companies in the "No-credit" category have tried to apply for credit from banks, but high interest rates, bureaucratic procedures and other conditions were obstacles forcing them to drop their applications. Thus it was discovered that bureaucratic procedures are a real impediment to credit activity. This is one among many reasons (such as high interest rates, high capital requirements/guarantees, limited long-term loans and other restrictions) that can explain why a lot of Albanian enterprises "prefer" to borrow money from the informal market.

According to participants that answered "Yes" to our third question, four sub-samples were determined. Participants used credit for:

- Buying equipment and automobiles (24% of the participants that used credit).
- Buying inputs (46% of the participants that used credit).
- Buying land for business activities (11% of the participants that used credit).
- Expanding their investment (19% of the participants that used credit).

This questionnaire did not set the above categories from the beginning. It was an open question, making reference to what kind of credit the participants used, and through their replies the researchers categorized the answers.

Actually, as mentioned in Bitzenis *et al.* (2005), most of the participants in the questionnaire survey cited as the most decisive obstacles to doing business in Albania the unfair competition factor (169/226=74%), followed by the changes in the taxation procedures factor (142/226=62%), the energy crises factor (139/226=61%), and the lack of financial sources factor (127/226=56%).

Furthermore, Fries S. *et al.*, 2003 observed that Albania had some of the highest transaction costs in bank lending after Armenia, Azerbaijan and Uzbekistan. More clearly, they argued that one measure of the extent to which finance represents an obstacle is the length of time between the submission of a successful loan application and the time at which the loan is granted. This is a measure of the transaction costs involved in this process and underpins our findings in the current survey.

The results to the sixth question (in Section III), "Do you transfer or invest the money abroad? If yes, in what countries?" are as follows (Table 5):

Table 5. "Do you invest or transfer the money abroad?"

	No answer	No	Yes				Total
			Italy	Greece	Italy& Greece	Other countries	
Fieri	10	97	4	10	4	8	133
Other cities	4	77	1	3	1	7	93
Total	14	174	5	13	5	15	226

The “No” category included 77% of the total population, 6% did not care to answer at all, while 17% gave details of money transfers. In the “Yes” category, sub-samples of choosing “Other countries” specifically included: Turkey, Bulgaria, Montenegro, Romania, America, Spain and China. To conclude, Albanian entrepreneurs do not invest their capital abroad because of their lack of knowledge of international business and their lack of business connections with other countries and other foreign financial institutions.

Question 7 (Section III) is divided into two sub-questions, a) “To expand your operations, what is the investment strategy you will plan in advance?”, and b) “Do you use the help of financial intermediaries in framing your strategy (consulting services/ advisory services)?”. The answers are displayed in Table 6 and Table 7 respectively.

Table 6. Determination of the investment strategy

	No answer	No strategy	The strategy is well determined	Total
Fieri	31	54	48	133
Other cities	20	46	27	93
Total	51	100	75	226

The results in Table 6 showed that 67% of the participants had no further investment strategy or did not answer, while 33% had a well-determined strategy. Entrepreneurs in the “No strategy” category remarked, “I started up the business just to gain money” or “I have inherited the business from my father”. On the other hand, participants with a “well determined strategy” commented:

- “We developed a strategy according to the demands of the market”.
- “We developed a strategy exploiting the market according to its geographic position, and its development”.
- “We took into consideration the need to improve the quality of our products”.
- “We try to organize our management better”.
- “We aim to expand our product line”.
- “We aim to satisfy our clients’ preferences better”.

Question 8 (Section III) comprised two sub-questions: “Do you believe that Albanian enterprises benefit from foreign investors?” and “Are you involved in joint ventures or other foreign collaborations?”. We searched for information regarding the capital sources which come from a foreign country and looked for joint ventures with foreign investor interest. The results are shown in Table 7.

Table 7. “Does Albanian business benefit from foreign investors?”

	No answer	No	Perhaps	Yes	Total
Fieri	6	12	12	103	133
Other cities	2	13	10	68	93
Total	8	25	22	171	226

It appears that 76% of the enterprises (the “yes” category) believed that Albanian companies benefit from foreign investors, while 14 per cent did not believe they benefited at all or gave no answer, while 10% gave the alternative “Perhaps”. The “No” category participants believed that foreign investors show no interest in the prosperity of Albanian business, but instead prefer to exploit the low labour costs and other opportunities available in their own interests. (for example, in two Italo-Albanian joint-ventures (shoes and tailor-made clothing companies), a working days’ wage (8-9 hours) is 400 leks, approximately 3.2 USD/day, 1 USD=125 leks).

Table 8. Joint Ventures in Albanian Enterprises

	No answer	No	Joint Ventures				Total
			Local joint ventures	Italian	Greek	Others	
Fieri	8	107	7	5	1	5	133
Other cities	5	74	3	5	4	2	93
Total	13	181	10	10	5	7	226

According to Table 8, the category advocating “Joint ventures” has four classifications:

- Albanian joint ventures (31% out of the total joint ventures)
- Italian –Albanian joint ventures (31% of the joint ventures sample)
- Greek-Albanian joint ventures (16% of the joint ventures sample)
- “Others” Albanian joint ventures with Belgium, Swiss, Turkish and German companies (22% of the total joint ventures).

181 of the 226 participants (80%) replied “No”, they did not engage in joint ventures, while entrepreneurs of the “Joint Venture category” were only 14% of the total. Thus, Albanian enterprises are not mainly joint ventures and those that are - 22 out of 32 in 69% of the cases - were local companies with foreign partners.

Another conclusion to be drawn from Table 8 is that 25% of the entrepreneurs that replied “No”, intend to engage in joint ventures in the future. They believe that joint ventures offer a good opportunity to increase their competitive advantages, to improve their technology and to exchange management experiences. The “joint ventures” participants believed that extra capital funds, more managerial experience and expertise, and other managerial skills are needed.

According to Meka (2003), in July 2003 the “Tirana Stock Exchange” S.A. effectively started to act as an alternative for Albanian enterprises to ensure them the necessary capital to finance their everyday activities. Question 9 and its sub-component (Section III) examine whether entrepreneurs believe that the timing for a venture is appropriate. More specifically: (i) “Do you believe that the time is appropriate for your enterprise to be listed in the Albanian Stock Exchange?” (Table 9) (ii) “Are you aware of how the Stock Exchange operates?” (Table 10).

Table 9. “Is the time appropriate for your company to be listed in the stock exchange?”

	No answer	No	Do not understand the question	Yes	Total
Fieri	10	30	7	86	133
Other cities	3	25		65	93
Total	13	55	7	151	226

Those answering “No” believed the time was not appropriate for Albanian companies to be listed in the Stock Exchange because many enterprises do not have clean and correct (unbiased) balance sheets. The “No answer” group along with the “Do not understand the question” category comprised 33% of the total participants. 67% of the participants believed that the time is appropriate to participate in the Albanian Stock Exchange (the “Yes” category).

Table 10. “Do you have information on how the Stock Exchange operates?”

	No answer	No	To some extent	Yes	Total
Fieri	10	66	36	21	133
Other cities	3	44	22	24	93
Total	13	110	58	45	226

54% of the participants are either unaware of how the Stock Exchange operates or give the “No answer”, another 26% give the evasive answer “To some extent”, while 20% are ignorant of the Albanian Stock Exchange. Paradoxically 68% claim to be ready to be listed in the Stock Exchange.

Regarding the informal market in Albania, Bitzenis *et al.* (2005), in Question 4 (Section II), wanted to identify more clearly the best sources for financing Albanian enterprises. More specifically, they concluded that 71 per cent of our observations indicate that Albanian firms prefer to borrow first of all from bank institutions and

21 per cent from the informal market, while 4 per cent prefer not to take on debt at all. 2 per cent do not specify any category, but do indicate a willingness to borrow when better economic conditions arise. Moreover, 2 per cent prefer to deal with non-financial institutions. However, actually only (80/226) 35% of all the companies had asked for loans at different times via banks, while at the same time another 35% of the companies had never gone into debt, and 28% had borrowed from the free (black) economy. Thus, a contradictory outcome appears: only a minority of the surveyed enterprises (35%) in Albania use banks for credit lines (loans), although the majority of the surveyed enterprises (71%) stated that they would prefer to use banks as a source of financing at any stage of their company's operation in Albania if a financial need arose. Moreover, whenever we take into consideration the black or free market for financing companies' activities, "Friends & other known people" is the most preferred group, consisting of 41 per cent of the sample, while 36 per cent turn directly to family members to meet their capital needs. These results were based on the question: "If you turn to the informal market for financial help, where will your enterprise turn first?" (see Bitzenis *et al.* 2006).

Finally, regarding the managers and the skilled labor force needed for the banking system and financial intermediaries in the Albanian business environment, Bitzenis *et al.* (2006) found that entrepreneurs in Albania prefer to hire managers from among their close family or friends, although, in most cases, the manager of an enterprise in Albania is the owner himself, the entrepreneur, the manager or the consultant. In other words, Albanian enterprises do not entrust business affairs to professional people, but manage affairs by themselves. Bitzenis *et al.* (2006) found in 58% that the managers came from the first four options of their questionnaire (1→Family Members, 2→Family member suggestions, 3→Friends of the Entrepreneur, and 4→Business Friends suggestions). 13% replied that they do not employ a manager or an economist, and therefore, they do not adopt the above-mentioned argument, that in the absence of a specialist, the persons who manage company affairs on their own can be called managers. Moreover, Bitzenis *et al.* (2006) pointed out that 86% of the enterprises "employ" local managers in the belief that the local manager has better knowledge of the environment and secondly because there is an absence of foreign investment interest and thus an absence of foreign entrepreneurs and managers. Bitzenis *et al.* (2006) also concluded that 67% of the total managers had not studied abroad, and only 23% had completed studies abroad. Furthermore, 56% of the entrepreneurs or managers in the sample had not participated in any seminar or course in order to improve their management skills.

4. Conclusions

This research was conducted on the basis of interviews. The sample was structured to be fairly representative of Albanian business, taken from the industrial areas or from the banking environment. The research was based on the bottom-up approach, where the target group were Albanian enterprises. The findings of our empirical study suggest that:

- Small & medium sized enterprises in Albania deal almost as frequently with foreign banks (35%) as with domestic banks (33%). However, this trend in 2004 changed because the Savings Bank of Albania (SBA) was privatized. In mid 2003, the period in which this survey was conducted, the SBA was a state-owned bank, holding 65% of the Albanian market share. The sub-sample of participants choosing both bank-types comprise 18% of the observations, while 14% do not claim relations/transactions with banks.
- The results presented that 67% of the participants had no investment strategy, while 33% had a well-determined strategy. Some of the participants without a strategy answered, “I started up the business just to gain money” or “I inherited the business from my father”.
- 76% of the enterprises believed that Albanian enterprises benefit from foreign investors and joint ventures with foreign partners, although 80% of the 226 interviewed companies had not established joint ventures with foreign partners. However, they believed that joint ventures with foreign partners increase a company’s capital funds, its competitive advantages and technological and management experience.
- Only a minority of the surveyed enterprises (35%) in Albania use banks for credit lines (loans), although the majority of the surveyed enterprises (71%) stated that they would be willing to use banks as a source of financing at any stage of their company’s operation in Albania if a financial need arose.
- The results show an equal level of preference for domestic and foreign banks. The participants state that they will take advantage of the most attractive offer in the banking market. In 71% of the cases, the participants that have used credit lines complained of long and bureaucratic procedures. This is one of several reasons why many Albanian enterprises “prefer” to borrow money from the informal market.
- Albanian entrepreneurs (77%) do not invest their capital abroad because of their lack of knowledge and lack of business connections with other countries and other foreign financial institutions.
- Finally and paradoxically, 67% of the participants believed that the time was appropriate for their companies to be listed in the Albanian Stock Exchange and to take an active part in it. However, 54% did not actually know how the Stock Exchange operates as 26% gave an evasive answer (“to some extent”) and only 20% had knowledge of the Stock Exchange.

Financial intermediaries play a decisive role in the efficient functioning of an

economy. The most fundamental contribution of the financial system is to efficiently allocate resources from individuals and companies with surplus resources (lenders) to those with deficit resources (borrowers), thus accelerating investing and consumption patterns and opportunities, and thereby favoring economic growth. This is not the case of Albania during its transition to a market economy, a period in which banks are struggling with bad loans, bad corporate governance, working in an unfavorable business and macroeconomic environment, facing credit, foreign exchange, and interest rate risk, and operating with an absence of proper accounting standards. The Albanian banking system is excessively liquid, owing to the lack of lending opportunities, and banks dominate financial intermediation in Albania. However, the Albanian system seems to have developed following the privatisation of state-owned enterprises, and especially the privatization of the Savings Bank of Albania in 2003. Therefore, increased competition and credit growth acceleration have been seen in the Albanian banking sector since 2004.

More specifically, bureaucratic procedures are a real impediment to credit activities in Albania. The lack of financial resources seems to be another major barrier to enterprises starting up or expanding their activities. From our analysis, we can suggest the following specific policies in order to improve the total performance of the Albanian financial system and economy:

- A designed strategy of training programs for improving management skills must be realistically implemented. The training programs should emphasize: upgrading of management/entrepreneurial skills, collaboration of domestic with foreigner enterprises.
- Technical assistance should be provided to show how a clear and straightforward strategy will help the enterprises to be more competitive.
- Strategies and government intentions to reduce bureaucracy and corruption must be considered. Reduction of bureaucracy in business registration procedures, and proposals for fiscal incentives in poor regions will give a further boost to the Albanian economy.
- The long bureaucratic procedures for a company to gain approval for a credit line must be shortened.
- Action must be taken against corruption, and preparations made for a more stable business environment within a stable legal framework, in order to attract more foreign financial institutions, and increase competition in the financial market.
- Interest rates must be lowered through increased competition in the financial market and through an improved Albanian macroeconomic environment.
- Correct implementation and enforcement of the competition law can be seen as a first priority, given that competition from the informal sector in Albania arises not only from unregistered enterprises, but also from informal activities and informal behavior of the registered enterprises themselves (Bitzenis *et al.* 2005).

- Taxation rates must be reduced and strict governmental authorities trained in the collection of taxes in order to minimize the black economy, corruption, and bribery, thus minimizing the number of Albanian enterprises that “prefer” to borrow money from the informal market.
- New credit lines must be introduced for short-term loans for working capital or for long-term loans for new investment projects.
- Proper accounting standards must be introduced and enforced.
- There is a need for the system to pursue efforts to increase the awareness of consumers and other bank borrowers of the risks inherent in foreign currency borrowing, by encouraging or requiring banks to discuss exchange rate risks explicitly with borrowers before contracts are signed (IMF 2005).
- The Albanian financial market must be broadened and deepened to encourage financial intermediation such as securities, insurance and pension funds. At the moment the banking sector dominates the financial sector with over 90% of all the financial intermediaries’ assets (IMF 2005).
- The liquidity of the system should be decreased and lending opportunities should be increased. The banking system is highly liquid, with liquid assets at a high 75 percent of total assets, owing largely to a lack of lending opportunities and relatively high and safe returns on government securities (IMF 2005).

Entrepreneurs in Albania lack the financial resources, the experience and the ability to develop a well-organised strategy and they tend to go along with simple centralized organisational structures. In a country like Albania with significant low GDP *per capita*, unstable macroeconomic environment and decisive financial problems, entrepreneurs are low risk investors and prefer not to borrow either from banks or from the informal economy. The limited tendency of Albanian entrepreneurs to borrow money for investment and other reasons, is due to the fact that most of them are Muslims (around 65%-70% of the total population). It is well-known that under Islamic or Shariah law, it is forbidden to charge or pay interest in any circumstances (Bitzenis *et al.* 2006).

As an outcome, the GDP will be increased, new financial intermediaries will enter Albania, entrepreneurship will be encouraged and thus the entire economy will be improved and there will be excellent prospects for Albania to become, by the end of this decade, an accelerating economy, receiving significant FDI inflows, overcoming its drawbacks and becoming an applicant for EU membership.

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