

# SMEs landscape in Albania

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## Introduction

Albanian economy has maintained a positive pace of growth in the last decade due to the untapped economic potential and active economic reforms implementation. A positive momentum continues but diversification of the economy focusing more on key growing and productive sectors is important to keep a long-term growth and to allow room for absorbing unpredicted external and internal shocks. 2018 resulted in an economic growth of 4.1 percent, the Gross Domestic Product totaled \$15,059 million, while 2019 is expected to be in the levels of 3 percent manifesting economy's potential for growth but in the same time room for improving efficiency given the existing output gap. However, still the economy continues to rely on a consumption led-growth model much depending on the increase of personal income fueling households consumption. Transition into an exports-led growth model appears to be a necessary long term aim for Albanian economy and active measures to orient public policies towards it have to be in synchrony with sectorial development strategies.

In terms of key macroeconomic indicators the Albanian economy has managed to maintain stability with level of prices volatility being within the target of the Central Bank within the monetary policy targeted inflation of 3+/- 1 percent, local currency has maintained its value compared to main hard currencies Euro, US dollar and pound; Government debt projected to fall on the level of 65 percent of GDP as per 2020 as result of growing revenues and campaigns against informality; unemployment rate is around 13 percent while youth unemployment continues to be a main challenges in need to be addressed by labour market active measures. Since 2014, Albanian exports volume of goods and services have known a positive annual rate of growth however volume of goods appears to be significantly volatile from year to year that being dependent on foreign demand for local exports.

The banking sector in the country is well-capitalized and profitable with all the banks exceeded regulatory requirements of minimum capital-adequacy ratio of 12 percent. Ministry of Finance and Economy in collaboration with the Bank of Albania have undertaken an action plan to improve the soundness of the banking system in the country by reducing Non-performing Loans (NPLs) levels. Referring to the Bank of Albania loan portfolios quality is constantly improving due to a coherent implementation of the NPL programme including mandatory write-off helping to reduce non-performing loans to 8.4 percent of total loans by December 2019.

Despite financial crisis is well behind and the economy appears to have recovered from negative spillover effects, weak crediting continues to characterize the financial sector while the obstacles to access financing sources remain high mainly for small and medium enterprises that in cases are not preferable by banks due to the risks they face while growing and consolidating. However, it is important to emphasize that favorable fiscal policies for growing enterprises by the Ministry of Finance and Economy and monetary easing measures by the central bank have positively affected conditions for growth in the private sector.

*Sectoral and enterprise structure*

With a poorly developed heavy industry, alongside a small scale production light one and an Agriculture sector limited by low productivity and limited production; Albanian economy is naturally shifting towards Services, INSTAT numbers show that Services further increased their share in GDP from 45.8% in 2014 to 48%, in 2018 led by trade and tourism related services and an increasing share of services in education and health. Agriculture as well as industry have lost some ground between 2014 and 2018 with shares decreasing from 23% to 18.4% and 14.8% to 12.2 respectively. The number of foreign enterprises in tourism, ICT and agriculture increased by almost 29.5% from 2016 to 2018.

Reports show that due to market concentration, big companies are those that determine private investments and employment trends in the economy. INSTAT Enterprise Surveys show that most investment and employment depends on a very small number of enterprises. 93.9% of all enterprises in Albania had less than 9 employees in 2018 ('micro-enterprises') and only 6.1 percent of all enterprises had over 10 employees. The slow change in this structure in recent years signals persistent obstacles for enterprise growth. Micro-enterprises Startups often cannot access financing sources due to their lack of know-how or because they operate in the informal economy, whereas many SMEs face the burden of high interest rates applied by Non-bank financial institutions as banks are not willing to support them with financing.

EU Progress Report<sup>1</sup>, considers that country's potential improve competitiveness in a free market economy could be boosted by prioritizing improvements in the business environment by enhancing ease of doing business for local and foreign companies. Stable growth in small, medium and big enterprises in Albania from 2014 to 2018 is a clear indicator of the potential for growth. Main issues voiced by the business community include lack of effective implementation of legislation, ad hoc regulatory changes, cumbersome tax payment procedures, and the controversial use of public-procurement procedures. Consultation with the private sector has been improved, compared to previous years, many platforms including the one of Ministry of Health and Social Protection, but the result of the consultations could have been better focusing primarily in implementation of recommendations concluded during these sessions. Furthermore, property titles overlapping and weak enforcement of the legislation in place in protection of property rights has created obstacles for the real estate market in terms property development and investments. Lack of access to finance through banking channels is found to be another constraint for SMEs willing to grow and expand while non-traditional sources of funding such as non-bank financial institutions are far from providing good lending conditions in support of their growth.

## **SMEs quest for growth**

Small and Medium Enterprises are perceived to be a sleeping powerhouse when it comes to their potential to contribute in Albanias economic growth and development. Still trapped

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<sup>1</sup> European Commission, Albania 2019 Report <https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/20190529-albania-report.pdf>

in legal and operational obstacles, their future might be a changemaking determinant directly contributing to boost employment, raise households income and grow the portfolio of locally-made products by promoting Albanian originality through upskilling economic agents and their communities. In this perspective, programmatic action measures have to be undertaken following a clear vision for redimensionating the future of Albanian SMEs.

### *Challenges SMEs face*

According to the latest SME Policy Index: Western Balkans and Turkey 2019<sup>2</sup>, Albania has made moderate progress in implementing the Small Business Act (SBA). This progress has been evident in terms of improving delivery of public services and simplifying regulations, positive changes that contributed in reducing on small and medium enterprises, as well as improving the overall business environment. Important achievements attained are: setting up procedures for regulatory impact analyses (RIAs) allowing now on to start measuring the impact of new legislation on business competitiveness; legal framework on insolvency proceedings has been strengthened; Registering a business and applying for licences and permits have been streamlined while digitalisation of government services has reduced the administrative burden on SMEs; strengthening of quality standards infrastructure has created more opportunities for Albanian SMEs to be more competitive.

As main priority areas where Government attention should be focused remain: growing institutional capacity of institutions responsible for developing and implementing SME policies; improving SMEs' uptake of business support services by redesigning existing schemes that have not performed well meaning impact evaluation should also take place periodically from internal and external evaluators; increasing support for innovation infrastructure to advance business-academia collaboration; Increase awareness of available supporting grant schemes; embed entrepreneurship learning in school curricula; Increase support to stimulate e-commerce practices among SMEs and roll out new supplier development supporting programmes that can help grow effective links between SMEs and multinational enterprises. However Albanian SMEs still face a number of institutional and market obstacles that pose challenges to effective business operations. Five main challenges need to be addressed to pave the way for success under present circumstances: a) an incomplete institutional framework for SME policy; b) limited access to finance for SMEs; c) a skills mismatch in the labour market and low job creation; d) limited export activity by Albanian SMEs; and e) limited innovation activities and research and development expenditure.

#### *a) an incomplete institutional framework for SME policy*

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<sup>2</sup> <https://www.oecd-ilibrary.org/docserver/1a375be0-en.pdf?expires=1583660728&id=id&accname=guest&checksum=7A131D01EE0AAFE97A3F61A393B11424>

The institutional framework for SME policy is still incomplete. Significant progress has been made in improving the operational environment for SMEs and the institutional framework for SME policy. Major achievements have been the creation of one-stop-shop Public Service Halls, the extension of e-government services for businesses and the establishment of dedicated service lines from National Business Center and ADISA in support of SMEs to fastprocess business procedures. However, obstacles remain to improve SME policy making, including: Ad hoc co-ordination of SME policy and public-private consultation. This limits effective policy implementation, and hinders the SME sector from regular participation in policy making. Limited data collection on SMEs. Data are limited to basic structural business statistics, which hinders the ability to monitor and evaluate the impact of SME support policies.

*b) limited access to finance for SMEs*

Access to finance is a key barrier to SME growth, particularly in Albania, where SMEs are less likely to access external finance and typically face higher costs than large enterprises and similar companies in comparable countries. Commercial banks in Albania introduce heavy requirements to counter the higher risk of SME lending. High collateral requirements (up to 200% of the loan value) and difficulties that because of weak business records make it difficult to borrow from banks. Land and real estate are the preferred forms of assets demanded by banks as collateral, but SMEs are typically undercapitalised and innovative Startups often own mainly intangible assets. Low levels of financial literacy among SME entrepreneurs increase the credit risk perceived by banks and microfinance institutions. Lack of accurate financial statements and sound business plans increases the opaqueness of SME performance, and thus the asymmetry of information plays a role in a disadvantages positioning in front of lenders. Limited availability of alternative non-bank and equity financing mechanisms. Asset-based finance, such as leasing and factoring, is underused, and the venture capital environment is still at an experimental stage.

*c) skills mismatch in the labour market and low job creation*

Skills mismatch in the labour market and low job creation translate into a high unemployment rate, especially among people with higher education. An inadequately educated workforce is reportedly the most problematic factor for doing business in Albania, particularly among small and innovative firms. Lack of analysis of the skills demanded by the labour market, limits the government's ability to design educational policies to supply the right mix of skills. Shortcomings in the vocational education and training (VET) system, including limited business relevance of curricula, low attractiveness to students and weak capability of teachers. Lack of an entrepreneurial culture, which limits the rate of people willing to engage in entrepreneurial ventures, start a business and create jobs. Furthermore, entrepreneurial activities and intentions are unevenly distributed with respect to gender, with earlystage entrepreneurs more likely to be men than women. Female entrepreneurship is more often driven by necessity rather than opportunity.

#### *d) limited export activity by Albanian SMEs*

In order to grow their exports performance Albanian SMEs have to address significant challenges such as limited information on foreign markets' requirements and business opportunities; limited availability of financial and insurance products for exporting SMEs. A particular problem is the lack of export finance and insurance schemes required to counter the main risks of international trade, such as longer cash-flow cycles, physical distance from buyers, and currency risk; lack of structured support to help SMEs integrate into global value chains. Besides ad-hoc matchmaking events, no systematic effort is made to ensure that incoming FDI translates into business opportunities for SMEs.

#### *e) limited innovation activities and research and development expenditure*

Innovation activities and R&D expenditure are low. Institutional progress has been made with the creation of AKTI, Agency of Research, Technology and Innovation and innovation facilities but a national innovation strategy should be developed. However, important issues remain that limit innovation by SMEs: Obstacles in the legal framework for R&D and innovation activities, including the inability of public universities and research institutes to commercialise their inventions, and few innovation components in demand-side policies (e.g. public procurement); limited collaboration between industry and academia, with no structured networks for involving universities and SMEs in joint research projects, and lack of technology transfer offices at universities to realise commercial possibilities of university-based R&D results.

### **Small and Medium Enterprises landscape**

Albanian economy is characterized by a high number of enterprises, 57 businesses per 1000 individuals, totalling a number of more than 160 thousands referring to Enterprise Survey by INSTAT, of which 95 percent are micro and small enterprises, while medium enterprises have been growing in numbers during 2018 but remaining within the level of 4 percent. Companies with more than 50 employees constitute only 1.1 percent of the total. This is a clear evidence of the essential importance development of SMEs has for the economy overall.

By 2018, most of SMEs are concentrated in two main sectors, Trade and Agriculture, respectively 27.6 percent in Trade and 26.2 percent in the Agriculture Sector. Hospitality and Agro-processing follow but worth to mention that since 2016 their numbers have been declining from year to year. SMEs in Agriculture continue a growing trend in overall terms, overpassing other sectors. Interesting to notice that despite the doubling of Agriculture SMEs number from 2015 to 2018 there has not been a significant growth in the contribution of this sector on country's Gross Domestic Product, and this might be related to the formalization of the sector during this period.

## Exporting SMEs

In terms of numbers, exporting SMEs count for only 1.8 percent of the total small and medium enterprises in 2018, however they count for around 60 percent of total exports. An interesting fact is that growth in the number of exporting SMEs has been much faster than the total number of this group of enterprises. Exporting SMEs in Albania are concentrated mainly in two economic activities, Manufacturing and Trade. These two activities define around 79 percent of total exporting enterprises, this being in line with other countries in the Region and with EU directives.

Exports in Manufacturing from Albanian small and medium enterprises have been directed mainly towards Italy, emphasizing that they represent 67 percent of total SMEs exports for the industry. While when it comes to Extractives, around 58.4 percent of exports for the industry are directed towards China in 2017. In the Agriculture sector is interesting to see a shift of the Agricultural products exported by SMEs from Kosovo market towards Italy, with 31.8 percent of exports being directed to Italy. In total, around 75 percent of Albanian SMEs exports are towards European Union countries, where Agriculture exports has seen a substantial growth. From only 39.8% of Agriculture SMEs exports toward EU in 2015, by 2018 European Union markets counted for 76.2 percent of total Agriculture exports from SMEs in 2018. As shown from the statistics EU market is more preferred for exports than for importing trade flows. This might be related to a higher purchasing power of European consumers and proximity that reduces transport costs allowing higher margins for Albanian small and medium enterprises.

Hence in 2018, number of exporting SMEs has been 2924 from 160,868 active in total for this year, around 1.8 percent the highest number in time when it comes to exporting SMEs.

**Table 1:** Number of exporting SMEs for economic activities

Code	Economic Activity	Number of SMEs			
		2015	2016	2017	2018
A	Agriculture and fisheries	42	55	59	64
B	Extractive Industry	120	123	117	112
C	Manufacturing	908	965	1,064	1,123
D	Electric energy and Gas	15	17	17	14
E	Waste Management	20	26	29	22
F	Construction	111	120	135	128
G	Wholesale and Retail	952	1,057	1,108	1,155
M	Professional and Technical Activities	47	45	51	55
	Other	194	229	271	251
	Total Exporting SMEs	2,409	2,637	2,851	2,924
	Total SMEs	150,636	158,989	160,624	160,868
	Weight	1.6%	1.6%	1.8%	1.8%

Source: INSTAT, 2019



Referring to exporting SMEs trend compared to the total, is possible to see that growth in number of exporting SMEs during 2015-'18 is faster than that of the total, showing that Albanian SMEs are finding new opportunities for growth in international markets, mainly in EU demonstrating in the same time a consolidation and standardization of quality making them competitive when facing international peers.

Despite the relatively small number of SMEs engaged in exporting activity, it is worth to mention that they represent the most significant part of total exports in the country. During 2016 and 2017 SMEs exports represent around 60 percent of total exports, while this trend in percentage has declined during 2018. This decline is dedicated to the fast growth of total exports even if in nominal terms SMEs exports have maintained the growth pace.

**Table 2: Exports weight and number of exporting SMEs according to economic activity.**

NACE Code	Economic Activity	2015		2016		2017		2018	
		Exports Weight	Weight of exporting SMEs	Exports Weight	Weight of exporting SMEs	Exports Weight	Weight of exporting SMEs	Exports Weight	Weight of exporting SMEs
A	Agriculture	0.8%	1.7%	0.9%	2.1%	0.9%	2.1%	1.1%	2.2%
B	Extractive Industry	6.2%	5.0%	6.5%	4.7%	6.1%	4.1%	4.7%	3.8%
C	Manufacturing	59.0%	37.7%	62.4%	36.6%	64.0%	37.3%	58.8%	38.4%
D	Electric Energy	1.7%	0.6%	2.4%	0.6%	1.4%	0.6%	6.8%	0.5%
E	Waste Management	3.7%	0.8%	2.7%	1.0%	3.4%	1.0%	3.3%	0.8%
F	Construction	1.1%	4.6%	2.1%	4.6%	1.5%	4.7%	1.8%	4.4%
G	Trade	25.1%	39.5%	21.2%	40.1%	20.2%	38.9%	21.3%	39.5%
M	Professional Services	0.9%	2.0%	0.9%	1.7%	0.8%	1.8%	1.3%	1.9%
	Other	1.4%	8.1%	1.0%	8.7%	1.7%	9.5%	1.0%	8.6%

Source: INSTAT 2019

Analysing SMEs exports based on economic activities, Italy, Kosovo and China are main destinations for Albanian products of small and medium enterprises. Italy counts as a prime destination for manufacturing, Agriculture and Trade, while China continues to import substantial quantities of extractives from Albania, of which a good part is channeled via SMEs operating in the industry. Proximity seems to play a role in determining exports of Albanian SME for Agriculture, Manufacturing, Services and Wholesale.

**Table 3: Main countries where SMEs export according to economic activities**

Code	Economic Activity	Number of SMEs							
		2015		2016		2017		2018	
A	Agriculture	Kosovo	32.6	Italy	21	Italy	28	Italy	31.8
B	Extractive Industry	China	37.9	China	43.6	China	58.4	China	51.7
C	Manufacturing	Italy	67.7	Italy	65.8	Italy	67.9	Italy	66.7
D	Electric Energy	Slovenia	38.9	Slovenia	24.7	Germany	40.4	Kosovo	20.4
E	Waste Management	Italy	53.2	Italy	54.3	Italy	49	Italy	57.6
F	Construction	Italy	37	Italy	73	Germany	42.3	Italy	59.5
G	Wholesale and Retail	Italy	31.9	Italy	27.7	Italy	26.3	Italy	32.1
M	Professional Activities	Italy	31.8	Italy	74.1	Greigia	31.4	Netherland	30.1

Source: INSTAT

### Concluding remarks: Addressing access to finance issue

Access to finance continues to torment growing small and medium enterprises and startups that need financing to grow, flourish and contribute value to the local economy and communities. As evaluated by EC Progress Report as well, financial intermediation remained undeveloped in 2018, and credit growth to the business sector stayed subdued. Credit to the private sector amounted to about 39% of banking sector assets in 2018. Credit growth to business was sluggish due to: (i) banks' greater risk awareness; (ii) tighter lending conditions; (iii) the low financial literacy of SMEs; and (iv) 'unbankable' business plans. Only lending to households picked up recently. The small but growing non-bank financial sector, with about 30 institutions, owned 10.7% of total financial sector assets in the first half of 2018. In February 2018, the first private stock exchange (ALSE - the Albanian Security Exchange) began trading government securities, but equity and corporate bond finance remain underdeveloped. Overall, financial inclusion remained low, with only 40% of adults and about 75% of SMEs holding bank accounts. There is a high rate of physical-cash use in the Albanian economy and in some cases this penalises SMEs that operate in informality. The central bank has drawn up a plan for increasing financial inclusion, which is important for reducing remittance fees, illicit financial flows, and the size of the informal economy. A stronger development of the still very small nonbanking financial sector could support financial inclusion as well as access to finance for SMEs. Government support will be important to make this initiative a success in national scale.