

## SMEs- Their Development and Financial Sources

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### Abstract

*The topic I have chosen is "SMEs - Their development and financial sources", referring to our country. The reason that pushed me to select this topic is the opportunity to stay closer to the profile of my dissertation taking into consideration the difficult situation in Albanian economy in recent years, caused by the financial crisis all around the world. This paper will discuss the importance of small and medium enterprises in Tirana, the factors that affect their development, and what are the sources of financing the economic activity of these enterprises. Afterwards, an analysis of the data obtained from a questionnaire designed for 50 small and medium-sized businesses operating in the city of Tirana will be provided. Finally, some recommendations will be given to improve the performance of SMEs. Choosing this topic not only helped me to understand the problems that these businesses may face but also to see and find out which may be the chances for them to overcome these difficulties.*

**Keywords:** SME, Financial Sources, Importance of SME, Development of SME.

### 1. INTRODUCTION

During the years of transition till nowadays Albania has built a broad framework of laws and regulations to enable the functioning of businesses in a country that was constantly evolving towards an open and competitive economy. A suitable business environment is a requirement for regional and essential economic growth for small and medium enterprise sector. As a result, policies and initiatives are taken for the development of small and medium enterprises. Small and medium enterprises are the engine of a country's economy. They are an essential resource for the workplace, for employment and for creating an entrepreneurial spirit.

In Albania, the sphere of commercial register is regulated by law, that of companies, licensing, privatization, competition, state aid, financing and insurance, intellectual property, real estate, bankruptcy and a series of other regulations that are in the process of improvement and evolution.

Enterprises in our country, according to the law "On small and medium enterprises", are classified into micro enterprises, small enterprises and medium enterprises.

Micro-enterprises are enterprises, which employ up to 5 employees.

Small enterprises are enterprises which:

- employ 6-20 employees.
- their annual economic turnover does not exceed the amount of ALL 40 million.
- 100 percent of the capital of these enterprises is owned by entities, which, in the sense of this law, are classified as small enterprises.

Medium enterprises are enterprises which:

- employ 21-80 employees.
- their annual economic turnover does not exceed the amount of ALL 80 million.
- less than 25 percent of the capital of these enterprises is owned by entities, which, in the sense of this law, are not classified as small and medium enterprises. (INSTAT)

## 2. FACTORS THAT INFLUENCE THE DEVELOPMENT OF SME

### *Internal factors*

Margi Levy and Philip Powell argue that business growth is determined by a combination of strategy, entrepreneurship and firm organization. The authors determine that the key factors in SME growth are internal factors, which affect the quality of decisions making.

Firm growth depends on the managerial skills of managers (Macpherson and Holt, 2007, 172 - 192). The SME owner has significant personal influence over a firm's strategies, tactics, and operations. As a result, although small, these enterprises have organizational structures (mostly informal), while decision-making tends to be centralized around the owner. Entrepreneurial personality and behavior are causal factors for or against growth. It is characteristic of small businesses, in which decision-making is centralized to the owner-manager, so his / her personality, skills, responsibility and behavior are crucial in business strategy (Levy and Powell, 2005, pg.22).

**Employee education** - SMEs face difficulties in hiring and retaining qualified graduates because the latter prefer a higher salary than what an SME can offer, want job security and opportunities for career. In order to meet the demands of the ever-changing labor market, small and medium-sized enterprises need to develop a training plan for their employees as well as a specific training budget.

**Marketing** - According to Brush et al. (2009), marketing is another obstacle for SMEs, as these businesses face various challenges such as: building effective distribution channels, communicating product features,

pricing products and services in an attractive way, implementing sales and marketing plan to gain and retain customers and continuously developing products to support sales. SMEs generally have no knowledge or information about other markets, thus limiting their ability to market their products to larger customer groups and expand their business.

**Technology** - SMEs tend to have low productivity and they are “weak” in terms of competition, as a result of inefficient use of technology, malfunctioning at full capacity and lack of investment in technology, due to financial constraints. The World Bank (2009) states that investments in technology are necessary to improve the quality and productivity of production, which affect the improvement of firms' competitiveness.

**Innovation** - Innovation also has an important role to play in today's businesses. Innovative companies are able to respond to changes required by the customer in terms of products and services offered.

In general, developed countries allocate about 3 percent of GDP to research and development activities. (Morrison, 2006)

### ***External factors***

In addition to internal factors, there are also external ones that affect the performance of a business.

**Financial support** - According to Guffey, a business plan is essential to starting a business. Unless financial resources can be obtained from relatives, businesses will need financial support from financial institutions or new investors. A business plan is necessary to provide financial support (Guffey, 2008, 401).

**Laws and regulations** - World Bank researchers argue that complex tax systems are an obstacle to the development of small and medium-sized businesses. Another shortcoming observed in Southeast Europe is the low level of trust in the judiciary to enforce laws, as well as the need to pay large bribes for access to basic public services.

**Business location** - The business location should be accessible to the customer. In choosing the location, several factors must be taken into account, such as labor costs, transportation, proximity to suppliers, language and culture of a country, exchange rate, etc.

**Competition** - Competition has a huge impact on a business' s chances of survival.

In 2002, several studies were conducted on the factors that hinder the growth of small and medium enterprises in Kosovo. According to these studies, the main obstacle was "unfair competition", which includes the imposition of taxes, informality in the economy and public services (Dinh, Mavridis and Nguyen 2010, 9).

**Globalization** - Globalization is, perhaps, the most important source of change. The reasons why enterprises tend towards globalization are

numerous, where the two most important are reducing labor costs and responding to competition.

### 3. FINANCIAL SOURCE OF SME

A financially strong business means that it has the ability to provide its own funds for further continuation of economic activity. Sometimes SME does not have the capacity to start the business with their own funds. They tend to search for help in other entities or relatives that may offer help.

Firms provide financial resources through retained earnings. Retained earnings and other internal sources of financing make up the majority of financial resources for financing firms' activities. Today, over 70% of business financing funds are provided from their own sources, mainly from reinvesting profits.

On the other hand, there is a variety of external sources of financing, which in relation to the activity of SMEs are classified as sources of debt financing. Firms that choose to be financed by external sources have in mind that the latter can be classified: a. by term (long-term and short-term sources) b. according to the institution providing funds (in the financial market, financial intermediaries).

External financing can be done in two ways:

Without intermediaries (directly), as in the following cases:

- *Informal loan* - is to borrow without the help of financial intermediaries. These loans are generally taken from well-known persons.
- *Investors* - are significant providers of funds, which do not require a fixed annual rate of return.
- *Commercial Credit* - This loan consists of securing financial resources from the purchase of products and services with subsequent payment. This form of financing is quite common in Albanian business.
- *Clearing* - is a legal method of trading and there is no problem until every transaction is performed by contract. This source of funding is mostly used by the construction sector.

Through financial intermediaries (indirectly), where the financial intermediary transfers funds from units that have excess funds to those that lack funds. The types of this form are:

- *Microcredit* - The level of funding from microcredit institutions has increased significantly in recent years.
- *SME Investment Funds* - These funds aim at developing the private sector in Albania and securing financing for SME activity.
- *Bank loan*

#### 4. METHOD AND RESULTS

The study is based on an empirical research, trying to make a valuable measurement, to understand how to finance small and medium enterprises, as well as to understand their problems and other characteristics. The method used in this survey is a qualitative method of selection in combination with quantitative method of measurement. The software used for this research is SPS and the method used is OLS (ordinarily least squares). Through this method I have analyzed statistical trends, tendencies and relationships between variables.

The questionnaire is spread on 50 entities that are based in Tirana and consist of 10 questions, where the focus of these questions was more on how to finance SMEs, but also to learn more about their operations and their characteristics. The selection of these businesses was made randomly, in areas with the highest concentration. The answers were obtained from direct contact with the responsible persons.

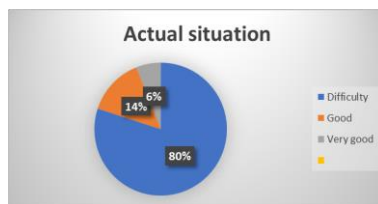
##### *Questionnaire data analysis*

The chart below shows how many businesses have been willing to answer questions. As can be seen, 90 percent of small and medium enterprises responded, while of the remaining 6 percent hesitated to complete this questionnaire and 4 percent of owners were not present.



**Figure 1. Effectiveness of questionnaire. Source from questionnaire**

The interviewed SMEs were generally in a somewhat difficult financial situation, due to the decline in purchasing power as a whole. As can be seen in the graph below, 80 percent of the businesses interviewed were in difficulty, while 20 percent were in good or very good financial condition.



**Figure 2. Actual situation of SME. Source from questionnaire**

In the short run the interviewed enterprises are pessimistic, while in the long run they are more optimistic. They think that the future of their business depends on the three factors mentioned in the questionnaire: employee training, competition and technology.

	Employee training	Competition	Technology
Nr of SME that think that future depends:	36% - 17 SME	52% - 25 SME	12% - 5 SME

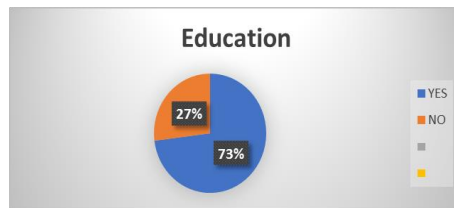
**Figure 3. Factors that depend the future of SME. Source from questionnaire**

Mainly, since they are small and medium businesses, the number of employees varies in low values, from 1-20 employees. This depends on the space the business occupies, the number of affiliates that exist for a particular business, and the profit they have.

	Nr of employees from 1-10	Nr of employees from 10-20
Nr of SME	41	7

**Figure 4. Nr of employees in SME. Source from questionnaire**

The interviewed small and medium enterprises do not spend much time and money on employee training, so they aim to find the right person ready in the market. To be appreciated, they are always under surveillance by superiors, in some cases even through security cameras. Nowadays the number of educated people has increased compared to previous years, but still, in the market the managers of enterprises are careful in choosing the worthy employee.



**Figure 5. Do employees have the right education. Source from questionnaire**

Under these conditions, most SME leaders believe that they can find skilled workers, but there are also those who are very conservative and trust only their way of training or do not trust anyone but their job.



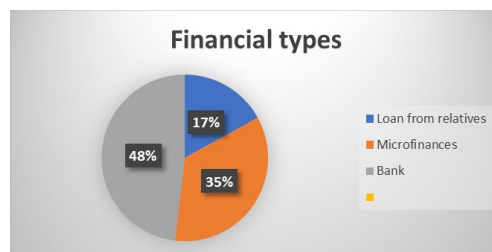
**Figure 6. Qualified employees in the market. Source from questionnaire**

Of the SMEs interviewed, 80% needed financing, but currently, those who had received financial resources, only 51% of them had received loans from banks. One of the reasons was that for small loans banks have applied high interest rates. In this way, their cost was too high for these businesses to afford.



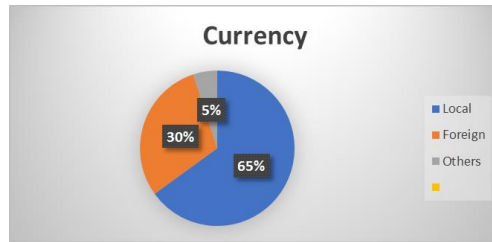
**Figure 7. How many SME needed financial help? Source from questionnaire**

Most SMEs interviewed think that one of the best ways to finance their business is loans taken from banks, while the rest think that they are financed by loans from their relatives and a small part, intend to be financed through loans from microcredit institutions. Distributed in percentage would be as follows:



**Figure 8. Financial types. Source from questionnaire**

Of these SMEs, which were financed or in need of financing, the borrowing preference was in local currency. The reason was that, since the income benefited them in local currency, they also wanted to repay the loan in this currency, in order to avoid losses from the exchange rate change.



**Figure 9. Preferred currency. Source from currency**

The problems faced by small and medium enterprises interviewed for funding sources are:

- Finding the source of funding;
- Accurate preparation of proper financial documentation;
- High value collateral that they must leave as collateral;
- High interest rates and commissions;
- Problems with collateral ownership;
- Loan duration;

In addition to the many problems that SMEs face in funding sources, they face a number of other problems. The data obtained from the study conducted among 50 respondents in the city of Tirana, showed that among the main problems faced by entrepreneurs in Albania are:

- High tax rates;
- Injustices;
- Low purchasing power of the population;
- Lack of cooperation between various public and private institutions to support SMEs;
- Unstable legal environment;
- Lack of qualified staff;
- Poor level of quality management within the company;
- Discrimination in the case of participation in tenders;
- Unfair competition.

When asked if our country offered good opportunities for growth and development of SMEs, most answered no. This is because they did not think that the state and their reforms helped them. One of the problems in recent years mentioned was the receipt of fiscal cash registers, which according to them was more of a political action which led them to additional expenses and was not necessary. Even now they are not controlled whether they use them or not. They feel that their purchasing power is not high enough to cover this cost quickly. In addition, the recent changes that are taking place in politics and their announcements of tax changes still do not have a very good attitude, at least they do not yet know their effect without that reform being undertaken, they are not well informed what reforms tax will be realized.



But, in general so far, they find their progress difficult, as a result of the problems mentioned above and from the economic situation in which our country is, but not only.

## CONCLUSION AND RECOMMENDATIONS

SMEs have a very significant impact on the economic life of our country. Exactly 95% of the private sector consists of small and medium businesses. These businesses are main source for employment and for development of the country.

There are a number of factors that influence the development of SMEs. They are divided into internal factors, where we mention: entrepreneurial ability, employee education, marketing and technology. While in external factors we mention: financial support, laws and rules, competition, etc.

During this survey we have come to the conclusion that SME financing comes as a result of internal resources, such as retained earnings, savings through efficient management of working capital. In terms of external financing it is done without intermediaries (informal loans, investors) or with intermediaries (microcredit, investment funds, financing from bank loans). Usually most of this entrepreneurship prefer to get help from their relatives, or getting help from bank loan even though there are some difficulties that they may not accomplish; such as preparin the proper financial documentation, high value collateral, and generally high interest rates.

### *Recommendations*

Given the current situation, some new reforms need to be undertaken by our government in order to help small and medium-sized businesses to start and proceed in their business.

- A good help would be to create special funds for those SMEs in need of external financial resources.
- Take steps to facilitate the funding process, enabling the reduction of some of the problems that SMEs face during this phase.
- This study has identified the lack of access to funds as one of the main business problems faced by this enterprises in Tirana. Easy access to funds is needed to increase productivity and lead to the growth of emerging economies. This means that more financial resources will result in greater success, including greater economic contribution to the country.
- Given that this research focuses on SMEs in Tirana, future research should include a wider range of SME taking into account even other countries. This would consolidate our knowledge of SMEs in Albania

and would be useful for policymakers and those who are able to help develop the full potential of SMEs.

- SMEs play a very important role in the country's economy, so they should be helped to eliminate unfair competition, false marketing and meet their need for new technologies.
- On the other hands SMEs should focus more on training their staff and believing more in their skills. Perhaps government should be more concerned on opening professional schools and emphasizing more its importance for the workforce.

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## QUESTIONNAIRE DESIGNED FOR SMEs

The questionnaire consists of 10 questions, which are directly related to the topic I am addressing. It has more open-ended questions, but also closed-ended questions with short answers.

The questionnaire questions are as follows:

1. What is the current state of your business?
2. How do you see the future of your business? What do you think depends more: on employee training, technology or competition?
3. What is the number of current employees in the business?
4. Do you think they have the right education and training for their jobs?
5. Is it easy to find skilled workers in the current market?
6. Did you need external funding sources?
7. If yes, what form of financing did you prefer? If not, if one day you had to secure funding, what form would you prefer?
8. In which currency would you like it?
9. What are the problems you encounter in the country during the need and until it is covered for financing?
10. Do you think that our country offers you opportunities to develop and grow your business? What are some of the problems that exist in the country?