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Financial Inclusion and the Performance of Micro, Small and Medium Enterprises. Case of Albania

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Abstract

The impact of financial inclusion on the performance of Micro, Small, and Medium Enterprises (MSMEs) is significant. Banks and non-bank financial institutions play a critical role in the financial system and in maintaining the stability of a country's economy. In many developing countries, both financial and non-financial institutions contribute to economic growth and development. Financial Inclusion (FI) has emerged as an effective strategy to enhance opportunities and promote inclusivity for businesses. This study aims to examine the role of financial inclusion in the performance of MSMEs and to identify the challenges these enterprises face in accessing financial services. The primary challenge for MSMEs in obtaining financial services is the lack of collateral needed to secure a loan from financial institutions. A second major issue is their low-income levels, which often leads banks to deny credit applications. Additionally, the perceived high interest rates on loans deter many businesses from seeking debt financing from commercial banks.

Based on a review of the literature and empirical studies, the results indicate that financial inclusion positively affects the performance of MSMEs, particularly in terms of profitability and sales growth.

Keywords: financial inclusion, MSMEs, enterprise performance, financial services, economic indicator.

1. INTRODUCTION

Small and medium enterprises (SMEs) play a significant role in the private sector and contribute to economic activity in both developed and developing countries. The success of many economy-related Sustainable Development Goals (SDGs)—including the expansion of employment opportunities, promotion of equitable and sustainable economic growth, reduction of poverty, advancement of sustainable industrialization, and improvement of living standards for all—largely depends on micro, small, and medium-sized enterprises (MSMEs) (United Nations, 2009). MSMEs are sectors that support growth by improving standards, contributing to local capital formation, and fostering innovation and competitiveness in developing economies (SMEDAN, 2017).

Financial institutions often hesitate to lend to new and small businesses due to their limited knowledge and information regarding small business performance (Verheul, Stel, & Thurik, 2006). The conversation on improving the financial system for the impoverished has recently shifted from microcredit to microfinance and more broadly to financial inclusion (Mader, 2016). Some researchers define financial inclusion as ensuring that all segments of society, especially poor families, young people, women, individuals living in rural areas, and business owners, have access to financial services. The goal is to eliminate the involuntary lack of access to these services (Stephen A. , 2016). Some researchers proposed it as a process where individuals have access to financial services and products like deposit accounts, loans, and insurance, and they effectively utilize those services to satisfy their various needs (Klapper & Hess, 2016) and (World Bank, 2019).

Financial inclusion contributes to better enterprise performance. Having access to financing is crucial for improving business performance (Fowowe, 2017). Insufficient financing would hinder the growth and performance of the enterprise (Domako, Danso, & Ofori-Damoah, 2016). Access to finance would reduce liquidity constraints, increase investment and increase enterprise size and structure (Nizam, Karim, Sarmidi, & Rahman, 2020). Financially included SMEs are more likely to perform better than those that are financially excluded (Turyakira, Kasimu, Turyatunga, & Kimuli, 2019). Increasing financial inclusion can be the main opportunity to improve the performance of MSMEs and stronger economic growth (Gammage, et al., 2017).

2. METHODOLOGY

This paper provides a detailed review of existing literature, and a thorough analysis of the factors related to financial inclusion and the performance of Micro, Small, and Medium-Sized Enterprises (MSMEs).

- *Literature Review*

Consistent with the methodology employed by other researchers such as Beck, Demirguc-Kunt, & Martinez Peria (2007), this literature review analyses existing research on financial inclusion and its effects on the performance of micro, small, and medium enterprises (MSMEs). This process involved:
Identification and selection of relevant sources: Following the guidance of the World Bank (2024), studies and reports were chosen that clearly illustrate the financial inclusion of micro, small, and medium enterprises (MSMEs) and its impact on their performance. The incorporation of in-depth theoretical and empirical studies from the finance literature was instrumental in identifying key factors related to access to finance and business performance. The classification of main topics is based on the framework proposed by Manzoor, Wei, & Sahito (2021). The reviewed literature has been organized into several key categories: barriers that prevent micro, small, and medium enterprises (MSMEs) from accessing finance; the role of financial inclusion on the growth and sustainability of MSMEs; and the role of financial policies and institutional support in promoting financial inclusion.

- *Descriptive Analysis*

After finishing the literature review, a descriptive analysis was conducted to gain a clearer understanding of the main trends and findings identified. The data utilized are secondary sources generated from reports and studies by the World Bank, the Bank of Albania, and the IMF. Based on the research by Miller & Yoon (2021), key factors that contribute to the financial inclusion of Micro, Small, and Medium Enterprises (MSMEs) include access to bank loans, alternative financing options, and institutional support for the sustainable development of these businesses. According to Kraemer-Eis, Botsari, Gvetadze, Lang, and Torfs (2019), research has explored the relationship between financial inclusion and the performance of Micro, Small, and Medium Enterprises (MSMEs) through case studies and data collection. This research focuses on improving productivity, ensuring financial sustainability, and enhancing competitiveness. Our study incorporates analyses based on findings from various studies and reports from reputable institutions, including the World Bank, the Bank of Albania, and the International Monetary Fund (IMF).

The role of policies and institutional support: Enterprises that are included in financial systems generally tend to be more sustainable and perform better, as suggested by Honohan (Honohan & King, 2012). This analysis examines how supportive policies, and institutional developments impact the ability of micro, small, and medium enterprises (MSMEs) to access financial services.

3. LITERATURE REVIEW

3.1 The role of SMEs in the economy.

Micro, Small, and Medium Enterprises (MSMEs) play a significant role in generating employment, reducing poverty, and fostering economic development worldwide. They are essential components of the economic landscape in developing countries and are crucial for promoting growth, innovation, and prosperity. Financial inclusion refers to the ability of individuals to access and effectively use basic financial services such as savings, credit, and insurance. These services should be designed to be convenient, reliable, and flexible. Financial inclusion provides individuals with access to essential services like loans, savings accounts, and insurance, ensuring they are adaptable and dependable. (Nwanko & Nwanko, 2014). Access and use of financial services is one of the key drivers of economic growth (Sharma, 2016).

The theoretical approaches on the importance of the financial sector in the economic performance can be classified into two categories (Puryan, 2017). The first theory is rooted in Schumpeter's idea (Schumpeter, 1911). He emphasizes the importance of the financial sector in the process of economic development (Schumpeter, 1911). The second perspective is rooted in Robin's studies of the financial system as a less obvious factor in the development of growth. He asserts that if other conditions are constant, financial development will be the result of growth (Robinson, 1952). Examining the differences between credit access and SME growth in Ghana showed that there is such a positive effect on SME credit. The results of the multiple regression analysis revealed that access to credit, initial capital, annual turnover and the increase in total current investment had a significant positive effect on the growth of SMEs in the manufacturing sector (Ahiawodzi & Adade, 2012). According to authors Fan & Zhang (2017) in their study investigated financial inclusion, entry barriers and entrepreneurship in China.

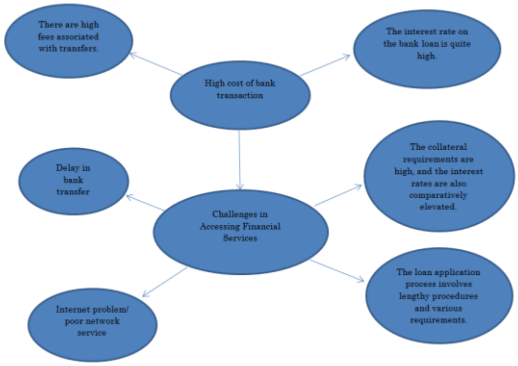
Analysing the regression, their findings reported a positive effect of financing involvement on enterprise formation in China (Fan & Zhang, 2017). The impact of financial inclusion and performance of MSMEs was also studied by the authors Ibor, Offiong and Mendia in Nigeria. The results showed that financial inclusion had a positive impact on the operations and growth of MSMEs. It was also noted that distance from financial services access points and poor infrastructure hinder MSMEs' access to financial services in Nigeria (Ibor, Offiong, & Mendie, 2017). Authors Atueyi, Nkechukwu and Jacobs (2019) examined the effect of financial inclusion on small and medium enterprises in Nigeria. They found that commercial bank loans to rural areas have such a positive effect on small and medium enterprises in Nigeria. So, financial inclusion had a significant impact on small and medium enterprises in Nigeria (Atueyi, Nkechukwu, & Jacobs , 2019). In his study, Harelimana (2017) investigated the role of access to finance on the performance of small and medium enterprises in Rwanda. Its findings revealed that access to finance by small and medium enterprises will increase their profitability and efficiency, prevent liquidity constraints and increase asset quality. In another study in Uganda, inclusion was investigated in relation to the effect of SMEs. They found that financial inclusion has such an impact in relation to SMEs. The findings showed that the cost of buying and maintaining prices is high and there are also difficulties in using some financial services (Eton, Mwosi, Okello-Obura, Turyehebwa, & Uwonda, 2021).

Small and medium-sized enterprises (SMEs) often struggle to access financial services due to several factors. They may fail to meet requirements such as providing guarantees, collateral security, and having a solid business profile. Additionally, barriers such as high transfer fees, delays in bank transfers, poor internet connectivity, and lengthy procedures for obtaining credit further impede MSME owners from accessing essential financial services and products (Eton, Mwosi, Okello-Obura, Turyehebwa, & Uwonda, Financial inclusion and the growth of small medium enterprises in Uganda: empirical evidence from selected districts in Lango sub-region., 2021). Financial inclusion is a process that provides easy access to financial services in an economy. According to the author, ease of access is measured by indicators such as the number of bank branches or ATMs per 1000 adult population (Sarma, 2008). Promoting financial inclusion, in the wider context of economic inclusion, can improve the financial conditions and raise the standard of living of the poor and disadvantaged (Khan, 2011).

3.2 Challenges of Financial Inclusion.

The provision and use of financial services is not without cost for both the service provider and the user. For the service provider setting up branches in rural areas is generally not beneficial due to high cost and low business. From the service user's point of view, it is observed that the poor living in rural areas is reluctant to use these services due to high cost such as minimum balance requirements in savings account, fixed charges on credit cards and debit cards. debit, credit processing fees, etc. (Pallavi & Bharti, 2013). High transfer fees, delays in bank transfers, poor internet connectivity and lengthy processes/procedures involved in securing credit also act as barriers to access to services and information products as reported by MSME owners (Dorcas , Rosemary , & Taiwo , 2023).

Figure 1: Barriers to Accessing Formal Financial Services



Source: Dorcas , Rosemary , & Taiwo (2023)

In their study, the results are like those of the other authors mentioned above. Financial inclusion positively affects all performance indicators of SMEs. Their study analysed the effects of financial inclusion on the performance of MSMEs and identified the challenges MSMEs face in accessing formal financial services, using MSME survey data generated from a self-administered questionnaire. Quantitative and qualitative results showed that access to and use of financial services such as POS, ATM/debit card, mobile money transfers, e-banking transactions, savings and loans improve business performance. The main challenge in accessing formal financial services was the lack of collateral needed to secure a loan along with high interest rates on the loan (Dorcas , Rosemary , & Taiwo , 2023). The findings of the study are consistent with the findings of Harelimana (2017) that access to financial services by SMEs will increase their profitability and efficiency, prevent liquidity constraints and increase the quality of their assets. Microcredit helps the performance of beneficiary enterprises to increase profit, increase the entrepreneurship of their businesses and had a positive impact on performance and growth (Laetitia, Shukla, & Luvanda, 2015).

In the study conducted in Nigeria, the results that, the involvement in the activity positively and in the way of the activity in the operations and actions of MSMEs. But the distance to the access points of all expenses and the lack of use of accessory challenges is fast and effective in the services of services by MSMEs. Digitization of sites across the country should be prioritized to include ICT/E-banking tools and a consumer protection framework (Bassey , Amenawo , & Enyeokpon , 2017). The findings of another study in Kenya show that: Banking agency, online banking and mobile credit applications have a positive significance in the financial inclusion of SMEs. With the support of agency banking and online banking, most SME owners can access financial services ranging from credit to financial planning tools, driving business growth and further expanding financial inclusion of SMEs (Agelyne, 2017).

According authors Hariharian & Marktanner (2012), concluded that financial inclusion is a key factor for economic growth and development based on its ability to increase financial sector savings, capital creation, intermediation and implicating investment In the study conducted in Kenya by the authors Ibor, Offiong, Mendie (2017), the results confirm the support for the effect of financial inclusion on the performance of MSMEs and agree with the findings of some past researchers, who identified financial inclusion as one of the solutions for the growth and development of

Small and Medium Enterprises (Onaolapo & Odetayo, 2012), (Stephen & Sibert, 2014), (Godwin, 2011).

3.3 The role of SMEs in economic indicators in Albania.

Small and medium-sized enterprises (SMEs) are the foundation of our country's entrepreneurial landscape. In Albania, there are 103,857 SMEs out of a total of 104,031 enterprises. SMEs represent approximately 99.8% of all active businesses, both in Albania and across EU countries. In Albania, the classification of enterprises as micro, small, and medium is established by Article 4 of Law No. 43/2022, titled "On the Development of Micro, Small, and Medium Enterprises." For statistical purposes, enterprises are categorized as follows: Microenterprise: 0 to 9 employees; Small enterprise: 10 to 49 employees; Medium enterprise: 50 to 249 employees. Statistics from the Structural Enterprise Statistics survey for 2022 reveal the following about small and medium-sized enterprises (SMEs) (INSTAT, 2022):

- SMEs account for 99.8% of all active enterprises, unchanged from 2021.
- 82.1% of employees are employed by SMEs, up from 81.6% in 2021.
- SMEs generate 80.1% of net sales, an increase from 79.0% in 2021.
- 75.6% of investments are made by SMEs, a slight decrease from 76.4% in 2021.
- SMEs contribute 78.4% of total value added, rising from 76.1% in 2021.

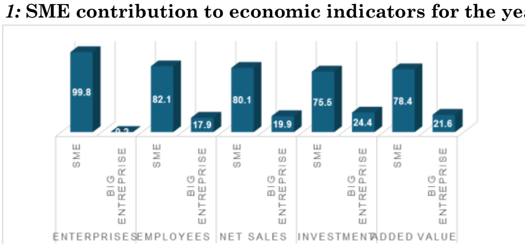
Table 1: Key indicators and their structure based on enterprise size for the year 2022.

Type of enterprises	Enterprises (%)	Employees (%)	Net sales (%)	Investment (%)	Added Value (%)
All	100	100	100	100	100
SME (1-249 employees)	99.8	82.1	80.1	75.5	78.4
Microenterprise (1-9 employees)	93.5	37.7	22.3	16.4	25.6
Small enterprise (10-49 employees)	5.1	21.0	30.3	34.6	25.7
Medium enterprise (50-249 employees)	1.2	23.4	27.5	24.6	27.1
Big enterprises (250+ employees)	0.2	17.9	19.9	24.4	21.6

Source: INSTAT (2022)

Small and Medium-sized Enterprises (SMEs) made significant contributions to key economic indicators in 2022, as follows: 9.1 percentage points of the total growth in the number of enterprises; 5.0 percentage points of the total growth in employment; 22.5 percentage points of the total increase in net sales; 6.1 percentage points of the total growth in investments; 24.2 percentage points of the total increase in value added.

Figure 1: **SME contribution to economic indicators for the year 2022.**



Source: INSTAT (2022)

The development of the small and medium-sized enterprise (SME) sector is considered one of the most effective drivers of sustainable economic growth in the Albanian economy. It contributes to increasing the employment rate and reducing poverty levels. In recent years, our country has seen rapid growth in lending; however, banks tend to favour large businesses that have a positive lending history and sufficient collateral. As a result, SMEs often face challenges in accessing financing from financial institutions. This is primarily due to their limited collateral, weaker solvency, the nature of bank-borrower relationships, and high transaction costs (Asai, 2019). The development of SMEs in transition countries faces several challenges, including limited access to finance, administrative barriers, high risk exposure, and restricted opportunities for implementing new technologies. In recent years, lending to the Albanian economy has surged, primarily benefiting large businesses. However, access to credit for small and medium-sized enterprises (SMEs) remains limited. Utilizing borrowed capital is one of the main methods for conducting business, and the costs associated with obtaining loans are a significant factor in promoting and developing entrepreneurship.

Several obstacles hinder the financing of small and medium enterprises (SMEs), including:

- Lack of collateral and guarantees required by banks for funding;
- High interest rates;
- Lengthy administrative procedures for securing loans;
- Costs and financial risks associated with running these businesses;
- Insufficient loan amounts to meet their operational needs;
- Limited positive lending experiences;
- Risk perceived by lenders;

To enhance access to financing for SMEs, measures have been implemented in recent years, primarily through the introduction of credit guarantee schemes specifically designed for these businesses. A positive development in the financial landscape is the growth of digital financial services (FinTech), which facilitate easier access to financing for small and medium-sized enterprises (SMEs). Technologies like online payments, digital lending, and microfinance platforms are now more widely available, allowing SMEs to access funds more quickly and at a lower cost.

3.4 The current situation of financial inclusion in Albania.

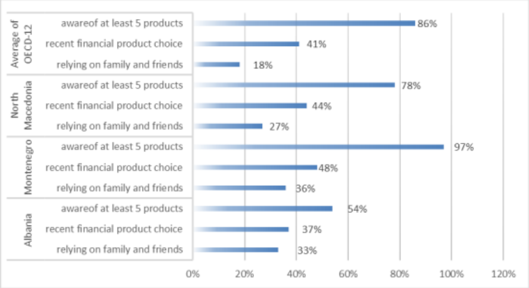
Bank finance is still not very inclusive for either citizens or businesses in Albania. In terms of accessibility—specifically, the availability of bank finance to the population—only 44.2% of Albanians had a bank account as of 2021. This is the lowest percentage in the Western Balkan region, where the average is 71.2% (International Monetary Fund, 2023). To enhance access to bank financing, the National Bank of Albania has started implementing its national strategy for financial education for the years 2022-2027. This strategy aims to raise financial awareness among primary school pupils, high school students, and the public. One notable initiative is the annual Global Money Week event (Bank of Albania, 2023). Private organizations, like the Sparkasse Foundation, provide training in financial literacy for SMEs and farmers.

When it comes to accessing bank finance, small businesses face significant challenges. In 2022, small and medium-sized enterprises (SMEs) accounted for only 29.6% of total loan recipients from commercial banks. In contrast, this figure was 39.0% in the Western Balkans and over 60% in comparable European Union economies, such as the Slovak Republic (60.5%) and Latvia (76.0%) (OECD, 2022). The temporary credit guarantee schemes, known as the First and Second Guarantee Schemes, were approved by the Council of Ministers in April and May 2020. However, these schemes have not been made permanent due to their considerable strain on the government's budget, despite their positive effects on the liquidity and profitability of Albanian firms (World Bank, The Global Financial Development Database, 2022). Despite progress in establishing a legal framework for digital payments, their adoption is still limited. This is largely due to the reluctance of commercial banks to implement open banking protocols required by the "Law of Digital Payments," which has a deadline of December 2023. In 2021, only 34.5% of the adult population in Albania reported having made or received a digital payment. This figure is below the Western Balkan average of 61.7% and significantly lower than the EU average of 93.0% (World Bank, The Global Financial Development Database, 2022).

The low adoption of digital payments presents several challenges, including increased transaction fees for businesses, limited financial accessibility, and higher remittance costs for individuals. This issue is especially significant for Albania, given that remittance inflows accounted for 9.2% of GDP in 2022 (World Bank, Remittences Prices Worldwide, 2024). Access to banking finance for small and medium-sized enterprises (SMEs) is restricted by strict collateral requirements, limited credit guarantee schemes, and a lack of supportive policies for microfinance. As a result, SMEs received only 29.6% of total loans from commercial banks in 2022, which is significantly lower than the Western Balkan average of 39.0%. This gap highlights the urgent need for targeted interventions to improve financing conditions for SMEs, including the establishment of permanent credit guarantee schemes.

In Albania, only 54% of individuals are aware of at least five financial products, which is below the global average of 83% and the OECD average of 86%. This level of awareness is also lower than in neighbouring countries. The data indicates that 33% of Albanians rely on family and friends for borrowing and saving, rather than turning to the formal financial sector. This trend signals to authorities the need to intensify efforts in promoting financial inclusion and education.

Figure 2: **Indicators of financial inclusion in Albania, 2022.**



Source: OECD, 2022.

In Albania, the percentage of people using financial products is significantly lower than the global average, often by two to four times. Specifically, 29% of Albanians have payment products, 22% have savings products, 13% own credit products, and only 9% hold insurance products. Recent reports from the Bank of Albania and international institutions, including the World Bank, indicate that most small and medium-sized enterprises (SMEs) in Albania struggle significantly with accessing financing.

According to various studies conducted by the World Bank and the International Finance Corporation (IFC), approximately 50-60% of SMEs in Albania encounter serious challenges in obtaining the necessary funding for their operations.

DISCUSSIONS, CONCLUSION AND RECOMMENDATIONS

At the end of this study, the findings based on the literature review and the empirical studies of different authors, in different countries, the increase in financial inclusion positively affects the performance of MSMEs. So, the relationship between financial inclusion and performance of MSMEs is positive. However, different countries face many difficulties and challenges regarding the development and growth of financial inclusion.

It is estimated that Albanians possess only 53% of the necessary financial knowledge, behaviours, and attitudes. Additionally, survey data indicate that their level of financial inclusion is significantly lower than the global average. While Albanians demonstrate a higher awareness of financial products, their actual usage of these products is relatively low. In comparison to other countries, there are still considerable disparities in financial inclusion indicators and the ownership of financial products. Recent reports indicate that the percentage of small and medium-sized enterprises (SMEs) with full access to financing remains low. Key barriers to this access include high collateral demands, elevated interest rates, and a lack of institutional support and financial information. However, advancements in the microfinance and FinTech sectors could create new opportunities for enhancing financial inclusion for SMEs in the future.

The study recommends that lending interest rates should be attractive to promote access to financial services. This means that banks should set rates that are neither too low nor too high to encourage economic agents to save and borrow, thereby stimulating economic activities. Currently, the interest rates on commercial bank loans are perceived as high, which discourages many operators of micro, small, and medium-sized enterprises (MSMEs) from seeking debt financing from commercial banks. Additionally, the fees and costs associated with financial services and products, such as point-of-sale (POS) fees, ATM fees, and transfer charges, should be affordable to encourage usage. The main challenge that MSMEs face in accessing formal financial services, as indicated by respondents regardless of their business types, is the lack of sufficient collateral to secure a loan.

The digitization of payments, including the enhancement of ICT and e-banking tools, along with a consumer grievance and protection framework, should be prioritized to build trust and promote financial inclusion. Additionally, it is essential to accelerate the implementation of the agent banking framework through shared infrastructure and partnerships to encourage the effective use of payment and savings services. Financial system regulators should establish policies that require financial service providers to expand into underserved areas. This should involve developing a comprehensive roadmap to increase access points for financial services in regions lacking such access. By doing so, we can address the challenges of accessibility, costs, and distance related to these services.

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