

SME'S ROLE IN THE ALBANIAN AGRICULTURAL ECONOMY AND THEIR LEGAL FRAMEWORK BEHIND IT

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Abstract: *Small and medium-sized enterprises (SMEs) have a crucial role in the transition process in every country. SMEs already make up the vast majority of private agricultural businesses operating in Albania and because of their size and adaptability are likely to be the main source of employment generation. Improving the agricultural business environment for SME development is a key objective of the rural policy framework in Albania. The Albanian authorities are increasing the support given to the agricultural SME sector, in recognition of the growing importance of SMEs to the national economy. The institutional responsibility for the rural policy formulation and the supporting of the SME development remains with the Ministry of Economy. Institutional set up seems to be simple and straightforward. However, the impression is that they lack capacities to do their work. Various reports find the work in most cases is organized in a spontaneous way; although there are developed organization charts, there are not clear lines of responsibilities within the organization structures, etc. Agricultural reform measure have largely contributed to strengthening the rural private sector development and supported the SME development. However, the progress is still behind the other competing countries from the region. The main challenges associated with the development of the agricultural private sector, in particular SMEs, remain the relatively poor investment climate and the level of corruption. Poor law enforcement, very weak corporate*

governance, both at the macro and at the enterprise levels, lack of management skills and poor infrastructure, constitute major impediments to the SME development. The legislation and the regulations influence the SME-s in a wide range of ways. They influence the process of the creation of a business which consists of the business registration and the provision of the respective license. Basically, after the year 2000, Albania has approved several laws to enable the proper functioning of businesses. The improvement of the business climate or the creation of its regulatory and institutional mechanisms has been one of the priorities of the Albanian government. The commercial legislation is one of the priority areas in the framework of the integration process There is still much more to be done in the area of the financing of SME-s since the climate of micro-credits or long term credits is not too favorable. The findings are related to the fact that new SME-s encounter a lot of difficulties to receive a credit from the banking sector and there is a fairly high credit cost. The conditions required from the banks are not too favorable for the businesses and the interest rates are too high in cases when the credit is required for investments in machinery and equipment. On the other hand, identifying the financing and the development of SME-s as one of its priorities in application of the SAA obligations, the Albanian Government has approved several important laws in that framework.

Key words: *Small and medium enterprises, employment, legal framework, rural economy, etc.*

INTRODUCTION

The development of private sector is essential to assure the economic growth persistence. Since SMEs are the majority of private sector in Albania, it is reasonable that the SME multidimensional support is focused on developing the private sector. The enhancement of small and medium enterprises is the key element of a stable economic environment, to lower

the levels of poverty and ease social problems, resulting to a better equal income distribution and increase of employment rate.

Taking in consideration the importance that SMEs play in the social-economic development of our country, this study is primarily revising the recent developments of the SME sector in Albania as well as the problems that this sector faces.

SMEs are very important for the Albanian economy. 90% of registered enterprises in our country are SMEs. There are several government agencies that are working and supporting the growth and development of SMEs.

SMEs play a very important role in the transition process. These are the main private enterprises that continuously provide jobs and contribute in the restructuring sector, while increasing services and the production of goods. SMEs help to increase the competition as well as to promote the presence of Albanian products at the European markets.

The Albanian government needs to implement better policies enforcing a rapid improvement of the business and investment climate in order to promote and increase competition between SMEs; attracting foreign investments in Albania while expanding Albanian exports at regional and global markets. Therefore, it is crucial to be focused on technology and innovation progress, avoiding administrative barriers while easing the way of doing business.

SME SECTOR IN ALBANIA

The national definition of SME: Article IV of the law nr. 8957, date 17-10-2002 “On Small and Medium Enterprises” states the definition of the micro/small and medium enterprises applied in Albania. The micro enterprises definition embodies only the staff headcount criteria – and states that entities employing fewer than 5 persons will be classified as micro enterprises. Small and micro enterprises definition except the staff headcount criteria add to the definition financial indicators as those of the turnover and balance sheet as well as the ownership and financial independency elements.

Small enterprises are those entities that employ 6-20 persons, and have an annual turnover that does not exceed 40 million *Leke* (around 320 thousand Euro). The capital of the enterprise should be owned by subjects that are classified under this law as small enterprises as well.

Medium enterprises are entities that employ 21-80 persons; the annual turnover of the entity does not exceed 80 million *Leke* (around 620 thousand Euro) and at least 25% of the capital of the firm does not belong to an enterprise that is not small and medium.

The development of the SME sector is considered one of the most efficient factors for the Albanian economy that would generate a stable economic growth, increase of employment rate, and will decline the poverty levels. During the last three years, Albania has encountered a 6% economic increase, which is esteemed as the best in the region. Certainly SME sector has played an important role in this process. The SME contribution is estimated to be around 64% in GDP and offers almost 66% of the jobs in the private sector.

According to legal statistics, due to the advantages in the tax and tariffs system the number of SME's registered as individuals are larger than those registered as legal corporations comprising more than 75% of the registered businesses.

According to INSTAT's data: 99% of active enterprises in Albania are SMEs with 1 to 80 employees. There are only 348 enterprises that have over 80 employees, while there are only 89 enterprises that have 250 employees.

- *The majority of enterprises have 20 or more employees:* In 2006, the number of active enterprises has been 55.6 thousand. The number of employees reaches 199.8 thousand,

45.5% of which have been employed by 1,102 of those enterprises with 20 or more employees. These particular enterprises have also reached the entrepreneurship goal of 48.6% and 84.2% of the investments goal. Enterprises with 20 or more employees continue to lead in the industry and construction sector. Enterprises with 1 to 4 employees make up almost 91.7% of the economy, reaching 25.9% of the entrepreneurship digit. Small enterprises are primarily service entities.

- *Service enterprises have reached 64.1% of the entrepreneurship digit, while the industrial sector has employed 34.4% of the workforce:* During 2006 almost 50.5% of active enterprises were in the commercial segment. The entrepreneurship digit of this sector is 46.9% of the entire enterprise market. The industrial sector represents the highest employment rate with 68.7 thousand employees. The producers of goods have reached 35.9% of the entrepreneurship digit.

- *Public enterprises help the economy slightly:* Public enterprises have employed 17.8% of the workforce, while reaching 10.1% of the entrepreneurship digit. They are primarily component of the industrial and transportation sectors, therefore, reaching 32.9% and 21.1% of the entrepreneurship digit.

- *Industrial sector has reached 62.1% of the overall investments:* In 2006, the total investment amount was 80 milliard Lekë, 51.6% of which has been invested in "Construction and general installation", while the remaining amount of 23.9% has been used for "Technical installation, machinery and tools". The industrial, transportation, and commercial sectors have all contributed to 85% of the total investment.

- *In 2006, enterprises in construction and service sector with 5 or more employees have increased the entrepreneurship digit by 30.6% and 27.5% accordingly:* The number of active enterprises increased to 7,555, mainly companies with 1 to 4 employees (7,164 companies); increasing the number of employees by 9.8%. The producers of goods marked a higher rate of increase by 10.6%. The entrepreneurship rate also increased to 11%. In 2006, the sales of goods and services resulted to be 74 milliard Lekë more than in the year of 2005.

- *In 2006 investment have increased by 22milliard Lekë:* 95% of this increase is contributed by companies that produce goods. The employment rate seems to be 1.2% higher compared to the previous year.

DEFINITION OF SME

The Law No. 8957, dated 17.10.2002, "On small and medium enterprises" is the fundamental law governing state measures and policies on the classification, the support of establishment and the development of small and medium enterprises. Such law aims to govern the functioning of small and medium enterprises through the creation of an institutional, regulatory and financial framework. The article 4 of the above-mentioned law gives the definition of SME according to which "The micro enterprises definition embodies only the staff headcount criteria – and states that entities employing fewer than 5 persons will be classified as micro enterprises. Small and micro enterprises definition except the staff headcount criteria add to the definition financial indicators as those of the turnover and balance sheet as well as the ownership and financial independency elements. Small enterprises are those entities that employ 6-20 persons, and have an annual turnover that does not exceed 40 million Leke (around 320 thousand Euro). The capital of the enterprise should be owned by subjects that are classified under this law as small enterprises as well. Medium enterprises are entities that employ 21-80 persons; the annual turnover of the entity does not exceed 80 million Leke (around 620 thousand Euro) and at least 25% of the capital of the firm does not belong to an enterprise that is not small and medium."

The definition given in this law clearly introduces the incompatibility with the definition given by the Recommendation of the EU Commission dated 6 May 2003, pursuant to which.. “SME enterprises consists of firms that employ less than 250 people, and which have an annual turnover not exceeding EUR 50 million, and/or a balance sheet total not exceeding 43 million EUR. The category of the small enterprises is sub grouped under the criteria of having fewer than 50 employees and annual turnover/balance sheet that does not exceed 10 million EUR. The logic of defining SME in Albania is consistent with the EU definition, but because of the economy size and performance the criterion do differ. The number of employees is the main criteria employed in both definitions, and this is seconded by the turnover and balance sheet figure”.

The compatibility of the definition of SME in Albania with the one of the EU is an obligation which already stems from the Stabilization Association Agreement (ratified by the law No.9590, dated 27.7.2006) specifically in its articles 70, 91 and 93.

This necessarily leads to the taking of effective measures in order to give a clear definition of SME in conformity with the EU recommendations and the obligations stemming from the SAA.

CREATION OF A SUPPORTIVE CLIMATE FOR THE DEVELOPMENT OF SME-S

The Albanian state which aspires to become part of the European family and market is committed to carefully pursue the reform processes and the processes related to economic and structural development on unemployment reduction, enhancement of productivity and competition in the European economy. In addition to the provision of economic and social sustainability, the central role of the government in support of the development of private sector is also the creation of a regulatory environment maximizing the potential of the sector to survive and develop. A series of strategic documents approved by the Albanian state are drafted in accordance with the SAA and the European Charter of Small and Medium Enterprises.

Upon the signature of the SAA, the Albanian State has drafted the National Plan for the Implementation of the SAA for the period 2007 -2012. The Plan has provided for in details the current situation and the short term, mid term and long term priorities to be launched by the Albanian state in the framework of the development of SME-s. Such priorities shall be increasingly oriented toward the area of the promotion of exports, foreign investments and SME development as important factors to speed up the integration of Albania in the EU.

In the wake of such significant document, the Ministry of Economy, Trade and Energy as one of the responsible institutions for the drafting of policies on the improvement of the business climate of SME-s, has drafted the “Business and Investment Development Strategy ” (2007-2013). This Strategy constitutes one of the most important documents in this area aiming at the creation of a sustainable partnership between state and business and a promoting climate for sustainable economic growth through the development of the promotion of investments or enterprises in the framework of SME-s. Such strategy has shifted its focus on the responsibility not only to be shared by the Ministry of Economy, Trade and Energy but also on the coordination and correlation with other institutions. The said Ministry has formulated the Strategic Program for the development of SME-s for the period 2007-2009 which provides for in more detailed terms the 2 year priorities of the Albanian State in the area of the development and approximation of the Albanian SME policies with the EU ones.

The legislation and the regulations influence the SME-s in a wide range of ways. They influence the process of the creation of a business which consists of the business registration

and the provision of the respective license. Basically, after the year 2000, Albania has approved several laws to enable the proper functioning of businesses. The improvement of the business climate or the creation of its regulatory and institutional mechanisms has been one of the priorities of the Albanian government. The commercial legislation is one of the priority areas in the framework of the integration process. The recent approval of the Law No. 9901, dated 14.4 2008 “On Traders and Commercial Companies” and of the Law No.9723, dated 3.5.2007 “On National Center of Registration” is one of the successes of the Albanian state influencing in particular the reduction of time and the cost required for the business registration.

SME AND LEGAL OBLIGATIONS IN THE EMPLOYMENT AREA

The growth of small and medium enterprises (SME) is an essential component of economic development. SME-s are normally a significant source of employment and foster the innovation, economic dynamics and competition.

The Albanian legal framework is consolidated on a year by year basis and such a fact is reflected since the approval of the Code of Labor (the law No 7961, dated 12.07.1995) which creates a statutory basis for the rights of employees, the right for minimum basic salary, the duration of the working day, holidays, working hours, working conditions and other benefits of the employees such as permits for temporary working disability, permits before and after child labor etc.

The legal framework in the employment area has manifested a series of positive aspects upon the approval of the Law on Encouragement of Employment (No. 7995 dated 20.09.1995). Such law aims at the employment, vocational training and qualification through the pursuit of overall active policies in order to support the full, productive and freely chosen employment by the young people who may be involved in small and medium enterprise systems.

On the other hand, the Law on State Assistance (the Law No. 9374, dated 21.04.2005) provides for in its provisions, the article 9,10,11,12, the supply of assistance for the development of SME-s, employment and opening of new vacancies. Additionally, the law has provided for assistance on special or basic training of people employed in the SME-s.

Yet, what is deemed too problematic is the lack of an accurate strategy concerning the employment or qualification to identify the relevant needs and to potentially avoid informality. In the meantime, it would facilitate the social and economic integration of social groups such as young people, housewives or disabled persons.

Special importance must be attached to the investment in education, qualification and learning, aiming at the drafting of a strategy on the promotion of enterprises with a concrete action plan which shall be focused on the introduction of the culture of enterprise both in educational institutions or the training sessions required for the entrepreneurs.

COMPETITION AS AN IMPORTANT ELEMENT FOR THE DEVELOPMENT OF SME-S

Equality in the market and the fight against monopolies demand economic development and business consolidation. In Albania, it is created the legal framework for the control and supervision of competition. According to the reports completed in this area (Progress Report in Political Reforms, Index of Investment Reform 2006, OECD) irrespective of a slight improvement of the free competition in the market, there is still much more to be done in respect of the institutional strengthening, where the Competition Authority must display a more effective function but also the strengthening of the supervision of the market of

its constituent components. Specifically, it is required the development of a sustainable cooperation between the Technical Central Inspectorate and the Directorates of Standardization, Accreditation and Calibration.

The approval of the Law on State Assistance which distorts or is at risk of the distortion of competition, favoring one or several enterprises or the production of specific products, is based on the key principle of the implementation of the EU state assistance policy, which is also incorporated in the article 71, point 1, paragraph 3, of the Stabilization Association Agreement. Given that there shall be a transitory period during the Stabilization Association process, this legal framework aims at the creation of balance between the supportive policies pursued by the state on the economic and social development of specific regions of the country as a whole and the fulfillment of the commitments undertaken by the Republic of Albania in this area.

Additionally, in this respect, the strengthening of the role of the Directorate of State Assistance is deemed of major importance in order to enable the registration of the schemes on the provision of state assistance so as they can be readily controllable to be in compliance with the EU recommendations. In the meantime, this must be accompanied by the necessary legal amendments and initiatives in order to ensure fair competition and the support of SME integration into the international market.

FINANCING OF SME-S

There is still much more to be done in the area of the financing of SME-s since the climate of micro-credits or long term credits is not too favorable.

The findings are related to the fact that new SME-s encounter a lot of difficulties to receive a credit from the banking sector and there is a fairly high credit cost. The conditions required from the banks are not too favorable for the businesses and the interest rates are too high in cases when the credit is required for investments in machinery and equipment.

On the other hand, identifying the financing and the development of SME-s as one of its priorities in application of the SAA obligations, the Albanian Government has approved several important laws in that framework, specifically the Law “ On state assistance” which provides for the provision of assistance for the development of small and medium enterprises as in the case of the assistance for investment (intensity does not exceed 15% of the additional eligible investment costs) in the case of counseling services or for the participation for the first time in fairs and exhibitions (when the assistance does not exceed 50 % of the additional costs for renting, establishment or functioning of billboards).

Under such conditions, the improvement of the business climate in the area of financing and crediting of SME-s would be necessary in order to ensure a sustainable and competitive market with the regional market and the launching of steps to be compatible in a near future with the EU market.

A favorable bank credit environment must be established by increasing the reserve funds, in order to launch an effective relationship between the financial sector and SME’s. This practice will boost the growth of small enterprises.

Source of funding

The financial channels in our country are not aligned properly, as we would prefer to. Other countries at the same comparable economic development stage as ours have used the external funding sources profoundly, which has led to a major contribution to reducing the use of internal financial sources.

There is a big difference between countries with developed market economy and the economies of Balkan region which we are part of. The developed countries have utilized the

proper asset allocation procedures to promote the financing of small enterprises.

In our country, small enterprises seek the internal or personal funding as the main financing source, while the external funding is very limited. Internal funds are generally provided by owners or debts taken from relatives. Our country's financing technique is quite the opposite of developed countries, where the majority of funding is provided by lenders; consequently entrepreneurs may need to provide a small amount of their reserves.

In comparison with previous years, the use of external sources to finance businesses has increased significantly, while businesses show a greater interest in using these types of sources. At first, entrepreneurs did not have the proper knowledge about the financial market and were not comfortable in borrowing money to finance their business activities. The demand for loans has increased overtime, while businesses have grown along with the opportunity to have a greater exposure to financial market information. The report of Bank of Albania would be the appropriate reference source, in order to obtain the correct data about the economy in its entirety, and to specifically define the right credit levels of our country's economy.

The credit environment for SMEs remains critical, as neither small nor long-term loans are positioned favorably. Even though business lending has shown a market increase in the economy since 2005 onwards, the credit portion of GDP is still lower compare to other countries.

According to the 2007 annual report of Bank of Albania, the private sector has achieved a better credit performance; while there the request for credit has increased significantly for the entire economy. In response to this request, commercial banks have deepened their role as financial intermediaries by offering new products tailored around clients needs. These positive developments have promoted the expansion of loan portfolio by improving significantly the financial intermediation indicators.

The credit ratio in relation to the gross domestic product has been increased significantly by 8.8 percentage points, reaching 30.1 percent at the end of the year. In December 2007, the credit portion increased in report to the money supply and business activities, marking respectively 38 and 40 percent levels. However, during 2007, the credit growth rate slowed by 50.4 percent, marking the lowest rate in the last two years. Even though within these limits, the loan portfolio is estimated to continue to grow; this will carry potential mid-term risks regarding pricing and financial stability. The foreign currency loan structure has been steady during the year, has dominated the excess of 72.3 percent of the portfolio, compared to 71.1 percent in December 2006. Unlike the last two years, during 2007 banks have showed a greater tendency to lend loans in foreign currency, especially in the second half of the year. The portfolio in foreign currency marked the highest growth rate (average of 53.5 percent), compared with the one in local currency Lek (average of 49.8 percent). Business entities have been the key factor to the credit growth. They dominate almost 63 percent of the entire loan portfolio. However, in the last two years this contribution has been in a steady decline, because banks have shifted their primary focus on retail banking, seeking to lend mainly to individuals. In December 2007, the annual rate of business loans was reduced to 43%, as a result of the slowdown for investment loans and the faster growth for capital floating loans.

The capital floating loans are characterized by maturity short terms; therefore the expected high levels of repayment have contributed to a lower growth of business loan portfolio. During the same year, banks have issued more loans to retail businesses (38.1 percent), industry businesses (26.1 percent), and construction businesses (21.1 percent). Only 1.2 percent of the credit loan portfolio has been issued to agriculture sector, which is the less financed segment by the banking industry.

Our study regarding the private sector credit environment is based on several reports published during this period by Bank of Albania and the European Bank for Restructuring and Development.

Even though the financing options for SMEs have increased, there is still more need for financial sources to promote a rapid development of the sector. In the recent years, several measures have been taken to improve the SME financing structure, one of which is the introduction of secured loan programs. These programs serve as tools to support the ability of SMEs in obtaining loans, by lowering the required collateral. However, the secured loan programs are not guaranteed to fulfill each and every credit request as needed.

Leasing in Albania is a great opportunity for SME-s. The leasing program in Albania was initiated in October 2003 as a cooperation between the Albanian Ministry of Economy and South European Economic Cooperation. The passage of the Financial Leasing Law by the Albanian Parliament in May 2005. The new *Financial Lease Law* provides the terms and conditions of a financial leasing contract, and some minimum requirements must be fulfilled by companies that wish to act as lessors

Leasing is still in its very early stages in Albania. Four leasing companies began operations in Albania, one owned by Piraeus Bank of Greece (Tirana Leasing), Raiffaissen Leasing the other owned by the local representative of leading German equipment suppliers (Landeslease Sh.A) and Bileasing Sh.A-recently Credins Leasing too. Leasing can meet the demands of small, medium and large businesses, it can create a strong competitive advantage as a financial option offering many benefits such as: it provides access to the equipment, real estate that business need, by minimizing the financial and technological risks that accompany ownership; business can be more flexible, reacting quickly to changing market conditions; businesses leverage strengthens creating a greater cash flow, conserving capital and also preserve existing credit lines; the business often benefit from fiscal advantages because lease payments may be considered deductible expenses, reducing the effective cost; can allow a wider amount and range in brand of vehicle, equipment, real estate acquired, refreshing the technology; business with budget restrictions may use equipment by expressing the capital cost as a fixed rental amount.

Leasing has also some disadvantages such as: the lessee have no equity until it decide to purchase the equipment at the end of the lease term, at which point the equipment perhaps has depreciated significantly; obligation to continue making payments posing a major financial problem for the owners of a business experiences a down-turn; the lessee is not the owner, but is still responsible for maintaining the equipment as specified by the terms of the lease; failure to do so can prove costly; usually end up paying out more over the asset's life than the lessee would have paid if it purchased the asset.

EFFECTIVE COMMUNICATION WITH THE PRIVATE SECTOR

Effective communication with the private sector is a feature which includes in the majority of categories the analysis of needs. The established mechanisms must be built in such a way as to be capable to guarantee that there exists a sound basis of top to bottom communication, starting from the local level. This is important as it is hard to find an appropriate representation of items coming from the SME sector at national level.

The communication and information technology has started to significantly change during the two last years. The improvement of the website, the online information of the Tax General Directorate is a quality step in this respect.

It is worth underlining that in the formal part of the SME sector, the communication may be expanded through the supply of the main stakeholders with which the small and

medium business interacts, with concrete and practical information to be effectively available for subjects such as banks, professional services or different regulatory authorities at central administrative level.

The creation of facilities by relying on helpful instruments for the provision of information is deemed as highly important in terms of the consistency and consolidation of effective communication between the private sector and the state bodies, but also aiming at the involvement of the SME-s in the decision making processes. Such a fact would significantly encourage the drafting of a legal framework which shall respond to the needs of all groups of interest.

CONCLUSIONS

Irrespective of the progress of Albania during recent years in the business area both in legal and practical aspect, the improvement of the business climate still remains problematic. The regulatory mechanisms as regards legal formalities, reduction of informal economy, increase of SME competitiveness, improvement of infrastructure quality, are still problematic. In such closing part of that article, it would be of interest to underline some of the most important conclusions which may serve as elements in the improvement of legal and functional governance of the SME sector in Albania.

- There emerges the need of the identification of a clear definition of SME-s and the compliance of such definition with the EU one, as an obligation already stemming from the SAA.
- In view of providing a favorable climate for a sustainable market and increase of fair competition in relation to SME-s in the international market, concrete regulatory and controlling measures have to be undertaken by the Albanian Government. This requires inter alia, the strengthening of the effective cooperation between the competent institutions in such area.
- The creation of regulatory and facilitating mechanisms for the SME-s during the credit receiving process from the banking sector would influence both the economic development of the country and the upgrading of the in- country employment level.
- The drafting of a long term strategy on the promotion of enterprise with a concrete action plan which has to be focused on the introduction of the culture of enterprise both in educational institutions and the training sessions required for the entrepreneurs.
- The improvement of formal communication between the SME-s and the administration bodies both in the process of the provision of information and their involvement in the decision making processes.
- The Albanian Government must take measures in respect of legislation, paying special attention to the enforcement of the SAA obligations.
- The European Charter of Small Enterprises as one of the significant international documents in that area deserves special attention by the central administration bodies in terms of the approval of legal acts or bylaws for its implementation as it is of paramount importance for the development and the improvement of the SME sector in Albania.
- Due to high risks, such as the structure of albanian business, difficulties in accepting real estate as mortgage because of current situation regarding ownership the banks are mostly offering short term credits, which are acceptable for traders, not for production companies with long term investments
- Since early 2005, while the environment for leasing in Albania took a major positive step recently with the passage of the Financial Leasing Law by the Albanian

Parliament in May 2005, four leasing companies began operations in Albania

- The legislation is expected to fill an important financing gap for Albania's SMEs, who often need new equipment for their operations but cannot obtain the term loans from local banks required to make the purchase. The result is expected to be a shot in the arm for the local small business sector, the key source of job creation in our country
- It is very important training banking personnel and official to understand the situation and the importance of SME
- Stimulating and involving young people in management of SME

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