

THE ECONOMY ROLE OF SMES AND SAME PROBLEMATICS OF FINANCING THEM

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Abstract:

Small and Medium-sized Enterprises (SMEs) play a significant role in the progress of an economy. The purpose of this paper is to examine the contribute made by SMEs in Europe and specially on the Albanian GDP and total employment. SMEs in developing countries like our country need financing their activities. This study presents some advantages of SMEs why financing them is considered difficult and which are same of the main financial instruments offered from banks. This study will conclude with some suggestions of how SMEs influence the sustainable development of the economy and same main reasons of why Albanian SMEs have such difficulties in providing funds. This paper is helpful to researchers in the field of SMEs and banking, it also helps business people to see the development of their enterprise in a sustainable way.

Key words: SME, economy role, financial instruments.

Introduction

Small and Medium enterprises (SMEs) are like engines that influence growth in developing and transition economies like ours. In Albania they account for a significant proportion in trade and services and are major contributors to employment and GDP. The paper surveys SMEs importance and a discussion of how a financial institution affects economy and why SMEs have difficulties accessing bank financing.

What are SMEs?

Small and medium-sized enterprises (SMEs) are defined by the EU as those companies with fewer than 250 employees. Also there are same criteria to classify them: their annual turnover should not exceed €50 million, or their annual balance sheet should not exceed €43 million. According to their size SME-s may be: micro-enterprises which have fewer than 10 employees, small enterprises which have between 10 and 49 employees, and medium-sized enterprises which have between 50 and 249 employees. (6)

Table 1. Classification of SMEs

Enterprise category	Nr .of employment	Annual turnover	Balance sheet total
micro	< 10	≤ € 2 million	≤ € 2 million
small	< 50	≤ € 10 million	≤ € 10 million
medium-sized	< 250	≤ € 50 million	≤ € 43 million

Source:OECD statistics

Methodology of Research

The paper uses data provided by several researches undertaken by on SME's role. The data used consist in: macroeconomic data published about European Economy from OECD, and other Albanian institutions as Bank of Albania and Ministry of Economy, Trade and Energy which is based on INSTAD's data and studies.

The Position of SME-s in the European Economy

Micro, small and medium-sized enterprises as we classified at the beginning have a great domination in all countries of the European Union. There are at about 23 million enterprises in the European Union and more than 99% of them are SMEs. The most part of them (over 90%) are micro enterprise. (6)They are responsible for between 60% - 70% of jobs providing around 65 million jobs in all Europe. SMEs have employed people in sectors such as construction, metal products, transport and the wood and

furniture industries. Small businesses contribute to entrepreneurship, innovation and through bringing new products and techniques to the market.

Globally SMEs account for 99% of business numbers and 40% to 50% of GDP. (9)

SMEs in Albania

More than 99 percent of Albanian enterprises can be classified as small or medium-size according to The Strategic Plan for the Development of SMEs (2007-2013).Enterprises account for more than 60 % of private sector employment, providing the greater part of GDP. Also we can say that there is a high concentration of private enterprises in the region of Tirana-Durres (with more than 50% of total number of SME) than other regions and the most active sectors of SMEs are trade (about 49%), service, industry and transport. (10)

Table 2. Same statistics about SME in Albania

Year	2005	2006	2007	2008	2009	2010
Total number of active enterprises	64710	80710	87484	107342	105105	106477
Percentage of SME						
_(1-80 employment)	99%	99%	99%	99%	99.90%	99.90%
_(1-4 employment)				93%	92%	92%
SME contribution						
_to GDP	64%	64%	64%	64%	80%	80%
_to employment	60%	67%	66%	66%	82%	71%

Source: Various statistical reports of INSTAT(7)

As we can see from the table SME are principal driving forces in Albanian economy giving significant contribution to GDP and employment.

The private sector especially SMEs needs financial support. Until now banking sector has not been able to meet completely these needs. This is a problem not only for Albania but for all economies because it depends from the characteristics of this enterprises. (11)

Ugwushi Bellema Ihua in 2009 made a survey about the factors that can bring to Business Failure in SMEs Sector in United Kingdom and Nigeria. It showed that 82% of the people interviewed in UK and 87% in Nigeria think that Financial Problems can lead to SMEs failure in their country to a large and a very large extent. This implies that financial problems for SMEs exist in both developed and developing countries. (12)

Some of the Advantages of SMEs

They have same advantages that consist on:

- their size (the costs of raising such business is not very high)
- the period of raising a SME is shorter (usually they don't make strategic plans for the future because they don't know for sure how their business will go on)
- they operate on smaller markets (the costs of finding new market is low)
- the starting investments have a lower cost (the costs of equipments and machinery is low). (1)

The Importance of Financing SMEs

We mention the importance of SMEs and the role that they have in creating new jobs and also in the GDP of a country, but we can't see them apart from financial institutions. They are not capable to finance all their operations, develop the existing or create new products, invest in new and qualified staff etc. with their own funds and for all these reasons they need additional financing. The main characteristic of SMEs is that they begin from one or some persons, who invest their money and if the business is profitable they share the earnings and if they want to expand they try to get financing from banks or from other financial institutions. In this moment they begin to have problems differently from large

businesses. Small businesses represent greater risk for banks and for this reason they charge them with higher

interest rates and in place of helping them can cause their bankrupt. This is typical in developing country like Albania that is considered a changing economy where banks and micro finance institutions can offer financial support for them. Otherwise SMEs in developed countries have greater possibilities to financial markets and do not have a problem in taking bank loans. Many times SMEs are seen as very attractive from banks to diversify their portfolio.

There are many disadvantages for the economy of a country if SMEs can't fill the financial gap that they have. Some of them are:

- a reduction of the GDP of a country,
- a reduction of the employment opportunities,
- no promotion of ownership and entrepreneurial skills,
- they may not start up a business or go out of business,
- get out of the formal system and operate in the informal economy which means that they will not pay the taxes.

In this study are mentioned the difficulties of financing SMEs and now let's see some of the main disadvantages of the structure of this kind of businesses:

- they are unable to take market opportunities, could not achieve economies of scale and many times they can't compete with large businesses (lower quality and cost of productions and services),
- they don't have financial possibilities to purchase inputs, machinery and equipments which could help them to develop their products,
- they don't have financial possibilities to make researches of the markets (which products and services to produce),
- they are not able to obtain financial services or financial consultation,
- they often don't have the possibility to train their workers or to employ qualified and skilled staff. (1)

Same Reasons of the Difficulties in Financing SMEs

The difficulties that SMEs have when they try to have additional financing are because of:

- Lack of information between the bank and the SMEs.

- Start ups and very young firms are considered more risky than large ones.
- SMEs have greater variation of their earnings and the possibilities of bankrupts are greater than those of the larger firms.
- Small firms usually don't have managerial targets and strategic plans because their future is uncertain.
- SMEs often can't offer collateral because they don't have many long-term investments.
- Their financial statements are not audited and are not very credible for the banks.
- They don't have credit history (a bank doesn't know if this business is believable in paying the loan).
- Many proprietors of SMEs don't go to banks (cultural barriers or lack of information).

Same of the instruments of financing SMEs

Overdrafts and loans

Overdrafts and bank loans are the most known sources of finance for SMEs. Loans are used to purchase equipments, machineries, buildings that are able to generate revenues in the long term period. The terms of a loan are negotiated between the bank and the entrepreneur and usually it cost less than the other forms of financing but at the other side they it is more difficult to provide it, need personal guarantee and are not flexible in payment of interest and principal.

At the other side overdrafts are used to pay short term obligations, are more expensive than loans and the banks can request to close it if the firm is not capable to pay.

Commercial mortgages

They are long term agreements and are used when the business will buy a property. This property will be the guarantee in cases of non payment of interest and principal from the buyer. In most cases the bank doesn't finance 100% of the value of the property. (5)

Leasing or buying assets

A lease is a written, usage agreement by the lessee to pay rent to the lessor for a specified time for the use of vehicles, equipments etc. (8)

Leasing give the opportunity to the business to repay the cost of a equipment, machinery etc, not immediately but in form of rents. There are two forms: finance leasing and operational leasing.

In finance lease the business will pay all the costs of maintaining the asset which will be shown on the balance sheet as capital.

In operational lease the leasing company is responsible for all the maintenance cost and it will take back the equipment at the end of the agreement time. The asset will not be shown in the balance sheet. (5)

Credit Situation in Albania

During the year 2009, the main European banks applied different monetary politics to stimulate the loan activity which was reduced from the financial crisis of 2008. The European Center Bank has changed four times the basis interest rate to 1% from 2.5% at the beginning of the year. The Bank of England changed the basis interest rate to

0.5% from March 2009 which for this country is the lowest in the history. (2)

In 2009 in Albania we have a reduction of economic activity of the business sector and a tighten loan policy from banks. This happened because depositors started to take their deposits back from the banks causing lack of liquidity and the second reason for taking this policy was the financial crisis in international markets at the end of the year 2008. (2)

Another risk was that of reducing the quality of loan portfolio of banks. At the second half of 2009 the tighten standards of approving loans and the decrease of the economy brought to cut the demand for loans. Followed by the depreciation of the national currency the growing of the loans according to Bank of Albania was only 4%. While current bank deposits have reported surpassed pre-crisis levels and bank liquidity has improved, the demand for credit is still low. In December 2009, the growth rate of loans dropped to 12% from 33% in 2008. In general, the banking sector remains viable, well capitalized, and able to further finance the economy, as the ratio of loans to deposits, approximately 65%, is still low compared to the other countries. (2)

During the first period of 2010 the Albanian banks still used a tighten policy for loans approval. This is because of the non performing loans of the sector and macro economy situation of Albania. (3)

Actually the loan approval for the business sector is realized mainly through:

- increasing the profit margin for the high risky business especially for SMEs, (the percentage of interest is high even in cases when the loan is requested for investments in equipments and machinery for a medium term period) (11)

- increasing the demand for collateral, (the level of collateral requested is 120%-150% of the investment) (11)

- increasing of loan maturity. (4)

In 2010 the demand for loans from SME-s is increased, otherwise the application for a loan from different corporation is decreased in the first months of 2010. The businesses take loans especially to finance the floating capital and the investment expenditure.

The future expectation for credit activity is a facilitation of the procedures and standards in order to increase the number of small and medium business to be partners of financial institutions. (4)

Conclusions

SMEs play a catalytic role in the development of any country being the engines of growth in developing and transition economies. They are considered as job generators and vital for the economic growth.

Entrepreneurship is at the heart of the national advantage and small businesses are particularly important for bringing innovative products or techniques to the market.

Albanian economy, by large relies, on micro-businesses. Nearly all enterprises in Albania fall into the category of small and medium enterprises SME-s. More than 90 percent of Albanian enterprises can be classified as small or medium-size according to our INSTAT data.

In both developed and developing countries, the financial problem of under capitalization is considered as a very significant factors influencing SMEs failure.

The situation in Albania is problematic because we don't have very developed financial sectors and also SMEs have difficulties to access international financial markets. Other problems of Albania are:

-the macroeconomic situation (low growing of GDP)

-unclear property rights (banks don't accept real estate as mortgage if it hasn't the right property documents)

-absence of a land market

-we still suffer from instability of economic policies

-high level of informal economy(the reports that businesses give to banks not always are true)

-absence of adequate information for the businesses

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