

The Development of SMEs in Albania. Case Study of The Vlora City

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Abstract

Various studies assert that there is a positive correlation between SME development and economic growth. SMEs help in building productive capacities by promoting innovation. As they develop, they create new jobs, compete with large enterprises, become part of the global market, and contribute to poverty alleviation in developing countries, help to increase revenue, boost exports and reduce imports. Therefore the development of SMEs should be an essential part of any government project. Priorities for the development of SMEs are the sources of funding. Various surveys show that bank loans are the most common methods for the development of SMEs. Alternative sources such as leasing and factoring are also of great importance to the development of SMEs. But the financing of SMEs faces major obstacles which adversely affect their development. In the development of SMEs key roles also play the government policies, training of the workforce, business environment, attracting FDI, the use of new technologies etc. Policymakers around the world have applied specific measures to encourage SMEs to build international businesses. In this paper it is presented an analysis of the development resources of SMEs in our country. Special focus will be placed on the financing methods of SMEs in Vlora.

Keywords: *SME, Micro-credits, Loans, Leasing, Factoring, Government policy*

Introduction

The main source of the development of SMEs is financing. Without funding SMEs cannot use the new technologies and cannot be expanded to compete in global markets. Thus, the need for funding has been identified as the most important factor of survival and growth of small and medium-sized enterprises in developing countries and also in developed countries. A weak system of financing the SMEs has a negative impact on a country's development by reducing income and exports and increasing unemployment and imports. Despite their dominant number and importance in job creation, SMEs traditionally face difficulties in securing financing sources. While the increase in equity is seen as the main challenge from the owners of SMEs, they have limited access to obtaining loans due to the smallness of the capital they own. SMEs tend to have fewer external sources of financing available to them, and are more dependent on banks compared to large enterprises, which could raise the capital through means such as issuing bonds, commercial papers or other equity securities that are publicly traded. So large enterprises have a comparative advantage in their development methods compared to SMEs.

The impact of SMEs in economy

SMEs play a significant role in promoting economic development. Yunus (1999) comes to a conclusion that small enterprises are the engine of global economic growth. In most countries, SMEs dominates the industrial and commercial infrastructure (Avlovschi and Robu, 2011). SMEs play also an important role in the flow of foreign direct investments (Kuo and Li, 2003). Economists believe that the wealth of nations depends on the performance of their SME (Schroder, 2006). In developed countries and developing countries, SMEs contribute to the stability of the national economy. They help the economy to handle the shocks of the economic cycles. SMEs serve as the main engine of equal distribution of the incomes among employers (Hallberg, 2001).

The concept of SMEs

There is not a fixed definition for SMEs (Altman, Sabato and Wilson, 2008; Henschel, 2009). This is because there are no constant criteria to measure them in terms of costs that makes to the capital, number of employees, investment in fixed capital and machinery, etc. (Almeida, (2004). These differences are detected between SMEs from country to country, from industry to industry, from school to

school and from author to authors (Zaman, 2007). According to the United Nations Environment Programme (UNEP, 2003), some countries prefer to categorize SMEs in three categories: micro, small and medium enterprises; or, very small, small and medium enterprises. Several other countries classify SMEs into two categories: small and medium enterprises.

The Albanian law classifies SMEs:

- Microenterprises → economic entities that employ less than 10 employees and has an annual turnover of less than 10 million ALL
- Small enterprises → economic entities that employ 10 to 49 employees and has an annual turnover not more than 50 million ALL
- Medium enterprises → economic entities that employ 50 to 249 employees and has an annual turnover not more than 250 million ALL (Source classification: ILO)

SMEs active in 2015

The table below shows the number of active enterprises in Albania in 2015, divided by region. As shown in the table, Tirana district owns the largest number of SMEs in 2015. Subsequently ranks Durres district and beyond that Vlora.

TABLE 1: The number of active enterprises in Albania by region

District	Total	Farmers	Natural Persons	Legal Persons	Total
Total	152,288	19,543	103,414	29,331	100
Berat	7,205	2,439	4,129	637	2.2
Dibër	2,85	75	2,230	545	1.9
Durrës	13,125	88	9,932	3,105	10.6
Elbasan	11,493	1,927	8,203	1,363	4.6
Fier	19,199	6,628	10,704	1,867	6.4
Gjirokastrër	3,661	352	2,599	710	2.4
Korca	11,609	4,070	6,446	1,093	3.7
Kukës	1,543	88	1,087	368	1.3
Lezha	4,902	378	3,700	824	2.8
Shkodër	10,299	2,275	6,453	1,571	5.4
Tirana	54,237	529	38,425	15,283	52.1
Vlorë	12,165	694	9,506	1,965	6.7

Source: Instat, 2015

Key development methods of SMEs

The main methods of SME development are associated with the sources of financing. The main sources of financing in Albania, without including their own funds, are:

- Micro loans
- Bank loans
- Investment Funds

Microfinance for SMEs in Albania

The concept of microfinance has been driven by poverty and employment. Communities with low incomes promoted on a massive scale the idea of microfinance as an opportunity to reduce poverty and increase employment. Microfinance supports SMEs not only in the creation of new jobs, but also in the creation of better work conditions (Karnani, 2007; Dichter, 2006). This is possible only if SMEs employs mostly poor workers. Microfinance is the delivery of small loans (microloans) to poor families or small businesses to help them increase their incomes or participate in profitable activities. Microfinance involves a wide range of financial services like:

- Loans
- Savings
- Insurance

Microfinance institutions are extremely important source of funding for micro enterprises and rural sectors, which do not receive enough services from the banking system. Without these institutions, micro and small enterprises, as well as residents of rural areas are excluded from the financial market due to the lack of standard collateral and guarantees, distance from bank branches or agencies and the absence of knowledge about the banking system. Also, commercial banks have a lack of interest to provide this kind of service, at high cost. Moreover, poverty is still present in these areas and the level of income is very low. Lastly, micro enterprises and small farmers need small loans. Microfinance loans are more expensive than bank loans. In Albania the number of people who have access to microloans is smaller compared to other regional countries.

The microfinance sector in Albania is comprised of microfinance institutions and credit-savings unions. In the microfinance focus are the borrowers with lower incomes. The main microfinance institutions in Albania (source: Bank of Albania) are:

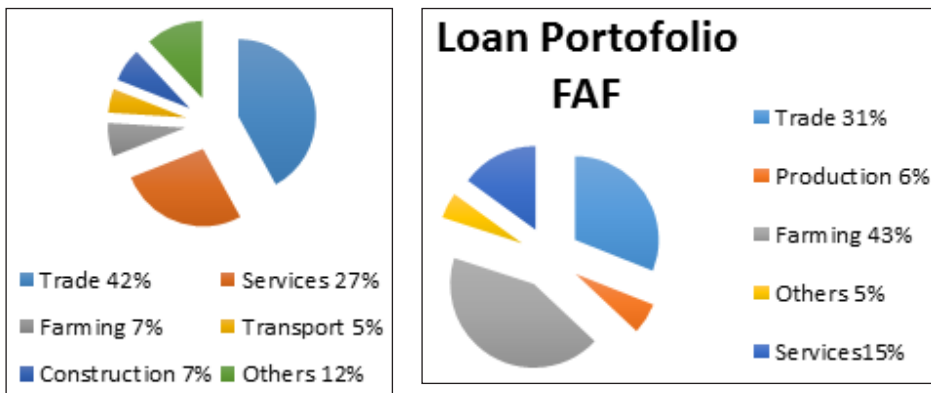
- Besa Fund → owns 33% of the loan portfolio of microfinance
- credit-savings union → owns 25% of the microfinance loan portfolio and 82% of the total portfolio of credit unions, savings
- NOA → owns 18% of the loan portfolio
- First Society of Financial Development FAF (SHA) → owns 16% of the loan portfolio

Most of the microfinance portfolio is owned by the non-banking financial institutions. These institutions possess about 68% of the total microloan portfolio. Then the credit, savings unions have 29% of the total. Banking, financial institutions are ranked third in providing microloans, occupying only 3% of the total portfolio (Source: Bank of Albania). The economic recession of the recent years has led to a reduction of the weight of the microfinance portfolio, not only in our country but also in similar institutions in the region. As opposed to the banking system, microfinance market has the advantage of having a low number of problematic loans. The risk portfolio of microfinance institutions ranges from 5-8%, while in the banking system the level of problematic loans has reached 23%.

Loan outstanding. Besa Fund & FAF

Through these two charts are compared the sectors in which Besa Fund and FAF operate their activity of loan lending. It is observed that Besa Fund is more present in supporting with microloans the sector of trade and services. In contrast, FAF is an institution which exercises its activity much more in rural areas, supporting the financing of agriculture and farming sectors. The charts below provide detailed information about the distribution of the loan portfolio, of the two major microfinance institutions.

GRAPH 1 & 2: The loan portfolio F. Besa & FAF



Source: F. Besa & FAF

Leasing

In many countries, leasing is used for rapid development of SMEs, especially in Belgium, Finland, Ireland and Spain. Leasing is an opportunity for SMEs to expand their access to medium-term and short-term financing. From an economic perspective, leasing can be defined as a contract between two parties where one party (the lessor) provides an asset for use to another party (the lessee) for a specific period of time in exchange for certain payments (Fletcher, 2005). According to Standard Accounting System, leasing is an agreement whereby the lessor transfers to the lessee, in return for a payment or series of payments, the right to use an asset for him for a certain period of time (European Commission 2012). Leasing is referred as an asset-based financing. Lessors retain ownership of assets during the life of the contract. Leasing is focused on the ability of lessees to generate cash flow from operations which service business for lease payments (Gallardo, 1997).

Leasing separates legal ownership of an asset from its economic use. Under a finance lease, substantially all the risks and rewards of ownership of the asset transfer to the lessee (as lessor remains the owner). Risks associated with ownership of the asset remain the landlord (Fletcher ET. Al 2005).

Leasing in Albania

Leasing is still in its very early stages in our country. In 2013 there have been four leasing companies in Albania:

1. Tirana Leasing JSC founded in 2004 provides financial leasing services for cars and trucks in special conditions. It is the first leasing company in Albania and in recent years has added a new service for mobile machinery, construction machinery, equipment etc.
2. Raiffeisen Leasing was established in May 2006 with Raiffeisen Bank JSC shareholders who own 75% of the stocks and Raiffeisen Leasing International GmbH, which owns a 25% of the partnership. RLAL provides leasing services for individuals in cars, and commercial vehicles.
3. Landeslease. Landeslease has operated in the Albanian market since 2005. It finances the cars of various kinds of companies, large and small companies as well as for individuals.
4. Credins leasing activity began in September 2007. About 55% of the leasing portfolios of the company's accounts are for machinery and equipment. Leasing provides financing for cars, trucks, medical equipment and medical funding.

TABLE 2: Market share of leasing companies

Leasing companies	Market Share
RLAL	51%
Tirana Leasing	34%
Credins leasing	9%
Landeslease	6%
Total	100%

Source: Bank of Albania 2014

Leasing in Albania is mostly used by SMEs. It is used more for customer automobile purchase than machinery or production lines. The leasing market in Albania has declined significantly in 2012 compared with 5 years ago. This market is reduced by 20% in the first 6 months of 2012. The reasons for damaging the leasing market are:

- The decline in investment
- Domestic political conflicts which reduce investment
- Increased sales of used cars
- The decline in the construction sector, which lowered demand for construction machinery
- The sharp fall in consumption
- The contraction of the loan application from clients
- The psychological effect on individuals, who tend to save in times of crisis
- An immense increase of import

Although this market is expected to take place in our country, it currently remains underdeveloped compared with neighboring countries in the region.

Factoring

Factoring is one of the most modern financial services that are made available to SMEs. It represents a contract for the transfer of a certain volume of trade credits still undiscounted, from the official to one factor that we might call it broker. During the 1960s, 1970s and 1980s, bank interest rates rose. This made it difficult financing of companies in the traditional way. Factoring became even more popular because it did not require the same kind of control as loans.

The factoring service in Albania is offered not only by banking institutions, but also by non-banking financial institutions. In Albania operate two non-banking

institutions in the field of factoring which have started their activities in 2011. These are the Albanian Factoring Services and Omni Factor. Also six commercial banks on the right to operate factoring in our country. According to Boa, there are in the licensing process also other financial institutions. In Albania there are no obstacles to the development and stimulation of the factoring activity, but for banks is safer and easier to evaluate the loan-receivers than factoring. Factoring is useful for banks with branches in other countries and also when the bank has a history of the parties, especially the debtor.

In our country is developed only in the factoring without warranty. This means that if the customer is not able to repay its obligation to the supplier, factoring companies are not harmed. Being a short-term funding source for SMEs, the factoring market is expected to grow in Albania. This for several reasons, among which we mention

- The large number of SMEs in Albania
- Lack of liquidity for SMEs has increased
- The high cost of bank loans has reduced the loan request, by directing customers to alternative forms of investment
- Increased investment in working capital and financial assets and the reduction of long-term investments

Factoring is not very common in Albania since there are not yet favorable conditions for this activity, and the market is not yet ready to accept this kind of financing. It also represents a complex product which often displays a high risk. While the loan is a bilateral agreement, in factoring participate three parties (the bank, the debtor, the seller of the invoice).

Development of SMEs beyond funding sources

In the development of SME, except the financing resources, influence:

- A detailed legal, regulatory and administrative framework
- Clearly recognition of property rights, an easy implementation of the contracts and a simple tax system, transparent and low cost
- Simplicity in business registration
- Minimize the licensing requirements for businesses
- Protecting the health and safety of consumers
- flexibility of labor regulations and protection of workers' rights
- Establishment of credit schemes of medium and long term, with low interest for SMEs

- Knowing the limitations of SMEs from financial sector regulations
- Evaluation of the contribution of entrepreneurs by engaging employees to be more productive
- Development of information technology and entrepreneurial culture
- Ensuring fair competition and support the integration of SMEs internationally
- The law must not impose high fines on entrepreneurs in case of bankruptcy of SMEs
- Avoiding evasion and the reduction of informality
- training and improving the skills of the workforce
- Accurate information on market
- Improvement of infrastructure for export promotion
- Drafting of a new law for SMEs to align it with the EU law on SMEs

Thus, in the development of SMEs an important role is played by the government through its regulations and programs. Disorders and competition are other important factors which affect the creation and development of SMEs. Studies show a clear negative correlation between the amount of administrative barriers and the development of SMEs (OECD, 2001). New strict regulations for market entry of new businesses are not related to products of the highest quality, the best environmental data, higher standards or greater competition. But strict entry regulations are associated with high levels of corruption and a higher level of informal economy. Nothing is more important in the development process, rather than the training of the workforce. Continuous training or learning for employees during their entire life, enables enterprises to become “learning organizations”.

Obstacles to the development of SMEs

There are some obstacles to the development of SMEs. The main obstacle is the overlapping of rules and the complexity of administrative procedures. The delay in granting business licenses and the overlapping of rules requires SMEs to obtain many licenses before the start of their production. Investing in training can be too costly for SMEs. SMEs face the risk of losing their staff since they can choose to switch to other companies with better opportunities and higher incomes. SMEs often have limited technology and a lack of investment in research and development (R & D). Certain market distortions, such as monopolies and unfair competition by large enterprises poses another challenge to SMEs. The main obstacles that SMEs development faces in Albania are:

- SMEs can not dispose the financial resources they need, due to capital constraints in their possession

- SMEs are facing shortages on alternative sources of funding such as venture capital, innovation vouchers, business angels, etc.
- Services offered to SMEs are not at the required standard
- Performance in innovations is not satisfactory
- Lack on technological capabilities of enterprises
- Informality in economy
- Limited access to private financing
- Difficulty in obtaining construction permits and property registration
- Low levels on R&D and human resources
- Lack of support programs for women entrepreneurs
- Limited IT skills and education

Albanian government programs for SME development

The institution responsible for formulating SME policies is the Ministry of Economy, Trade and Energy (Moe). The Ministry played an important role in drafting of the legislation, development strategy and initiate business support. A number of laws have been approved by the government with the objective of reducing the administrative barriers. Legal initiatives have contributed significantly to the improvement of the regulatory functions of SMEs; simplify the procedures for licensing, registration and protection of businesses. In 2006, Albania has established Business Council as an institution for a counseling component of SMEs. The objective of this structure was the institutionalization of the dialogue between SMEs and the legislative and executive authority. In October 2007 it was signed the “Memorandum of Donors Forum of SMEs”, creating a national platform for monitoring and evaluating the implementation of the strategic program of SMEs. Donor programs have focused their activity on development of road infrastructure and the development of some regions that have a significant number of SMEs. In Albania the EBRD has supported successful small enterprises through TAM / BAS program, which has implemented 37 projects in Albania for SMEs. The main obstacles that can be solved with the help of the program TAM / BAS is dealing with ineffective leadership and management skills, business planning, marketing techniques and the lack of international best practices. SMEs are desperate for the use of foreign resources to finance their activities because:

- Albania still has a structured system of export support, integrating export promotion activities, and the availability of credit financing
- Government support has been limited to the implementation of cost allocation schemes for supporting the participation of Albanian companies at trade fairs and other marketing activities. Albania has no Commerce Office in key export markets.

- Support for technological innovation of SMEs through the development of skills, technology centers and business incubators are still very limited.

In order to overcome this situation, the government has taken measures to establish a more active policy. It has developed a new program that covers all-inclusive technological and non-technological innovations. Multiannual program includes the creation of a center for business innovation in Albania, completion of the analysis relating to the training of the SME sector and the development of innovation and technology strategy. Activities to stimulate SME scheme implemented easing of the fiscal year. Our government has applied the possibility of annual turnover threshold for small businesses favorable. Therefore, businesses with a turnover up to 8 million all, pay a tax on turnover of 1.5 %-2.5% depending on the traffic volume, and were excluded entirely from VAT. After 2008, with the onset of the global crisis, these measures are removed or restricted for SMEs. Therefore, the turnover threshold was reduced from 8 million to 2 million. For businesses with a turnover of over 2 million ALL, income tax was set at 10 percent and the application of VAT to 20 percent, the same as for larger businesses. Moreover, for some freelance, annual turnover threshold was removed and they are required to pay profit tax of 10 per cent and VAT of 20 per cent despite annual turnover.

Analysis of SMEs in the city of Vlora

For the analysis of this study were surveyed 96 small and medium enterprises (SME) in the city of Vlora. Of these SMEs, 55 have been registered as a physical person, while 42 of them have the legal form of a juridical person. Most of SMEs taken for study are LLC and a very small part of them are JSC.

TABLE 3: The activity that perform SMEs based on the survey

The type of activity	%
Production	7
Construction	20
Services	35
Retail	28
Others	10
Total	100

Source: Results of the survey

From the above table it is noted that the surveyed SMEs deal with more than one type of activity. Most of the SMEs deal with services and less deal with production (7%). In the city of Vlora is observed an increasing number of enterprises engaged in construction. Although this activity is in a declining phase, new construction firms continue to register in the respective offices of the city of Vlora.

SMEs use some funding sources, but the most important are internal funds and bank loan. The below table illustrates this fact. Bank loan, despite being an expensive source of funding, occupies 60% of the specific weight of all sources of funding.

TABLE 4: Sources of funding

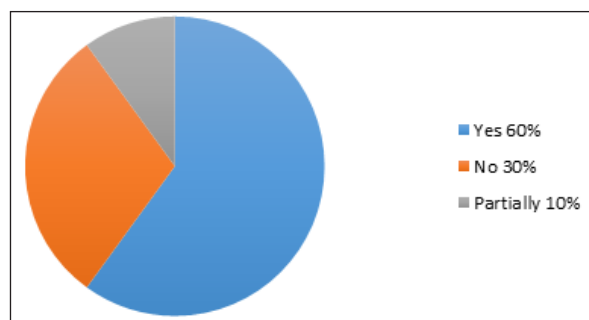
Alternatives	%
Internal funds	25
Family and friends	5
Private banks	60
Tenancy agreement	0
Leasing or Factoring	5
Others (specify)	5

Source: Results of the survey

Sources of SMEs development

Bank loan is one of the most used sources for funding, but we can not say that the banking system meets SMEs financial needs 100%. From the survey results that 60% of SMEs think that the banking system meets their need for funding, 20% of SMEs think that the banking system does not meet their needs for funding and 10% of SMEs think that the banking system somehow meets financing needs, thus not fully.

GRAPH 3: Meeting the needs for financing from the banking system



Source: Results of the survey

In a near future, 50% of surveyed SMEs think that will get bank loans, 30% think that will not use bank loans and 20% do not know if will borrow from the banking system. Usually, these SMEs use the loan taken for working capital, and less for investment.

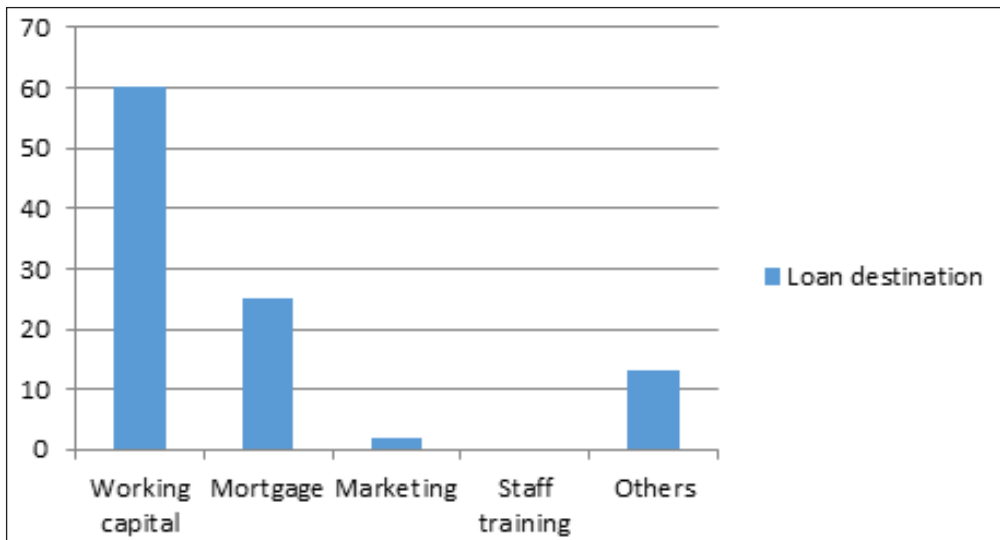
TABLE 5: The use of bank credit

Use of Loan	%
Floating capital	60
To buy land/building/equipment	25
Business promotion	2
Staff training	0
Others	13

Source: Results of the survey

This table shows that the development of businesses in Vlora focuses on funding sources. SMEs do not spend on staff training or promoting the business, which are essential elements affecting the development of SMEs.

GRAPH 4: Loan destination



Source: Results of the survey

SMEs in the medium term will continue to widely use the banking system to finance their activities.

TABLE 6: The relationship Banking System – SMEs

	Not at all	Slightly	On the average	Many
Banks demand for collateral	-	22.7%	45.9%	31.4%
Bureaucracy of banks	-	49.5%	43.6%	7.3%
The level of commissions for services	5.2%	8.7%	42.7%	43.4%
The speed of service	66.6%	6.7%	13.3%	13.4%
The percentage of loan interest	-	-	53.8%	46.2%
Lack of long-term loans	40.3%	33.1%	13.4%	13.2%
The need for special connections with banks	20%	53.3%	20%	6.75

Source: Results of the survey

In the relationship between the banking system and SMEs, there are various issues, where the most important are

- The interest rate on loans
- Banks requirement for collateral
- Banks bureaucracy
- Bank commissions

TABLE 7: The relationship SME – Government

	Not agreed	Slightly agreed	Averagely agreed	Fully agreed
Our government has clear vision, strategies and policies to promote SMEs	25	68	7	-
The procedure for starting a new business is transparent and simple	-	23.7	76.3	-
Government responsiveness to business needs is high	73.6	26.4	-	-
Government policies to support the development of SMEs are clear, transparent and easily understandable	31.2	66.7	2.1	-

Source: Results of the survey

The persons surveyed, think that the government has no strategy, vision and clear policies for SMEs development. According to them, the government should increase its responsiveness to business needs. The government should take measures to support the development of SMEs. So we arrive at the conclusion that in Vlora, SMEs see as the only way to develop sources of funding. SMEs do not develop through methods such as the promotion of business, training of the labor force or government support measures.

Conclusions

Sources of funding are the key contributors to the development of SMEs. Banks in our country have taken measures to serve the SME sector. They offer to SMEs various products and financial services, assisting them to cover their financial needs. The main source of funding for SMEs is the bank loan. But SMEs in our country does not have sufficient collateral and face difficulties in approving the loan. These loans focus on the economy sectors that have quick return, like trade. The manufacturing sector is supported primarily by micro loan schemes. Banks offer very little loan for the agriculture sector and have a stable relationship with large businesses, by discriminating somewhat small businesses.

In the development of SMEs, in addition to the financial resources, affect a variety of other factors like a detailed legal, regulatory and administrative framework, minimization of the licensing requirements for businesses, the development of information technology and entrepreneurial culture, training of the workforce etc. High interest rates, lack of reliability of banks to SMEs, many requests for collateral etc. appear as the main obstacles to the development of SMEs in Albania. Considering as vital the development of SMEs, the Albanian government aims to use some other instruments in their support such as factoring, leasing, increased funding for micro loans, etc.

A questionnaire was conducted in Vlora to understand more about the ways of development of SMEs in this city. From the results of the questionnaire were achieved the following conclusions:

- Most of the surveyed SMEs were businesses that developed their activity in providing services and in the trade sector
- The number of employees in most enterprises amounted to 10
- For the initial investment, the surveyed SMEs had used personal resources also combined with bank loans
- The surveyd SMEs almost did not perform spendings for staff promotion and training, which are important factors that affect the development of SMEs
- Most of the surveyed SMEs think that the Albanian government has no vision, strategy or clear policies to support the development of SMEs

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