

# SHAPING THE FUTURE - SME SECTOR EMPOWERMENT IN ALBANIA

**IRSIDA DINOSHI**

Ph.D Candidate at the Business Faculty of Aleksander Moisiu University, Durres

## ABSTRACT

The term SME encompasses a broad spectrum of definitions. Different organizations and countries set their own guidelines for defining small and medium enterprises. But the most important is that SMEs are the backbone of the national economy and the basis of the free enterprise economy. Considering the previous studies conducted on SMEs in Albania, it stressed the importance that they have on the economic growth of the country and the general level of the employment. The paper presents the model with the macroeconomic factors affecting the profit of SMEs in Albania, which includes the macroeconomic indicators such as GDP, the total number of active small and medium enterprises, CPI, Exports volume, Imports volume, the unemployment rate, the employment rate, and the exchange rate of Lek/Eur. But first, the paper analyzes the performance of the indicators in Albania during the last ten years and also makes a descriptive comparison between each of them and the SME profit (or profitability in some cases). Most of the macroeconomic factors we have selected were found not to be statistically significant and had no strong correlation with the firm's profit. The number of the active SMEs, imports volume and exchange rate has the greatest impact on the profit.

**Keywords:** *Small and medium sized enterprises, exchange rate, monetary policy, GDP, barriers.*

## INTRODUCTION

In different studies it is stated the importance of the small and medium enterprises (SMEs) sector for the economy because of the role it plays in boosting the economic growth. SMEs play an important role in the global economy through its significant contribution to the GDP and improving the people's standard of living. In the transition countries this sector represents the major part of the private economy. Except the main role it has, the performance of this sector (or the profit it generates), is affected by macroeconomic factors and the progress they have in certain periods. The profitability of SMEs is an essential indicator that influences the forecast of this sector development, the competitiveness, the government decision making to relieve restrictive barriers, to decrease the informality level, to incentive the employment, to facilitate access for financing this sector, etc (Shosha, 2014). The factors that influence the activity of a company can be divided into two main groups: micro or internal (company-specific factors) and macro factors or external (often specific to the state or region where the company operates) (Popa & Ciobanu, 2014). Profitability is one of the most volatile company's financial indicators that is influenced not only by internal but also by external, macro factors.

The aim of this study was to evaluate the impact of the macroeconomic factors in the SMEs profit, and to identify which is the most important indicator that influence the growth of this sector in Albania.

## OBJECTIVES OF THE RESEARCH

- To identify the main characteristics on which is developed the sector of SMEs in Albania;
- To analyze the performance of each indicator related to profit of firms during the last years,
- To identify the macroeconomic factors those have the strongest impact on the SMEs profit.

## LITERATURE REVIEW

Profit and profitability (sometimes measured by different indicators such as return on equity, or return on assets) has been given considerable importance in the finance and accounting literatures. According to (Hifza, 2011) profitability is one of the most important objectives of financial management since one goal of financial management is to maximize the owners' wealth, and, profitability is very important determinant of performance. A business that is not profitable cannot survive<sup>1</sup>.

During this year a lot of research studies are conducted on small and medium enterprises performance, the development of this sector, the competitiveness, the profitability etc. In the following, there are some findings of different researchers on the macroeconomic and microeconomic factors that affect most the small and medium enterprises profitability.

Bekeris (2012) the macro indicators that he included in his model was the population number, the enterprises number, exports and imports, FDI, GDP, unemployment, inflation, taxes paid, average salary, interest rate, the monetary base and others. He concluded that the interest rate changes and the unemployment have the greatest impact on SMEs profitability.

Profitability at microeconomic level has been studied depending also on indicators such as current ratio, liquid ratio, receivables turnover ratio and working capital to total asset (Singh and Pandey, 2008) or expressing it through economic value added (EVA), return on equity (ROE), operating profit margin (OPM), earnings per share etc (Rayan, 2008)<sup>2</sup>.

Popa and Ciobanu (2014) studied the financial factors that impact on the functionality and profitability of SMEs in Romania during the 2009-2012 period. The indicators they used to quantify the performance of a company were return on equity (ROE) and return on invested capital (ROIC). They stated that the microeconomic indicators are not sufficient to define the profitability of the company, but should be taken into consideration also macro indicators. They concluded their research that managerial decisions on investment influence decisively on SMEs performance especially in a period of economic instability. Also Ferati, Yzeiri, and Ejupi, (2012) stated the importance of the ROE indicator on the profitability of SME sector. They observed the 150 enterprises of Pogoani Region in Macedonia during the period 2003-

---

<sup>1</sup> Cited at Sivathaasan, N., Thasanika, R., Sinthuja, M., & Hanitha, V. (2013). "Factors determining profitability: A study of selected manufacturing companies listed on Colombo Stock Exchange in Sri Lanka". *European Journal of Business and Management*, 5(27), 99-107.

<sup>2</sup> Burja, C. (2011). "Factors influencing the companies' profitability". *Annales Universitatis Apulensis Series Oeconomica*, 13(2), 215-224.

2010. Many researchers have also brought their conclusions on some work done related to the factors affecting the profitability of SMEs sector. Margaretha and Supartika (2016) examined factors that affect most on the profitability of SMEs in Indonesia stock exchange. They concluded that two indicators such as productivity and industry affiliation have a positive impact on profitability and based on that they suggest the managers to define a strategy to increase the profitability with focusing on these two indicators. Firm size, growth, lagged profitability as other indicators included in the model had a negative effect on profitability. Since the indicators that affect the SMEs profitability are a lot, as mentioned above, Garcia-Teruel and Martinez-Solano, (2007) have studied the effect of working capital management on SME profitability and they suggest managers to reduce the number of days accounts receivable, the inventories and to shorten the cash conversion cycle in aim to improve firms profitability.

The development of SMEs (especially in the Mediterranean) can contribute in facing the numerous challenges associated with economic development, the effects of inequality and high levels of unemployment, population growth and the need for structural changes. In addition, the development of the SME sector can contribute to the strengthening of the competitiveness and productivity, promoting the revenue growth and per capita incomes (Euro-Mediterranean Regional and Local Assembly, 2012)

Chughtai (2014) stated that 90 % of businesses are engaged in the small and medium enterprises which play intense role in boosting the economic growth. He concluded that there is a positive correlation found between process innovation and SMEs growth while the performance of SMEs has significant impact on economic growth. Education as percentage of GDP has been found positively significant, also the patent application for non-resident and trademark total are the two main variables showing their significant impacts on SMEs growth and economic development as well. Whereas, variables like inflation, volume of exports as percentage of GDP are effecting the growth negatively. Taiwo, Ayodeji, and Yusuf, (2012) investigated small and medium enterprises as a veritable tool in economic growth and development in Nigeria. They stated that unfortunately SMEs have not played the significant role they are expected to play. They suggest a good implementation of the reforms helded by the government especially to the educational and industrial sectors. Given efficient and effective execution of these as well as the political will and good leadership and followership, the SME sector will certainly be an effective tool for rapid industrialization of the Nigerian Economy.

### **Small and medium enterprises definition in Albania**

Since 1990 when Albania changed the political regime, the country launched to implement a free market economy and started to develop the free enterprise. The SME sector was structured over the years and became in one of the most important sectors for the important role that had on the most basic economic factors. The contribution and the important role of the SMEs in the economy of a country it is discussed constantly due to the fact that it is proven that the creation of new enterprises has an impact on economic growth, on the increase of the employment, in innovation, productivity, etc. 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 employment rate, and will decline the poverty levels (Totojani, 2010). Runyan, R. Droge, C. Swinney, J., (2008) stated that a good performance of SMEs it is important to stimulate a better performance in the future and to support the survival and the growth of the enterprises. In many studies and institutional reports, the clasification of SMEs often is expressed through quantitative indicators such as: number of employments and annual turnover, even though in many cases it is used either

the indicator of financial asetes.<sup>3</sup> But, to give an acceptable definition on SMEs it's as much important as it is so different from one country to another, because of the criteria's taken into account to do the businesses classifications. The new definition of the European Union approved in 2005 take into account three criteria's: (i) the employee's number; (ii) the annual turnover; and (iii) the annual balance sheet. According to OECD,<sup>4</sup> SMEs are a very heterogeneous group and extending over all trading sectors.

The national definition that is applied for SME sector in Albania is according to article IV of the Law no.8957 date 17/10/2002 "On Small and Medium Enterprises" takes in consideration two criteria's: (i) number of employees; (ii) the declared annual turnover. The enterprises are classified into: microenterprises, small enterprises and medium enterprises.

**Table 1: Small and Medium Enterprises Classification in Albania<sup>5</sup>**

<i>Category of the Company</i>	<i>Number of Employees</i>	<i>Annual Turnover</i>
Micro	Up to 5 employees	
Small	6 – 20 employees	Less than 40 mil All
Medium	21 – 80 employees	Less than 80 mil All

Source: Law no.8957 date 17/10/2002 "On Small and Medium Enterprises"

### **The macroeconomic indicators affecting the SMEs profit.**

Many authors have analyzed the importance of different macroeconomic factors on firms' profitability such as: GDP, inflation, unemployment, FDI, exports and imports, money market etc. The macroeconomic indicators that are selected to be analyzed are: GDP, CPI, Total number of active SMEs, export and import volume, unemployment and employment rate, exchange rate of Lek/Eur. The performance of these indicators during the last ten years in Albania and the SME sector are presented on the tables and graphics below.

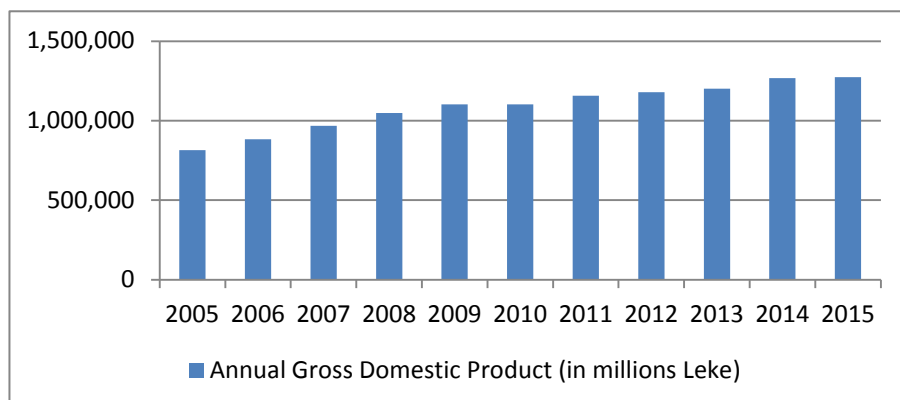
For years it is stated that GDP and macroeconomic environment are closely and mutually linked to each other. Macroeconomic environment defines business climate and therefore the dynamics of investment, which are an important factor for economic growth and stability (Zharakalli, 2015).

<sup>3</sup> Cited at Lipi, R. (2014). "Performanca financiare dhe orientimi sipërmarres i NVM-ve, Qarku Vlorë". Tiranë: Universiteti i Tiranës. pg. 39

<sup>4</sup> Organization for Economic C-operation and Development

<sup>5</sup> Law no.8957 date 17/10/2002 "On Small and Medium Enterprises"

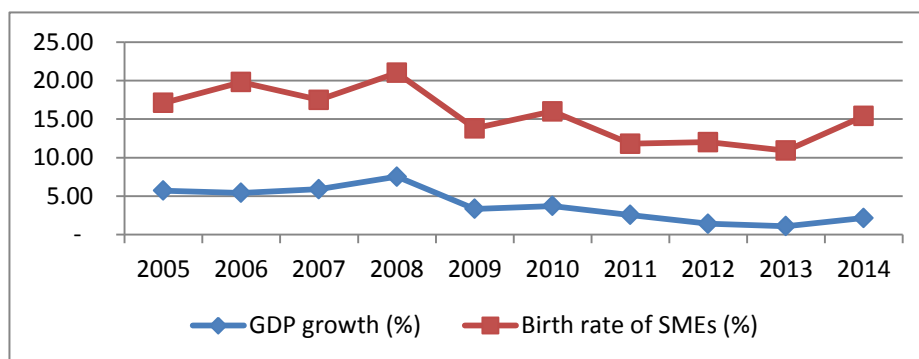
**Figure 1 - The Annual Gross Domestic Product (in millions) for the period 2005 - 2015**



Source: INSTAT Database, Bank of Albania Statistics

It seems that for the period we study, the growth rate of SME (or the number of new enterprises for each year) has increased at the same rate with the annual rate of GDP. After the 2013 the growth trend of new SMEs has been more positive than the GDP growth, because in 2012-2013 periods this indicator recorded the historical lowest levels of 1.42 % and 1.11 %. Only in 2014 it started to be improved at level 2.17 %. While, the new firms growth trend in 2014 was 15.4 % or in terms of number, there were 112.537 active SME out of which 17.377 new ones recorded. This means that, increasing the number of SMEs does not depend on growth of GDP.

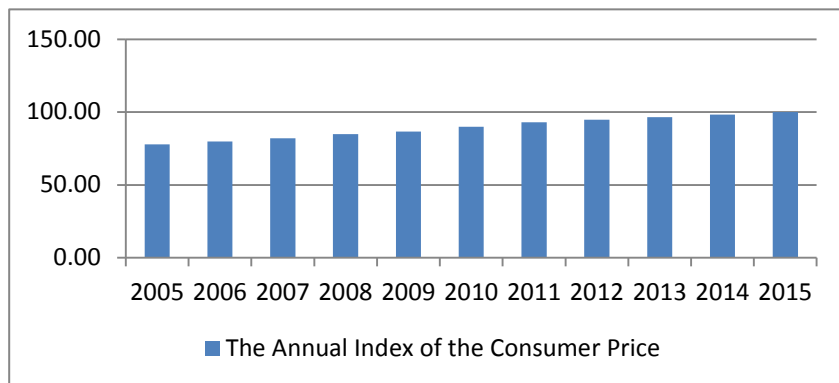
**Figure 2 - The birth rate of SME and GDP growth trend**



Source: INSTAT Database and World Bank Database

Inflation (or Consumer Price Index that is selected as a macroeconomic indicator). The low but controlled annual average of inflation rate, after 2011-2012 period start to decrease from 3.5 % up to 1.6 % for 2015 year recorded. According to the Bank of Albania Statistical Report, the decrease was driven by low growth of food prices and the continued decline in oil prices, which has further reduced costs of production and transportation of goods and services. At the macroeconomic terms, low levels of inflation continue to be determined by poor performance of aggregate demand, but the strong slowdown in the last quarter of the year seems that owes mostly of imported inflation fall.

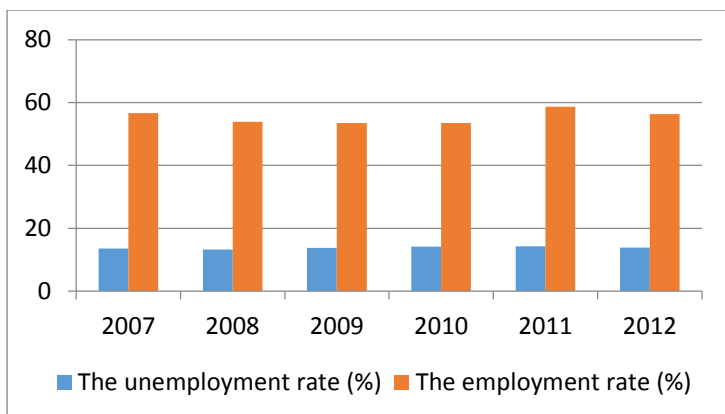
**Figure 3- The Average Index of the Consumer Price**



Source: INSTAT, Database

The unemployment rate, of course that the high level of this indicator has a bad influence on the economic performance of a country. As the high inflation rate, the high unemployment rates has the same consequences because of relatively small workers the market is becoming less solvent, the government collects less personal incomes taxes and there are less money for other different investment programs. The employment rate in 2011 has had its better level of 58.7 %, but after that year is decreased reflecting also the decreased level of GDP for the same period of Albania.

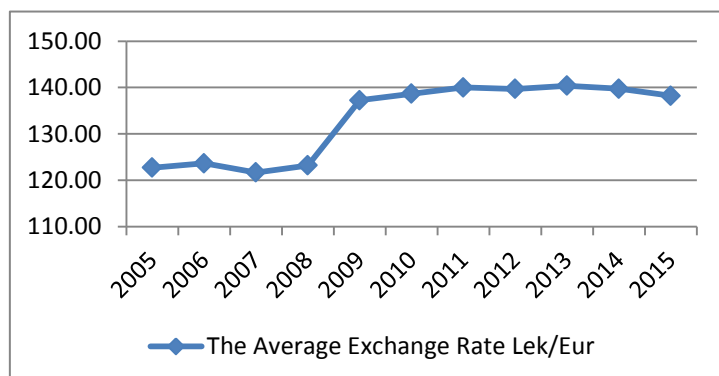
**Figure 4 - The Employment and Unemployment rates (%)**



Source: INSTAT Database

Exchange rate, as an important macroeconomic indicator, has a fundamental role on SME growth and especially on stirring or breaking the exports. During last decade the exchange rate volatility has been consistent.

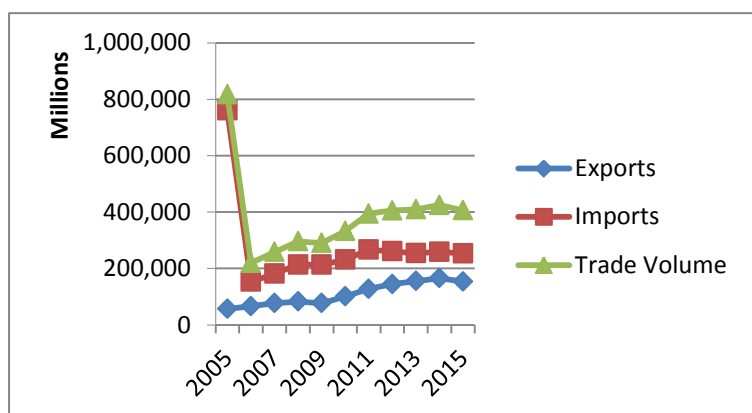
**Figure 5- The Average Exchange Rate Lek/Eur for the period 2005-2015**



Source: Bank of Albania, Statistic Database

Exports and imports are among the most important economic engines for a small country. Exporting firms have a greater diversification of business opportunities which guarantee stable revenues and profits, while importing promotes a faster technological development and competitive national economy by supplying raw materials and new technologies and services (Bekeris, 2012). The data of the trade volume, exports and imports are shown on the graphic below. They represent the total values of the 4 Euro zone countries, in which Albania has recorded the largest trade volumes of exports and imports on the last years (Italy, Greece, Germany and Spain).

**Figure 6 - The annual Exports, Imports and Trade Volume.**



Source: INSTAT, Database

The trade volume indices the openness of the country, as the Albania is performing now to a free market economy. Actually the customs policies, tax rates, the licensing process of starting a new business, trading across borders, etc are already quite liberal. But even those, it is not quite enough to do business in Albania and to perform well on a very aggressive private sector.

Exporting firms have a greater diversification of business opportunities which guarantee stable revenues and profits, while importing promotes a faster technological development and competitive national economy by supplying raw materials and new technologies and services (Bekeris, 2012).

### Methodology of the research

In order to analyze the impact of macroeconomic factors on SME profit, we have used the official publications of dates for each variable. The necessary data was collected from the



Instat database and Bank of Albania database for the time period 2006-2012 with annual periodicity. Indicators selected to construct the model are: GDP, CPI, Exports, Imports, Unemployment rate, exchange rate Lek/Eur, and number of active enterprises.

The research hypothesis rose:

*Ho: All the macroeconomic factors have a strong influence on small and medium enterprises profit*

*Ha: All the macroeconomic factors have not a strong influence on small and medium enterprises profit*

### The results of the correlation test and the conclusions

“SPSS” (Statistical Package for Social Science) version 23 has been used to analyze the data that are collected. To prove the hypothesis raised it is used the correlation test with the upper level of statistical significance at 5%. All statistical test results were computed at the 2-tailed level of significance.

Table2- Macroeconomic indicators and correlation with SME profit.

The correlations									
		GDP (in millions)	Total number of active SMEs	Consumer Price Index	Exports (in millions)	Imports (in millions)	Unemployment rate (%)	Employment rate (%)	Exchange rate Lek/Eur
Annual Profit of SMEs (in millions)	<i>Pearson Correlation</i>	0.674	<b>0.789*</b>	0.623	0.434	<b>0.718*</b>	0.468	0.583	<b>0.717*</b>
	<i>Sig. (2-tailed)</i>	0.067	0.02	0.099	0.283	0.045	0.243	0.13	0.045
*. Correlation is significant at the 0.05 level (2-tailed).									
**. Correlation is significant at the 0.01 level (2-tailed).									

The results of the study show that not all the macroeconomic factors have a strong influence on SME profit. The annual profit of the firms as a depended variable has the most correlation with in depended variables as: total number of active SMEs, the exchange rate annual average and the volume of Imports. Other variables of the model as GDP, CPI, Exports, the rates of Unemployment and Employment, were not statistically significant and showed no strong correlation with annual profit of SMEs.

*The total number of active firms* has a significant influence on their profit, because of the direct connection that exists between these two indicators. The growth of SME profit for this period is affected by the number of active SMEs and of course annual profit of each firm. *Imports*, since Albania for many years has a larger trade deficit, so imports are greater than exports, the activity of SMEs is concentrated more in imports than in exports. So, the increased level of imports has a significant influence on SMEs profit because of the fact that the activity of the SME sector is concentrated in trades with medium volumes, such as food, clothes, services, etc. They are not producers of large quantities to contribute in export volumes. Exchange rate Lek/Eur, is the third indicator that has a significant influence on SMEs profit. The exchange rate volatility is very important for firms having import-export activity because of the depreciation and evaluation of the local currency affect the profit / losses of the company. This indicator is related to imports and both have shown a significant influence on SMEs profit.



We have to admit that in this research there are some restrictions in dates, and it would be more persuasive the result if the periodicity of the dates would be quarterly/monthly or we suggest the use of data for a longer period of time.

But speaking separately for each of macro indicators GDP has a strong statistically positive correlation with variables: the total number of active SMEs, CPI, and trade volume (Exports and Imports).

Variables as Total number of active SMEs and Exchange rate Lek/Eur are not significant at all with Employment and Unemployment rates, but they have a significant correlation with other variables.

## REFERENCES

1. Bekeris, R. (2012). "The impact of macroeconomic indicators upon SME's profitability". *Ekonomika* , 91 (3), 117-128.
2. Burja, C. (2011). "Factors influencing the companies' profitability". *Annales Universitatis Apulensis Series Oeconomica* , 13 (2), 215-224.
3. Chughtai, M. W. (2014). "Impact of Small and Medium Enterprises on Economic Growth: Evidence from Pakistan". *Standard Research Journal of Business Management* , 19-24.
4. Euro-Mediterranean Regional and Local Assembly. (January 2012). *Raport për "Rolin e Ndërmarrjeve të Vogla dhe të Mesme në Mesdhe"*. Italy: ARLEM.
5. Ferati, R., Yzeiri, A., & Ejupi, E. (2012). " Impact of financial crisis on the profitability of sme in the Republic of Macedoni-pollon region". *Konferenca e Katërt Ndërkombëtare për Riskun* (pp. 213-222). Kroaci: Qendra Shqiptare për Riskun.
6. Garcia-Teruel, P. J., & Martinez-Solano, P. (2007). "Effects of working capital management on SME profitability". *International Journal of Managerial Finance* .
7. Group, W. B. (2016). *"Doing Business 2016 Albania"*. Washington DC: The World Bank.
8. Hifza, M. (2011). "Determinants of Insurance Companies Profitability: An analysis of insurance sector of Pakistan. *Akademic Research International* , 1 (3).
9. Lipi, R. (2014). *"Performanca financiare dhe orientimi sipërmarrës i NVM-ve, Qarku Vlorë"*. Tiranë: Universiteti i Tiranës.
10. Margaretha, F., & Supartika, N. (2016). "Factors affecting profitability of small and medium enterprises (SMEs) firm listed in Indonesia stock exchange". *Journal of Economics, Business and Management* , 132-137.
11. Peterson, R. A., Albaum, G., & Kozmetsky, G. (1986). "The public's definition of small business". *Journal of Small Business Management* , 63-68.
12. Popa, A., & Ciobanu, R. (2014). "The financial factors that influence the profitability of SMEs". *International Journal of Academic Research in Economics and Management Sciences* , 3 (4), 177-185.
13. Rayan, K. (2008). "Financial leverage and firm value". *Gordon Institute of Business Science*. University of Protoria.
14. Runyan, R. Droge, C. Swinney, J. (2008). "Entrepreneurial orientation versus small business orientation: What are. *Journal of Small Business Management* , 46 (4), 567-588.
15. Shosha, B. (2014). *"Performanca e ndërmarrjeve të vogla dhe të mesme në Shqipëri-Fokusi qyteti i Tiranës"- Disertacion*. Durrës: Universiteti "A.Moisiu", Fakulteti i Biznesit.
16. Shqipërisë, B. e. (2015). *"Raporti i Stabilitetit Financiar për 6-m parë 2015"*. Tiranë: Banka e Shqipërisë.

17. Shqipërisë, B. e. (2015). "Raporti i Stabilitetit Financiar për 6-mujorin e parë 2015". Tiranë: Banka e Shqipërisë.
18. Shqipërisë, B. e. (2013). "Raporti i Stabilitetit Financiar për 6-të mujorin e dytë të vitit 2013". Tiranë: Banka e Shqipërisë.
19. Singh, P. J., & Pandey, S. (2008). "Impact of working Capital Management in the Profitability of Hindalco Industries Limited". *Journal of Financial Economics* , 6 (4), 62-69.
20. Sivathaasan, N., Thasanika, R., Sinthuja, M., & Hanitha, V. (2013). "Factors determining profitability: A study of selected manufacturing companies listed on Colombo Stock Exchange in Sri Lanka". *European Journal of Business and Management* , 5 (27), 99-107.
21. Taiwo, M., Ayodeji, A., & Yusuf, B. (2012). "Impact of Small and Medium Enterprises on Economic Growth and Development". *American Journal of Business and Management* , 1, 18-22.
22. Totojani, O. (2010). "SMEs role in the Albanian agricultural economy and their legal framework behind it". *Research Journal of Agricultural Science* , 888-897.
23. Zharakalli, Z. (2015). "Investment impact on the economic growth. empirical analysis on the Albanian economy". *Albanian Socio-Economic Review* , 5-11.