

# THE ROLE OF SMES IN ECONOMIC DEVELOPMENT – AN EMPIRICAL STUDY OF ALBANIA

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## ABSTRACT

The role of SME-s considered as the most efficient and developer tool that generates sustainable economic growth, employment and poverty decrease. They are a source of employment, competition, economic dynamism and innovation. Also, stimulate the entrepreneurial spirit. SMEs gets broader geographical presence than large companies, so they contribute to a better distribution of incomes. In fact, the Albanian economy has gone through a long process of transition. Therefore, in this direction should to pay attention policies, opportunities for the development of SMEs in order to increases competition in business and progress of these companies. Creating a business environment like this, is a prerequisite for economic development. The main goal of this research consists in the role of SMEs in the economic development of Albania. Moreover, the main purpose of the research will be the evaluation of barriers and the impact of SMEs in creating a positive climate for business development. The methodology is based on primary and secondary sources. More specifically, we refer to previous research by other authors and other studies made by government and private agencies. The main goal is to provide data through interviews of business representatives. The main findings consisted about impact and effectiveness that plays SME-s in the capital of a country, the improvement of the economic climate, social, etc.

**Keywords:** *SME, Albania economy, entrepreneurship, business climate*

**JEL Classification:** *M21, O41, O44*

## 1. Introduction

SMEs are considered as the most efficient tool that generating sustainable economic growth, employment and poverty alleviation. In the developed and developing economies, SMEs are focused on profit and create added value to the enterprise by contributing to economic growth. In Albania, it plays a role in development after having known a constant growth across all years. The creation of a positive climate for business development helps the growth and strengthening of SMEs in order to increase their competitiveness in regional and global market. So, in Albania SMEs are dynamic element and contributor to the improvement of the economy, as in other countries. In this context, they have an essential role in the world economy. By the study was

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found that SMEs contribute over 50% to GDP and over 65% of total employment in developed countries. In the European Union, SMEs constitute about 99% of all businesses by employing over 55% of total jobs in the private sector. In Albania, 80% of the employees are employed by SMEs, where the trade and services sector have the highest number of employees. On the other hand, over 65% of the investment carried out by these enterprises. Almost at the same level adds value to the economy. Based on this discussion, the main purpose of the research will be the evaluation of barriers and the impact of SMEs in creating a positive climate for business development.

## 2. Literature Review

The literature review will focus on three ways. At first, we will define the concept of SMEs and their classification. Then, we will focus the discussion about the importance of SMEs in the economy of a country and especially in Albania. The discussion of this issue will end about factors that affecting the development of SMEs.

### 2.1 *The concept of SME*

Entrepreneurship is a creative process of organization, enterprise management and assuming the risk involved in venture (Rebecca and Benjamin 2009), where a person discovers, evaluates, and exploits opportunities (Darren and Conrad, 2009). In really, definition of the SME concept is difficult because different countries have different criteria. Baumback (1983) defined SMEs in terms of employment, asset values and sales. In general, SMEs can be defined as an economic enterprise that requires less capital, has the quality to make a quick decision, working in manual labor and a low level of expenses for its management and production to lower-cost products. The small enterprises, at the same time, are companies that are dynamical, innovative assessing opportunities at the right time (Erken, 1990).

The SME sector is categorized into three enterprises: micro, small and medium. There is much discussion about the size and definition of the SMEs criteria. In terms of economic definitions, the small firms are those that have a small market share; are managed by the owners or partners in a personalized way, and not through formalized management structure; and they are independent in the sense that do not participate in a large enterprise (UNECE, 2013). In 1996, the European Commission establishes a new definition of small and medium enterprises based on four quantitative criteria: (a) the total number of employees in the enterprise; (b) The annual volume of the turnover; (c) the total of the assets in the enterprise balance; (d) the degree of independence of the enterprise or the ownership over it. As the result of problems in the practical application to economic definitions, except from difficulties in the definition of small firms, the most widespread measure of SMEs is related to levels of employment. According to the World Bank, micro enterprises have fewer than 50 employees, small enterprises have 50 employees and medium-sized enterprises have between 50-200 employees.

**Tab. 1.** SME classification in European Community

Company category	Employees	Turnover	Balance sheet total
Medium-sized	< 250	≤ € 50 m	≤ € 43 m
Small	< 50	≤ € 10 m	≤ € 10 m
Micro	< 10	≤ € 2 m	≤ € 2 m

**Source:** European Community (2015)

The classification of enterprises in Albania was adopted by the European Community, which is classified as follows:

- 1–9 employees (micro),
- 10–49 employees (small), and
- 50–249 employees (medium).

Also, the classification of enterprises in Albania was based at turnover. Micro, small and medium enterprises includes those entities which employ fewer than 250 employees and have an annual turnover that does not exceed 8 million Albanian Leks.

**Tab. 2.** SME classification in Albania

Company category	Employees	Turnover
Medium-sized	< 250	≤ ALL 8 m
Small	< 50	≤ ALL 5 m
Micro	< 10	≤ ALL 1 m

**Source:** Albanian Law (no.8957, date 17.10.2002, changed)

## 2.2 *The importance of SMEs*

With the globalization of markets, intensive competition, and complex environment with a relatively high degree of variability, forecasting the future and providing a satisfactory profit, is often dubious and the bankruptcy risk that accompanies every step. In strategic terms in an economy, SMEs contribute to:

- Reducing unemployment. Employment is one of the factors that has a great impact on the process of economic development and it has the greatest impact on the realization to the general objectives of SMEs. In Albania, these enterprises employ about 65% of total employment.
- The growth of the GDP. Today, SMEs contribute about 60% in GDP. In this sense, the cause of macroeconomic indicators make it possible to have economic growth.
- The developing large businesses. The main factors of this situation is the economy relies heavily on small and medium business that are more resistant to the crisis than large businesses. The SMEs are more flexible compare with the large companies and as a result, have lower capital costs associated with the creation of jobs. Consequently, SMEs play an important role in economic development.
- The promotion and development across sectors and markets. SMEs have an impact on the improvement and efficiency of domestic markets because they use better the financial and human resources. In the global competitiveness index 2016-2017, Albania is ranked 80th from 93rd place to a previous year (World Economic Forum, 2017), by leaving below in ordering some of the Balkan countries such as Greece, Macedonia and Serbia.

This crossing is an indication of its economic development and achieving the overall economy to a higher level.

### 2.3 The SMEs factors

The development of SMEs depends on a number of factors. In general they can be:

- Business environment. The cost of entry, starting with the registration costs, payment of licenses and processing time, is very important for their development. These costs can not be covered during business operations, because required as initial capital. The enforcement of contracts and protection of property rights with low-cost are a very important element to start and survive a business. If the costs of enforcing contracts are too high, business may prefer to operate in the informal economy rather than engages in economic activities by law. Another factor that contributes to the development of SMEs is the level of the regulatory environment because it provides certainty for businesses operating in their respective industries. In particular, labor market regulations play an important role in the cost structure.
- Macroeconomic factors. The government expenditures are among the key macroeconomic factors that contribute to the growth of SMEs. Procurements help of registered businesses and discourage illegal businesses. Monetary policy plays a crucial role in the development and organizing the SMEs because a low inflation would reduce the informal economy. Additionally, a stable exchange rate is very important for SMEs because the business may be exposed to danger and can go up to bankruptcy.
- Growth opportunities. The SMEs in the early stages of activity are subject to bankruptcy risk. The survival rates of SMEs are not high, especially after the first year. Therefore, a well-functioning infrastructure in terms of services delivery such as police, energy, contribute to the growth of SMEs. They can not provide basic services privately different from the large enterprises, because they would be too expensive. On the other hand, political stability is essential for entrepreneurs. Also, fees and high rates of taxation may discourage the growth of SMEs and enhance the informal economy.
- Historical determinants. Businesses that are historically located in favorable geographical locations tend to survive and grow. Demography is also a determining factor. Businesses located in favorable environments, where mortality rates are lower tend to grow.

## **3. Methodology**

The main purpose of the research will be the evaluation of barriers and the impact of SMEs in creating a positive climate for business development. This paper is mainly based on the study and review of several papers by national and international authors. As secondary sources were used earlier studies by different authors, periodic reports from government agencies and consulting corporation. Meanwhile primary data was collected through interviews with business representatives. To assess the problems and to observe the impact of SMEs in the economy, we conducted a desk research and held direct meetings with representatives of selected business. After that, we used qualitative analysis for generating results from findings.

#### 4. Analysis of findings

Through primary and secondary data will be discussed in two directions. Firstly, we will focus on the peculiarities and distinctive features for SME development in Albania. Secondly, the analysis will be deeper about the possibilities of developing SMEs.

##### 4.1 The features of SMEs in Albania

The importance of a good climate for investment is a stable basis for economic growth and improvement in living standards. To achieve this, SMEs are a key element. Albania, after it came out from socialist system and during the transition period have been numerous variations in terms of the economy and not only. In the first steps in the democratic system and the country's economy was in shambles, destruction of public property and massive emigration/migration. Initially, construction of market economy institutions was a good omen. Many entrepreneurs started their business activity without proper education or experience required. Regardless of this, they have been successful. In many cases, success has been somewhat temporary and level of bankruptcy in this category businessmen has been much higher than individuals with background and professional training.

The main feature of SME development in Albania is their concentration in the main cities of the country. Lack of effective policies for distribution all over the country, it has led to the concentration of these businesses in about 20%-25% of the territory, mainly in the triangle Lezha-Tirana-Vlora, and a tiny distribution in the rest of the territory. More than 50% of these enterprises are concentrated in Tirana and Durres region, about 32% stretch in the cities of Fier, Korca, Vlora, Elbasan, and a share of about 14% is positioned in other cities as Berat, Dibra, Gjirokastra, Lezha, Shkodra. The new businesses are oriented in the main branches of the economy such as services, transport and commerce. In the structure of enterprises by economic activity continues to be the dominant trades and services sectors, which cover about 85% of registered enterprises. The development of the SME sector has its beginnings in the sphere of trades and services. This is a phenomenon known to all countries that are emerging economies. The SMEs will be attracted to invest in this sector because it is: a small initial investment, the rapid movement of capital, realization of higher profits, etc. Recently, there has been a trend of increasing investment in manufacturing field. SMEs that operating in the production field are still at an early stage of development. Even though, they occupy a small weight, the manufacturing sector possesses a great potential for development in the future. Investment in production field are those for processing of agricultural raw materials, wood processing, for the production of building materials, for the manufacture of clothing, etc. The possibility of investment in the manufacturing sector is a consequence of the initial capital accumulation in the trades and services sphere, the growing demand for building materials as a result of the impetuous development of the sector, creation of sustainable relationships with suppliers at home and abroad for the provision of raw materials, etc.

##### 4.2 Opportunities for SME development

The strengthening of financial sector is one of the key elements to enable the performance of small and medium businesses in Albania. One of the priorities to be taken into consideration for their contribution is to minimize barriers to their lending. Also, the adoption of new financial mechanisms. Although, Albania's financial sector is dominated by banks, again has helped to develop this sector. Likewise, a contribution was given by other financial institutions, as well as donors, who have encouraged investment and credits in the country. However, the SMEs funding

levels have been growing. Despite this, it considered insufficient to induce a rapid development of the sector. To improve the climate of SME financing in recent years they have been taken several actions related mainly to the introduction of credit guarantee schemes for SMEs. The guarantee funds in Albania are applied through some specific projects. The guarantee funds have been limited only to support with funding areas and certain categories of SMEs, by leaving out most of the sector. Especially new SMEs have great difficulties to obtain loans from the banking sector and credit costs are relatively high. The conditions required by banks are not favorable to businesses, and more concretely collateral is required in levels of 120% to 150% and credit interest rates are high, even when a loan for investment in plant and equipment for a medium period of time. The reallocation of resources in the economy is oriented towards productive sectors, to services, trades, hotels and restaurants. While the contribution of creative businesses is very small and is not clearly identified. The creative industry is based on talent and workmanship individual, able to produce, employing people, and is an integral part of intellectual property. The last few years in Albania, are born and are developing some new sectors of the creative industries as: advertising production, graphic studios, computer services, music and musical shows, architecture studios, design, etc. To increase the competitiveness of Albanian SMEs should be taken a few steps at the same time, to further improve the legal framework, improving the efficiency of institutions, facilities in credit management, both in cost and collateral.

## Conclusions

The SMEs are the main contributors to the economy, because they alleviate poverty, increasing opportunities for employment and allocate resources in a more fair distribution. In Albania are about 80% of employees by SMEs. Among the sectors that have the highest weight in employment are trade and services sectors. Also, over 65% of the investment was realized by these ventures. This study has the main purpose: the evaluation of barriers and the impact of SMEs in creating a positive climate for business development. About 25% of SMEs are in the triangle Lezha-Tirana-Vlore, where more than 50% of them are in Tirana-Durres region. This distribution is due to the lack of adequate policies and the migration of many population movements in these areas. Minimizing lending barriers would yield more development opportunities. The cost of credit is too high, and collateral is required in levels of 120% to 150%. In recent years, are developing creative businesses by enhancing the contribution and importance of SMEs. As for those sectors that were young and others, must be taken several measures simultaneously, to further improve the legal framework, improving the efficiency of institutions, facilities in credit management, both in cost and in collateral.

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