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in the context of EU integration

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EDITORIAL

Macroeconomic Policy Management in the context of EU integration

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Managing a country's economy while trying to join the European Union is complicated. It's not easy even for countries that are already members, but it's even harder for those, like the Western Balkan countries, who want to join. Imagine having to make many people with different styles dance together: it's a bit like trying to make the economies of very different countries work under the same EU rules. This process fundamentally, is about harmonizing diverse economic landscapes under the overarching framework of EU regulations, a task that demands meticulous coordination of fiscal and monetary policies. The core dilemma lies in achieving economic convergence amidst inherent disparities, navigating the constraints of EU fiscal rules, and mitigating the impact of economic shocks within a unified economic sphere. The European Central Bank, while a linchpin in guiding Eurozone monetary policy, grapples with the complexities arising from the varied economic realities of its member states.

For the Western Balkan nations, including Albania, the aspiration of EU membership transcends mere administrative compliance; it necessitates tangible and sustainable real convergence. This process, the gradual alignment of income levels with those of more developed EU counterparts, serves as a critical barometer of their economic viability and integration potential. Recent research, employing beta and sigma convergence analysis, has shed light on the progress of Albania, Montenegro, North Macedonia, Bosnia and Herzegovina, and Serbia between 2010 and 2023. While the findings confirm a degree of convergence, the pace of adjustment remains insufficient to bridge the income gap within a reasonable timeframe. This

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revelation underscores the persistent obstacles hindering the region's economic ascent, demanding a rigorous examination of the underlying factors.

The existing body of literature provides a valuable backdrop for understanding these dynamics. Studies have consistently highlighted the varying degrees of convergence across European regions and periods, with the Western Balkans historically exhibiting slower convergence rates. The impact of external shocks, such as the global financial crisis, has further exacerbated income disparities, revealing the region's vulnerability. This analysis underscores the imperative for deep, structural reforms within the Western Balkan economies. Mere adherence to formal accession requirements is inadequate. A concerted effort to enhance productivity, foster innovation, and strengthen institutional frameworks is crucial for accelerating the convergence process.

Focusing specifically on Albania, the nation has embarked on a transformative economic journey with the explicit goal of EU accession. However, the path to real convergence has proven complex and protracted. Studies indicate that while Albania has achieved some progress, the speed of adjustment remains insufficient to close the income gap rapidly. This suggests that despite advancements, significant impediments continue to stifle economic growth. Key factors include the necessity for profound structural reforms to enhance competitiveness, attract foreign investment, and foster innovation. Furthermore, the quality of institutions, including the rule of law, the fight against corruption, and the assurance of legal certainty, are paramount for creating a conducive business environment. Investing in human capital through education and vocational training is essential for boosting productivity and innovation capacity. The development of modern infrastructure, particularly in transport and energy, is also crucial for sustaining economic growth. Albania's vulnerability to external economic shocks, such as the global financial crisis and the COVID-19 pandemic, further underscores the challenges it faces.

Looking ahead, EU accession offers Albania the opportunity to access structural funds, benefit from the single market, and strengthen its institutions. Economic integration with the EU can stimulate growth, create jobs, and improve living standards. However, Albania must accelerate the pace of reforms and address structural challenges to realize its growth potential. The ability to attract foreign investment and promote innovation will be decisive for the success of the convergence process. In conclusion, while Albania has made progress on its path to real convergence, it must confront significant challenges to close the income gap with the EU. A sustained commitment to reforms, institutional strengthening, and investment in human capital are essential to realize the country's growth potential and ensure a prosperous future within the European Union.

Sustained and focused efforts are mandatory to overcome the difficulties of economic development and ensure a prosperous future for the area. As the Western Balkans continue their path to EU membership, the resulting data acts as a valuable guide, steering them towards a more equitable and integrated European future

Investigating the real convergence of Western Balkan countries

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Abstract

Purpose: *The aim of this article is to analyse the real convergence of the Western Balkan economies to the European Union. Real convergence is the process of reducing inequality in income levels between countries at different levels of development, where the economic growth of underdeveloped countries catches up to the growth of developed countries.*

Methodology: *Convergence is assessed through unconditional and conditional beta-coefficient, and sigma-coefficient. The study covers the period 2010-2023.*

Findings: *The analysis results confirm the hypothesis of convergence for all the Western Balkan countries included in the study, however, the speed of adjustment is not high enough to ensure the closing of the income gap in a relatively short period. The countries need to undertake deep reforms, to bring their economies closer to those of the European Union.*

Keywords: *real convergence, beta-coefficient, sigma-coefficient, speed of adjustment, Western Balkans*

Introduction

Accession to the European Union continues to remain the main objective of the Western Balkan countries, which have undertaken significant transformations of their economies to achieve this objective. Beyond fulfilling the formal criteria, accession to the EU implies above all the real convergence of the economies, which is defined as a long-term process that brings about a lasting increase in real GDP per capita in lower-income countries towards the levels shown by higher-income countries (del Hoyo et al, 2017). It is a phenomenon that happens when countries that are relatively underdeveloped and have lower productivity levels expand more quickly than more developed economies, eventually bridging the gap in living standards between the two groups.

The aim of this article is to conduct an analysis of the convergence of the Western Balkan countries, specifically Albania (ALB), Montenegro (MNE), North Macedonia (MKD), Bosnia and Herzegovina (BIH) and Serbia (SRB). Using data for the period 2010-2023, various convergence indicators are analysed to assess the current situation and the chances that these economies must soon become part of the EU.

This article is organized as follows: after the introduction, the current literature on this topic is discussed. Then the methodology is described, which is followed by the data analysis. The article concludes with conclusions, recommendations, and limitations.

Literature Review

The real convergence of European economies has been studied both for countries aspiring to join the EU and for those already part of the EU. This is because even within the EU, countries have different levels of economic development.

El Ouardighi, J., & Somun-Kapetanovic, R. (2009) studied income and inequality convergence across different time periods. Specifically, they find that during the 2000s, there was notable convergence in both income and inequality among the EU-27 countries, whereas the Balkan countries experienced most of their convergence in the latter half of the 1990s. Despite these improvements, a significant development gap between the Balkans and the EU persists. Their study reveals that income and inequality in the Balkan countries are converging at rates of 2.6% and 2.4%, respectively, indicating a substantial progress in real convergence. In contrast, the process is weaker across the EU-27, with distinct patterns of convergence observed across sub-periods.

Moron and Holobiuc (2019) created clusters of European countries and assessed their convergence or divergence over the period 2000-2017. The authors suggested that New Member states in Central and Eastern Europe had faster per capita income growth than Northwestern countries, while Southern European countries had a modest performance. Gros (2018) found contradictory results: while the countries of Central and Eastern Europe were in the process of catch-up, within the Eurozone there was a process of divergence between the northern and southern countries. Zuk and Savelin (2018) with data for the period 2000-2016 suggested that CESEE countries had GDP/c close to the EU average, indicating a very high degree of convergence. Meanwhile, in the candidate countries, specifically in the Western Balkans, the speed of convergence was relatively low. Krstevska (2017) also reaches the same conclusion in a study of the Western Balkans region. The author found that the region had low performance, suggesting a low level of convergence with the EU average. However, the author concludes that there was no income gap between this region and some of the less developed EU countries.

Following these studies, Stanišić, N. (2016), analyses income convergence among Western Balkan States (WBS) and new EU member states (NMS) related to economic crisis. The global economic crisis slowed down income growth, affecting the NMS for a short time and the WBS for much longer. As a result, the income gap between the NMS and WBS became larger after the crisis.

Gockov, G., & Antovska, A. (2019) find that Western Balkan countries are stagnating and have the slowest income growth. It also finds that the EU membership process has the strongest positive impact on real economic convergence in the analysed countries.

Researchers have suggested that not only do there exist different degrees of convergence between EU countries, but also between different regions inside the EU. Cartone et al (2020) in a study of 187 regions in 12 different European countries concluded that the degree of convergence was relatively different in different regions, but convergence was relatively higher in regions that had lower economic growth.

Methodology

Studies on convergence are widely based on the neo-classical theory of economic growth, which establishes a presumption that countries with access to identical technologies should converge to a common income level. Countries that are poorer and have higher marginal productivity of capital should, therefore, grow faster in the transition to the long-run steady state (Rodrik, 2011).

To assess convergence, absolute beta-convergence, relative beta-convergence, or sigma convergence coefficients can be used.

Absolute beta-convergence of an individual country or a group of countries, can be measured using the equation proposed by Barro and Sala-i-Martin (1992):

$$\frac{1}{T}\ln\left(\frac{Y_t}{Y_0}\right) = \alpha + \beta \ln(Y_0) + \varepsilon \qquad (1)$$

where Y_0 is the initial GDP per capita, Y_t is the final GDP per capita, β is the convergence coefficient, and the left-hand side shows the average growth rate of GDP per capita (in logarithm form) between t = 0 and t = T. The absolute convergence of an individual country occurs when β-coefficient is negative and statistically significant. The speed of convergence against the steady state is calculated as:

$$\beta_s = -\ln\frac{1-\beta}{T} \qquad (2)$$

Rodrik (2011) suggested that whatever convergence one can find it is conditional: it depends on policies, institutions, and other country-specific circumstances. So, the equation (1) can be extended with other explanatory variables to get the conditional beta-coefficient:

$$\frac{1}{T}\ln\left(\frac{Y_t}{Y_0}\right) = \alpha + \beta \ln(Y_0) + \gamma X_t + \varepsilon \qquad (3)$$

where X_t is the set of other explanatory variables influencing the growth of the GDP per capita. Extending the model with other variables suggests that the convergence of countries to their steady-state growth rates may differ depending on country characteristics. As explanatory variables in this paper will be included:

- Inflation (INFL), as the % annual change of the CPI
- Terms of Trade (TOT), as the share of total trade volume to GDP
- Unemployment (UNEMPL)
- Capital (K), as the share of gross capital formation to GDP.

All data is taken from the World Development Indicators database.

β-coefficient can be used to estimate the half-time t_(1/2) which shows how many years pass until the economy of a given country covers a half of the distance between the actual position and the steady state of the per capita income level (de la Fuente, 1997):

$$t_{\frac{1}{2}} = \frac{\ln(\frac{1}{2})}{\beta_s} \qquad (4)$$

Sigma-convergence measures the dispersion of income. If the income dispersion across a given group of countries declines over time, the sigma convergence is achieved.

$$\sigma = \sqrt{\left(\frac{1}{n}\sum_{i=1}^{n}(log\frac{y_i}{y^*}\right)^2} \qquad (5)$$

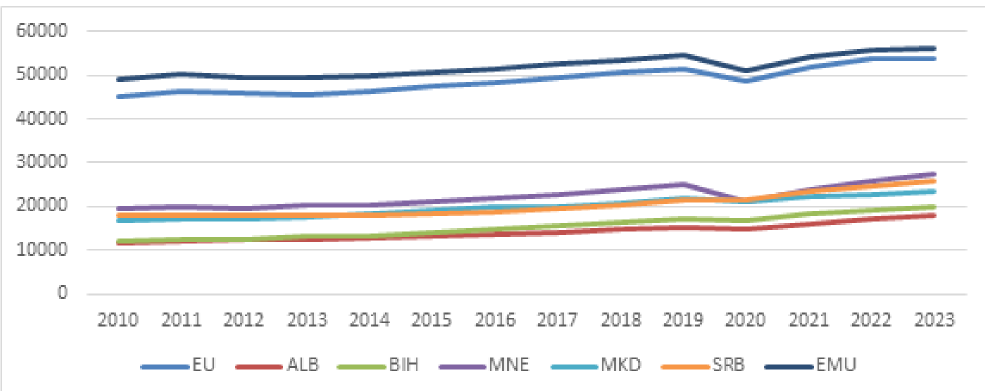
where $y^* = \frac{1}{n}\sum_{i=1}^{n}\log(y_i)$ (6)

Islam (2003) argues that sigma convergence is generally found, where beta convergence is present.

Results

Real convergence means convergence of income level. From the analysis of GDP/capita of the Western Balkan countries, a steady upward trend can be seen for all countries throughout the period under study. Figure 1 shows the GDP/c for all 5 countries included in analysis, as well as the EU and EMU average. From the graph it can be noticed that the growth rate is relatively higher than the average growth of EU countries or the Eurozone. Except for Montenegro, other countries have seen growth even during the pandemic. In the EU and in the EMU area, there has been growth at relatively lower rates. The average growth of the period in the EU is around 1.37%, while in the Euro zone it is even smaller, only 1.03%. From the Western Balkans the highest average growth of the period is for Bosnia and Herzegovina with 3.88%, followed by Albania with 3.29%, Serbia 2.9%, Montenegro with 2.85% and North Macedonia with 2.62%.

FIGURE 1. GDP/capita in WB-5, EU, EMU



Source: WDI

Although the growth is sustainable for all the Western Balkans, it is noted that at the end of the period under study, GDP/capita in Albania is only 33.4% of the EU average and 32.1% of the Eurozone average (Table 1). Meanwhile, Montenegro is in the best relative position, since in 2023, GDP/capita in this country was around 51% of the average EU level and around 83% of the average of the 4 worst performing EU member states (Bulgaria, Romania, Croatia, Latvia).

TABLE 1. Comparison of GDP/c in 2023 (PPP, constant 2021 international $) to average of EU, EMU, and some European Countries.

	Relation to the average EU (2023)	Relation to the average EMU (2023)	Relation to the average of 4 Western Balkan countries in EU (2023)	Relation to the average of 4 worst performing countries in EU (2023)
ALB	33.4%	32.1%	44.3%	54.2%
BIH	36.8%	35.4%	48.8%	59.8%
MNE	50.8%	48.8%	67.4%	82.5%
MKD	43.3%	41.6%	57.5%	70.4%
SRB	47.8%	45.9%	63.4%	77.7%

Source: WDI

From the analysis of the unconditional beta model (Table 2), we see that all beta-coefficients are negative, suggesting a narrowing of the income gap per capita between the economies of the Western Balkan countries and the EU average. However, the p-values are statistically significant only in the case of Albania and Serbia at 5%, and Montenegro at 10%. Similarly, the R-squared is relatively low for all countries, suggesting that the unconditional beta model is not a good model for analysing real convergence in the Western Balkan countries.

TABLE 2. Unconditional beta coefficients

	Beta Coefficients	R-squared	t-statistics	p-value
ALB	-0.01174	0.35	-2.5900	0.02365
BIH	-0.00570	0.18	-1.6667	0.12143
MNE	-0.02870	0.27	-2.1490	0.05272
MKD	-0.00443	0.04	-0.74524	0.47047
SRB	-0.01486	0.61	-4.41969	0.00083

Source: WDI

Extending the model with the set of explanatory variables, conditional beta-coefficients are estimated (Table 3). It is noted that all beta coefficients are negative, confirming the convergence hypothesis. The p-values show that the coefficients are generally statistically significant, with North Macedonia and Bosnia and Herzegovina significant at 10%, and Serbia which is not statistically significant. However, a high p-value does not mean that convergence in these countries is not verified, but that the close in the income gap may occur due to other factors that are not included in the model. The estimated models have improved, as an increase in the adjusted R-square is observed. Similarly, the beta coefficients have also increased, suggesting a higher speed of convergence. In the case of Albania, the speed of adjustment is around 2.7%, suggesting that the per capita income gap between Albania and the EU average is reduced by 2.7% each year. In the case of Bosnia and Herzegovina, the speed is also around 2.7%. The best performance is achieved by Montenegro, where every year is closed around 9% of the income gap.

TABLE 3. Conditional convergence

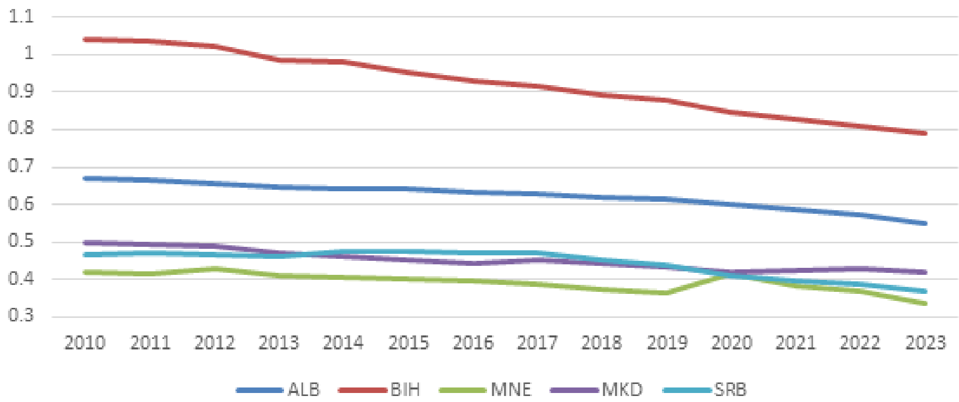
Coeff.	ALB (Adj. R^2=0.88)	BIH (Adj. R^2=0.76)	MNE (Adj. R^2=0.85)	MKD (Adj. R^2=0.20)	SRB (Adj. R^2=0.6)
Beta	-0.0270 (0.0007)	-0.0267 (0.0587)	-0.09 (0.0122)	-0.059 (0.0873)	-0.03 (0.1128)
INFL	0.0005 (0.0215)	0.0001 (0.3659)	0.0002 (0.5276)	-0.0001 (0.6722)	0.0001 (0.1885)
TOT	-0.0002 (0.0034)	-0.0001 (0.4845)	-0.0002 (0.1959)	-0.0000 (0.5251)	-0.0000 (0.3501)
UNEMPL	-0.0006 (0.01)	-0.0008 (0.0164)	-0.0012 (0.3535)	-0.0007 (0.0329)	-0.0004 (0.3501)
K	-0.0007 (0.0059)	-0.0011 (0.2406)	0.0009 (0.0072)	0.0002 (0.4331)	0.0000 (0.8220)
Half-time	26 years	26 years	8 years	12 years	23 years

Source: WDI. (p-values in parentheses)

With the estimated convergence rates for Albania and Bosnia and Herzegovina, it will take about 26 years to close about 50% of the income gap. Montenegro appears to be in a better position, needing only about 8 years. As for the other explanatory variables, in the case of Albania, all variables are statistically significant, suggesting their impact on reducing the income gap.

The sigma-convergence estimate further supports the verification of the convergence hypothesis, as a continuous decrease in the coefficient of variation is observed throughout the period under study (Figure 2).

FIGURE 2. Sigma-convergence



Source: WDI

Conclusion

The purpose of this article is to verify the hypothesis of real convergence for the Western Balkan countries. Different coefficients have been calculated for this purpose, with data for the period 2010-2023. The results of the analysis show that the Western Balkan economies are increasingly narrowing the income gap with the EU average, however, the speed of convergence is not sufficient to close all the gap in a short period. Even in the case of Montenegro, which has the highest convergence speed, under current conditions it will take about 76 years to close all the gap. This suggests deeper economic reforms in these countries, which will stimulate the economy at higher rates than the current ones.

This paper has several limitations. Convergence is analysed using linear models and the study period is relatively short. The same explanatory variables are used in the model, omitting country-specific factors that affect the economic development of the Western Balkan countries. Future research will focus on using country-specific models, allowing for non-linear relationships between variables.

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Banking System on the Albanian Path to European Union Integration

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Abstract

Purpuse: *This article aims to assess the contribution of the Albanian banking system to the European Union integration process by analysing its progress and challenges in alignment with accession criteria and compliance with EU acquis.*

Design/ Methodology / Approach: *The research spans 12 years (2011-2022) of monitoring by the European Commission. The methodology involves a thorough review and content analysis of annual EU integration progress reports for Albania, uncovering banking system-related criteria, requirements and recommendations enhanced by a thematic analysis identifying recurring themes and report patterns over the years.*

Findings: *The analyses confirm the hypothesis that the Albanian banking system has made significant progress in aligning with EU accession criteria, as evidenced by positive evaluations of the European Commission, mainly in macroeconomic and financial stability, but still ample room for lending and financial inclusion improvement. The progress reports over the years have consistently ascertained the positive impact of the monetary and macroprudential policy, while progress in non-performing loans (NPLs) is acknowledged, ongoing concerns persist regarding the extensive use of the Euro in the economy.*

Originality/Value: *This paper holds multifaceted value as a resource for policymakers, researchers, and those engaged in EU integration. It comprehensively assesses the Albanian banking system's progress and offers practical recommendations,* *with a particular emphasis on improving financial education as a key factor on the demand side. Using a long-term, data-driven approach, it uniquely examines the system's contributions and challenges in meeting EU standards, making it essential for Albania's European Union integration efforts.*

Introduction

It may feel distant, but the powerful statement from the students in December 1990, "We want Albania like all of Europe", was not just a slogan but the aspiration of a nation and a vision for a better future inspired by the standards and values that the European Union (EU) represents - a functional democracy with sustainable economic development. This call marked the most significant event in modern Albanian history: the fall of communism, paving the way for the country's Euro-Atlantic integration. This journey has been long, filled with challenges and achievements, but it remains a national strategic priority and the destination every Albanian wants. The opening of negotiations in the summer of 2022 brings Albania one step closer to the Union. The integration process involves continuous advancement and reforms in key sectors of the country by meeting the criteria and requirements that align Albania with EU countries. Among these crucial sectors is the banking system, which stands at the core of economic developments, not only as a financial sector but also due to its significance within the institutional and regulatory framework. A developed financial system is destined to create a more productive and efficient economy, playing an extraordinary role in a country's macroeconomic and financial stability, with banks being the most significant institutions in this system (Mishkin, 2016).

Aim and Objectives

This study aims to assess the contribution of the Albanian banking system to the European Union integration process by analysing its progress and challenges in meeting the accession criteria. The research examines progress reports to uncover the multidimensional dynamics influencing Albania's journey toward aligning its banking sector with EU standards. The objectives detail this aim:

1. To analyse the essential criteria and recommendations set forth by the European Commission in the yearly progress reports related to the banking system.
2. To provide insight into the implications of the banking system compliance with EU criteria on Albanian integration prospects.
3. To identify any challenges or areas of improvement encountered by the Albanian banking system in its pursuit of EU alignment.

Hypothesis and Research Questions

The Albanian banking system has made significant progress in aligning with the EU accession criteria, as evidenced by positive evaluation in the European Commission's annual progress reports, positioning it as a constructive contributor to Albania's integration path.

1. How has the Albanian banking system evolved over the years in response to the European Union's economic criteria and recommendations as documented in EU progress reports?
2. What are the key areas of compliance, improvements and concerns that must be addressed?

Methodology

This study is descriptive qualitative research based on secondary sources. The study utilises the annual progress reports since 2011, being the first report on Albania, up to the most recent one in 2022. These reports comprehensively assess Albania's progress in various sectors, including the banking system, and offer valuable insights into the alignment with EU criteria. The study incorporates information from the Economic Reform Program (ERP) and updated data from the Bank of Albania, focusing on critical financial stability indicators and monetary policy developments to gain further insight into the policy changes and recommendations related to the Albanian banking sector. The primary method involves a comprehensive review and content analysis of the yearly progress reports on Albania's EU integration to identify the criteria, recommendations, and policy changes related to the banking system. To complement the document analysis, thematic analysis will be conducted to identify recurring themes and patterns in the progress reports over the years. This analysis will help determine areas of compliance, progress, and persistent concerns.

Literature Review

From the Bonn Conference to the opening of negotiations

The principles of the integration criteria and, consequently, the banking system's responsibilities emanate from the Maastricht Treaty (1992) that established the EU as we know it today and the declaration of the Bonn Conference between the European countries and the former communist block (1990). These principles were detailed in specific requirements for aspiring countries at the Copenhagen Conference (1993), known as the Accession criteria. After the turmoil caused by the Bosnia, Herzegovina, and Kosova wars, the Member States confirmed a new perspective for the Balkan countries at the Thessaloniki Summit (2003), 'the future of the Balkans is within the European Union'. The Summit created a specific legal framework to advance the integration process — the Stabilization and Association Process aimed to enhance regional stability and prepare regional countries for European accession. For Albania, this process culminated with the entry into force of the Stabilization and Association Agreement (SAA) in (2009), a pivotal moment in Albania's European future. The Agreement legitimised mutual commitments and paved the way for a detailed process with clear objectives in political cooperation, economic collaboration, and alignment of Albanian legislation with the EU acquis (2009). The common denominator of the integration process, included in all the documents mentioned above, is the *existence of a functional market economy* as a requirement for being a reliable EU member.

Copenhagen criteria and the conditions and requirements of SAA

The banking system directly affects two out of five requirements needed for the existence of a market economy under the Copenhagen economic criteria, which are (i) macroeconomic stability *and the* proper functioning of the financial market. This last one includes (ii) financial stability and (iii) access to finance (EU, 1993). In addition to the economic criteria, Copenhagen also has political criteria and a third criterion: the ability to undertake membership obligations, which refers to a candidate country's administrative and institutional capacity to implement the acquis. The acquis includes all the rights and obligations that comprise the legal framework of the Union's functioning. They consist of treaties and laws created to implement these treaties, resolutions, declarations, court decisions, international agreements, policies, rules, and constantly evolving standards. Candidate countries must accept the acquis and align their laws with them before joining the EU. Alignment with the acquis is the primary process during the pre-membership phase, negotiations, and screening (EC).

As a detailed reflection of the Copenhagen Criteria, the SAA fulfils the comprehensive framework of Albania's requirements for integration, including those related to the banking system. The SAA contains a series of provisions grouped into chapters. These chapters, the political-economic criteria, and priorities have been the roadmap for monitoring progress since the signing of the SAA. In 2020, the European Commission (EC, 2020) reviewed the accession negotiation strategy, reorganising the 35 chapters into clusters, the progress of which is monitored and assessed by the EC. With the opening of negotiations, the screening process has begun to align with the acquis and fulfil key priorities. In summary, the criteria and chapters for the banking system are as follows:

TABLE 1. Economic Criteria and Acquis Chapters for Banking System

Cluster I: Fundamentals	I. Macroeconomic Stability II. Financial Market Function: Financial Stability III. Financial Market Function: Access to Finance
Cluster II: Internal Markets	1. Chapter 4 Free Movement of Capital 2. Chapter 9 Financial Services
Cluster III Competitiveness and inclusive	1. Chapter 7 Economic and Monetary Policy

Convergence Criteria

Under the criteria for assessing macroeconomic stability, it is crucial to emphasise the four convergence criteria outlined in the Maastricht Treaty (1992) as transition criteria for the member states to become part of the monetary Union and the adoption of the common currency, the Euro. Even though these criteria do not directly apply to candidate countries, they are the ultimate objective of such countries and provide measurable indicators that guarantee economic stability and cohesion. The banking system strongly impacts the achievement of these criteria, or they influence the financial stability of banks. Adherence to these criteria, detailed below (EU, 1992), is considered crucial for the success of the Union.

Price stability, as the primary objective of central banks and monetary policy, is considered a public good due to its crucial role in ensuring economic stability and impacting the real economy outcome (Mishkin, 2016) as the first convergence criteria requires that the average inflation should not exceed 1.5 % points above the rate of the three best performing Member States. Sound public finances, as the second criterion mandates that the government deficit should not surpass 3% of GDP and government debt shouldn't exceed 60% of GDP. When governments seek credit, they affect the monetary offer, increasing the private sector credit cost. However, they also pose a risk to stability when central banks finance public deficits or inject liquidity in breach of their independence, endangering the stability of the banks holding most of this debt, as Mishkin (2016) explained.

The third criterion on exchange rate stability is the direct responsibility of the central bank, which establishes and implements the exchange rate regime and maintains confidence in the local currency through various mechanisms like foreign exchange reserves requirements. Currency fluctuations impact the assets and liabilities held by banks' public debt costs, significantly influencing prices, balance of payments and trade, and the real economy overall (Mishkin, 2016).

Finally is the long-term interest rate, which should not exceed two percentage points above the rate of the three best-performing Member States in terms of price stability. This criterion serves as the leading indicator to assess the durability of the convergence. The long-term bond yield curve is considered the 'economic radar' by Langdana since it is closely linked to market actors' expectations of future inflation and economic risks, expressed in the interest rates- the Fisher effect. Anchoring future inflation expectations is one of the main concerns of the central banks, which highly impacts the country's sustainable growth (Langdana, 2022).

Financial development and access to finance

The financial system's role in economic growth is empirically confirmed from the 1800s to contemporary analysis. Banks, as promoters of savings and facilitators of investments, are essential for economic growth and contribute to the money supply as depository institutions (Mishkin, 2016). The Financial Development (FD) Index assesses financial institutions and capital markets' impact across three dimensions: deepening, access and efficiency. FD combines three dimensions, with depth reflecting market size and liquidity and access indicating individual's ability to use financial services (Sahay, et al., 2015). The index finds that financial development doesn't always guarantee economic growth; its impact varies with a significant effect observed at high deepening levels, as seen in European and U.S. markets.

Enhancing financial access at any level of financial development, particularly for under-served sectors like SMEs and crucial industries like agriculture or innovations, remains highly advantageous. Financial access is fundamental in fostering economic growth, reducing poverty, and promoting overall development. In the analysis of Western Balkan countries by Moder and Bonifai (2017), "access to finance" refers to the availability of quality financial services at reasonable costs, encompassing services such as bank accounts, deposits, ATM usage, online payments, and access to credit. Access Barriers decrease as financial systems become more advanced. Developing economies still have ample opportunities to leverage Financial Development across all dimensions: depth, access, and efficiency, contributing not only to economic growth but also to financial stability and mitigating inequality and poverty (Sahay, et al., 2015).

Banking System in Albania

The Albanian financial system has significantly transformed since the early 1990s, transitioning from a centrally planned economy to a market-oriented one. The system changed from a state-owned banking sector to a two-tiered one comprising the Central Bank of Albania (BoA) and commercial banks, including non-bank financial institutions. In the context of Albania's EU integration efforts, the BoA assumes a pivotal role as the country's monetary authority. It holds responsibility for establishing and implementing macro-financial stability policies and aligning them with the EU's policies and regulatory frameworks as the cornerstone for being a member country of the Union. Albania is home to 11 banks, primarily with foreign capital (75.12%), despite the recent growth of domestically owned ones. Banks with European capital constitute 46.15% of the foreign ones. The commercial banks dominate the Albanian economy, with their assets accounting for 87.95% of GDP, playing a central role in capital circulation and supporting economic activities within the country. Non-bank financial institutions represent 4.14% of the total banking system assets (BoA, 2022).

The Albanian financial system lags developed EU countries in developing and diversifying financial services, scoring 0.2 on the FD index compared to the EU average of 0.7 (IMF, 2021). Private sector credit-to-GDP ratios tell a similar story; Albania, for the last five years, has only reached 35.2% (BoA, 2022), while developed countries finance the private sector at 130% of GDP and developing countries at about 50%, accompanied by the lower access to finance ranking, leaving ample room for deepening in the banking system in Albania. Moreover, the capital market is relatively non-existent, a common trait among former communist countries (Sahay, et al., 2015).

Evaluation of Economic Criteria

Macroeconomic - Financial Stability and Access to Finance fall under the Fundamental cluster and constitute the initial package in the negotiation process. They are subject to reassessment at the end of the screening process, influencing the negotiation pace. The European Commission monitors progress through annual reports, assessing the implementation of commitments outlined in the Economic Reform Program (ERP) and evaluating compliance with economic criteria for the three above fundamentals and alignment with EU acquis for the three chapters covered in this paper. The following analysis is based on the EC progress reports from 2011 to 2022, highlighting their key findings and insights (DG-NEAR, 2011, 2012, 2013, 2014, 2015, 2016, 2018, 2019, 2020, 2021, 2022).

In the latest EC progress report (2022, p. 6), Albania received a positive evaluation regarding economic criteria, including the crucial aspects of the banking system. It notes 'good progress and moderately prepared' for the existence of a functional market economy. Albania is assessed as moderately prepared for criteria and acquis related to the banking system, covering the free movement of capital, financial services, and economic and monetary policies. Notable improvement compared to the 2011-2012 report, citing limited structural reform progress. Since 2015, the evaluation has been unchanged to 'moderately prepared' with 'some progress'.

The economic criteria remain consistent while the acquis requirements advance, adapting to market developments and EU regulations improvements.

Macroeconomic and Financial Stability Criteria

Throughout the 12 years, the progress reports consistently acknowledge that Albania has maintained macroeconomic and financial stability. Still, global economic events, such as the 2008 financial crisis, the subsequent Greek sovereign debt crisis, and, more recently, the consecutive shocks from the pandemic and rising commodity prices due to the Ukraine invasion, are reflected in macro-financial indicators. Significant challenges in maintaining macro-financial stability were identified during 2013-2014, with stagnant growth, rising debt, and extremely high NPLs. The latest report emphasises Albania's economic resilience, noting its ability to recover faster than anticipated.

The progress reports over the years have consistently ascertained the positive impact of the monetary policy and market interventions in maintaining price stability and contributing to economic recovery as part of the policy mix. The (2022) report acknowledges the effectiveness of the monetary policy response in limiting inflation (4%) compared to other countries in the region and the EU. The tightened monetary policy (3%) transmission has successfully contracted aggregate demand in 2023, and the BoA's goal is to anchor these expectations as closely as possible to the targeted inflation to reduce uncertainty and maintain macroeconomic stability. As per the fourth convergence criteria, the yield curve of bonds is likely influenced by lower inflation expectations and economic uncertainty, supported by the BoA's Inflation Expectations Survey findings. Additionally, investors are seeking safe-haven assets amid economic challenges. The steeper long-term end of the curve in July 2023 suggests anticipation of slightly higher inflation (BoA, 2023/III).

Exchange rates have shown seasonal fluctuations over the years covered by the reports. Still, the BoA has effectively maintained the stability of the domestic currency through short interventions when needed. In 2023, the Albanian lek has been notably appreciated against the Euro, and BoA has chosen not to intervene in the foreign exchange market. The report (2022) recommends maintaining the free-floating exchange rate regime and utilising the Euro's depreciation as a shock absorber for external inflationary pressures. BoA interprets this lek appreciation because of the increased availability of foreign currency, mainly due to higher tourism income, remittances, and foreign direct investments, and they consider the degree of fluctuation within the parameters of the free-floating regime (BoA, 2023/III).

The exchange rate fluctuation becomes more relevant in light of a persistent concern, which, despite minor improvements since 2015, resurfaced as a primary issue in the 2022 report. This concern pertains to the widespread use of the Euro in the economy. Despite BoA's efforts to encourage the use of local currency and reduction in euro-dominated loans (68% in 2012 to 25% in 2022), the risks remain on the upside. The unhedged FX loans, subject to interest rate risks due to lightened monetary policy and variable interest rates, endanger borrowers' repayment capacity with income in lek and impede monetary policy transmissions.

Euroisation also raises concerns about financial stability, significantly affecting non-performing loans (NPLs). A significant concern highlighted in the 2011 -2012 reports as a domino effect of the 2008 financial crisis reaching its peak in 2014 was the escalating number of NPLs. Responding to this, the government and BoA established an interinstitutional group, which initiated legal measures to address this issue. It remained a priority in progress report recommendations and ERP policies (policy 3.1, 3.2 2022 2024 and 3.2 2023-2025 ERP). The report (2022) positively evaluates the BoA financial stability policies during the two years of the crisis and values the significant improvement of assets. The NPL to total loans ratio has dropped to just 5% by the end of 2022, as reported by BoA.

Financial stability is a vital pillar of a nation's economic well-being, ensuring the smooth functioning of the financial system and its resilience to shocks, strictly impacted by the soundness of the banking sector and the implementation of BoA macroprudential and supervisory policies. Over the years, from 2011 to 2022, the Albanian financial system has consistently demonstrated stability, well capitalised and liquid, above the Basel III requirements, as confirmed by the reports. The banking sector's profitability has also remained positive, as reflected in return on assets and equity, except during the grave COVID-19 crisis in 2021.

The budget deficit and, consequently, the public debt has posed significant concerns for the country's economic and financial stability, with peaks (70-72.3% of GDP) observed during 2014-2017 and temporarily during the pandemic. However, there's been a remarkable improvement, as public debt by the end of 2022 stands at 63.3% of GDP, closer to convergence criteria, and is expected to continue its downward trend. Furthermore, the Albanian government's issuance of Eurobonds has changed the composition of public debt by reducing the domestic one. Nevertheless, persistent concerns outlined in progress reports include the substantial portion of the public debt held by the banking sector (25%).

Acquis Chapter 17: Economic and Monetary Policy

At the centre of this chapter lies the monetary policy decision-making and the independence of the Central Bank. The report (2022) assessment of being 'moderately prepared' evaluates the monetary policy's effectiveness in line with the targeted 3% inflation and the floating exchange regime. The chapter highlights the lack of progress in aligning the BoA's law on independence with the EU acquis, a recommendation not fulfilled since 2002. It concerns improving the governor's and supervisory council's independence and limiting public sector financing to ensure a country's macro-financial stability. The report acknowledges BoA's financial autonomy and its instruments, competencies, and administrative capacities for effective monetary policy. Legal independence is assured through the governor and supervisory council's appointment by parliament, which they also report. Albania has the lowest assessment of the independence degree on the 'Limitations on lending to the government', almost half of EU countries and other regions' peers, based on the Central Banking Index measured by Romelli (2022).

Acquis Chapters 4 & 9: Free Movement of Capital and Financial Services.

Chapter 4 outlines Albania's obligations on anti-money laundering and counter-terrorism financing, highlighting their role in stability. Given Albania's predominantly informal economy in 2011, it has progressively aligned its legislation with Moneyval's and EU acquis requirements over the years. In 2015, it was successfully removed from the grey list. Regrettably, in 2020, Albania was placed back on this list as a risk country that requires extended monitoring. Despite diligent efforts and the alignment of money laundering laws with the acquis by the end of 2021, coupled with enhancements in regulations and oversight by the Bank of Albania, the country still faces challenges in fully meeting the action plan requests by the FATF-Moneyval. Notably, a key recommendation in this chapter underscores the government's need to abstain from going forward with the fiscal amnesty legislation as underminer of the progress so far.

Chapter 9 receives a positive assessment for its progress in adapting financial service licensing, operation, and supervision to enhance competition and institutional stability. Albania's consistent alignment with Basel II and III regulations from 2011 to 2022, transitioning from micro-prudential to macroprudential policies, is a notable achievement highlighted annually in progress reports. In 2022, Albania continued to harmonise its regulatory framework with Basel III, introducing stricter capital and liquidity requirements and implementing extraordinary measures to ensure compliance. Substantial legislative improvements addressed some NPL issues, and mitigated macroprudential risks; it is recommended to increase the use of the national currency, as detailed in the ERP policies.

Access to Finance

In the 2019 report, improving access to finance and boosting financial inclusion became a priority for the first time. Previously, access to finance was measured solely by the private sector credit to GDP. However, since 2017, the assessment has expanded to include the number of financial service users, particularly adults over 15 with a bank account. In 2021, this indicator significantly improved, jumping from 40% in 2017 to 69%. This progress is attributed to technological advancements and increased demand for online transactions, mainly due to pandemic-related movement restrictions.

The theory section explains that the FD index combines these two indicators to provide a more comprehensive measure of financial inclusion and access to funds. Although the total credit volume has increased over the years, it has declined as a percentage of GDP. By the end of 2022, it reached 33%, compared to its peak of 43% in 2012. Over the past 12 years, financing the economy has been considered insufficient, with banks' perceived risks being a significant factor in tight credit conditions. These conditions result from high-risk premiums, along with challenges in collateral execution and the broader business environment.

As highlighted, the 2019 report marked a turning point by underlining the importance of enhancing access to financing and financial education to stimulate increased demand for funds. It also raised expectations and requirements for the capital market, which is not yet fully operational despite undergoing restructuring since its closure in 2017. Although slowly growing from 6.6% in 2012 to 12% in 2012, the non-banking sector still lags in development.

Acquis Chapter 9 & 4: Financial Services and Free Movement of Capital

Albania's ability to meet the accession requirements for chapters 4 and 9, related to financial access, involves payment system, financial education and inclusion. 2011 Albania, primarily a cash-based economy, faced payment system challenges and the first steps were regulations for the clearinghouse and interbank payment system to promote non-cash payments. Enabling banks to establish branches and conduct cross-border transactions in 2012 and the first-ever meeting of the National Payment Committee in 2016. Over the years, Albania has made significant and constant advancements in aligning with EU acquis in this area. The 2022 report recognises Albania's progress in implementing the National Payment System. The Bank of Albania (BoA) introduced a new platform for domestic interbank euro payments in January 2022, facilitating retail payments. During the pandemic, the BoA eased payment procedures and reduced online transaction costs, increasing financial inclusion. The number of adults with bank accounts reached the targets set in the financial literacy strategy, and online payments tripled.

Chapter 9 on Financial Services identifies finalising and adopting a strategic document on financial education and capital market development as key tasks for Albani to increase financial access. The (BoA, 2022) report confirms that BoA has completed the "National Strategy on Financial Education and Inclusion" in collaboration with the World Bank. While access to finance is ERP Policy 4.1, the banking system is not responsible for implementing this priority.

Conclusion and Recommendations

Albania has maintained macroeconomic and financial stability amid external shocks and domestic adversities, including ongoing inflation. The banking system is recognised for its constructive contribution to the moderate progress of these economic criteria, confirming the hypothesis. Yet, access to finance remains a challenging issue demanding substantial enhancement, as the FD index indicates. In more detail:

- The monetary and macroprudential policy decisions and implementation have positively contributed to maintaining stability and upholding the convergence criteria.
- Continued progress has been made in aligning with the Basel III and other financial stability requirements. The constant improvement of the payment system has played an essential role in increasing financial inclusion.
- There has been a significant improvement in the NPL rate and decreasing public debt; although the effects of crises have not yet fully materialised, authorities should remain vigilant.
- Significant concerns are the economy's persisting high euroisation and the immediate need to be removed from the grey list for money laundering.
- Since 2002, there has been no progress in amending the law regarding the independence of the BoA in line with the ECB standards. While it is part of the BoA's vision, it is not included in the medium-term objectives of the ERP.

Based on this conclusion the article has two recommendations:

1. Given the current inflationary environment and currency fluctuations in a highly euroised economy, it is crucial for the Bank of Albania to conduct a comprehensive analysis of these factors. While market-driven influences are apparent, the BoA needs to assess whether the floating exchange regime has had the expected impact on import prices. Furthermore, a deeper examination is necessary to understand the causes of euro depreciation, particularly in light of the high level of informality in the contracting and real estate markets, which might be a vulnerability for the stability.
2. While profit-oriented, the banking sector also has a public responsibility to alleviate poverty and reduce inequality by distributing the financial

capital in the economy. Together with BoA, enhancing access to finance and promoting financial education are crucial avenues to accomplish this objective. These institutions should actively formulate and implement concrete strategies and services aimed at improving this economic criterion. Northern Macedonia serves as a noteworthy example in the Balkans, having achieved commendable outcomes in this sector. It is essential to emphasise that these recommendations necessitate further in-depth examination and strategic planning."

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An empirical analysis of internal factors affecting bank performance in Albanian case

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Abstract

Purpose: *Commercial banks play a crucial and dynamic role in driving a country's economic development. An efficient, effective, and well-regulated banking sector contributes to accelerated growth in multiple sectors of the economy. This paper analyzes the impact of internal factors on the performance of banks in Albania. Return on assets (ROA) is used as a proxy to measure the performance of commercial banks in Albania. Additionally, evaluates the impact of the COVID-19 pandemic on the performance of Albanian commercial banks.*

Methodology: *This study combines two primary lines of data research. Initially, descriptive statistics are provided for both independent and dependent variables. The regression model utilized in the analysis relies on panel data, specifically quantitative data that explains the performance of commercial banks through the explanatory* *variables. Focusing on nine commercial banks in Albania from 2017 to 2021, the fixed effects model assesses the relevance of specific bank-related factors affecting their performance. Furthermore, this research paper investigates the impact of a COVID-19 dummy variable included in the analysis, hypothesizing that strong banking systems help economies survive adverse shocks and maintain the financial system's stability.*

Findings: *The findings show that all internal factors such as bank size, efficiency ratio, and liquidity risk, are statistically significant, while the COVID-19 pandemic dummy variable did not have a statistically significant impact on bank performance in the case of Albanian banks.*

Value: *This study makes a significant contribution by examining the performance of banks in Albania over recent years, utilizing the latest publicly available data. Additionally, it enhances the existing literature by introducing a focus on the COVID-19 dummy variable, a subject that has received limited attention from other researchers to its impact on banking performance. This investigation is expected to motivate a variety of stakeholders, including bankers, banking regulatory authorities, and the broader financial system, to engage with its findings.*

Keywords: *Bank performance, commercial banking, Covid-19, ROA, internal factors, banking system.*

Introduction

The financial system's importance in any country's economy is essential and quite critical since it is positively related to a country's development and economic progress. Commercial banks are an important part of the financial system because they connect capital sources and offer a wide range of financial services. Furthermore, a profitable banking sector enables economies to withstand adverse shocks and support the stability of the financial system (Athanasoglou et al., 2005). Bank profitability serves as a measurement of their financial performance, which is crucial for maintaining public confidence (Widyastutie et al., 2017). Consequently, it is essential to comprehend the factors that affect banks' profitability, particularly internal aspects, as they are related to banks and other economic entities.

In the context of Albania, banks are the foundation of our financial system since they account for around 1800 billion ALL, or 90% of the financial sector's total assets (Bank of Albania, 2022). The role of the banking industry in the Albanian economy is even more crucial than in more developed ones due to the lack of capital markets. According Central Bank of Albania (2023), despite the developments that this sector has undergone, the years 2017-2022 are considered a consolidation period of the banking sector in Albania. However, considering the crucial role they have we should pay particular attention to Albania's commercial banks if we wish to grasp the health of our financial system and throw light on it. Therefore, this study aims to answer the following first research questions: How do internal factors affect the profitability of commercial banks?

Furthermore, a robust banking system can withstand adverse shocks and support the stability of the financial system so we have tried to evaluate the effect of the COVID-19 pandemic on the bank performance of our banking system. Hence this paper aims to answer the following second research question: Did the COVID-19 pandemic, affect banking performance in Albania case?

To achieve this, bank performance was operationalized as the dependent variable and assessed through the return on assets (ROA) metric. The independent variables examined included bank size, efficiency ratio, and liquidity level. Additionally, the impact of the COVID-19 pandemic was incorporated as an independent variable to investigate the external shocks' influence on bank performance.

This research paper is significant because it can help regulators and policymakers better understand the variables that may impact bank performance and offer useful advice in light of the COVID-19 pandemic economy's unprecedented instability.

The findings of this study will contribute to the existing literature since for the management of commercial banks, stakeholders, and other interest groups like the government and central bank, it is essential to comprehend what factors are specific to each bank and how they affect bank performance.

This paper is structured as follows: Following the introduction, section 2 presents a literature that explores the factors influencing banking performance. In section 3, we outline the research methodology employed to empirically investigate the effect of those variables in the context of Albania. Section 4 provides analyzes and empirical results whereas section 5 offers conclusions and recommendations.

Literature Review

Over the years, many researchers have examined various factors that affect bank performance. Based on a large body of research in this area these factors have been divided into two major categories: external factors and internal ones. The environment and contextual factors, the laws and market in which the bank operates, and competitors in the same industry make up the first group, which can be considered completely outside the bank's control. Internal factors, on the other hand, are controlled by the bank's management goals and objectives, which is why they receive a lot of attention in this paper and elsewhere. Several researchers from different nations have delved into how internal and external bank issues affect a bank's performance. However, they do not come to the same conclusion on how each factors influence bank performance.

In their study, Borges and Tavares (2020) examined how the performance of Portuguese commercial banks was affected by a variety of internal factors, including bank capital, liquidity, costs, asset quality, diversification, and bank size, as well as external factors like GDP, unemployment, inflation, and market concentration. The findings showed that, as internal determinants, liquidity, and operational costs were the most effective in explaining the dependent variable ROA, whereas GDP and inflation were the most effective external drivers.

The main determinants of banks' profitability in EU27 over the period 2004-2011 were analyzed by Petria et. al (2015). Considering return on average assets (ROAA) and the return on average equity (ROAE) as proxy for banks profitability, they concluded that economic growth, credit and liquidity risk, management efficiency, the market concentration influence bank profitability. Different from this study, in their analysis of the profitability of the largest banks in the European financial market from 2013 to 2018, Karadžić & Đalović (2021) argued that internal factors, which are under the control of the bank's management, have no statistically significant influence on the profitability of large banks, but macroeconomic factors, such as GDP growth rate, inflation rate, and market concentration, do.

The internal factors influencing the profitability of China's state-owned commercial banks from 2007 to 2019 were examined by Koroleva et al. (2021) using fixed effect, random effect, and pooled regression models. According to the study, internal characteristics like size, liquidity, and credit quality have a positive effect on profitability. In the same vein, Olson et al. (2011) concluded that higher profitability has typically been linked to larger banks, a greater reliance on loans for income, and a higher percentage of equity capital to assets.

According to Pasiouras & Kosmidou (2007) study, there is a positive correlation between the profitability of European banks, specifically domestic banks, as determined by ROA, and the following internal and external factors: capitalization, liquidity, GDP growth, inflation, market capitalization to total bank assets, and the market capitalization to GDP ratio. The following factors are negatively correlated with profitability, according to this study: bank size, operating expenses as a percentage of profit, concentration sector banking, and total bank assets as a percentage of GDP.

Menicucci and Paolucci (2016) used regression analysis to examine how internal factors affected the profitability of 28 European banks between 2006 and 2015. According to the study, asset quality has a large and negative impact on bank profitability, but bank size and capital ratio have significant and positive benefits.

Numerous studies examined the effects of both internal and external factors that can impact banks' performance in the Albanian context. An empirical model was used by Duraj and Moci (2015) to investigate the variables influencing Albanian commercial banks' performance. They examined a total of 16 banks and used information gathered between 1999 and 2014. The rate of non-performing loans, GDP, inflation, and liquidity risk were all taken into consideration, and the dependent variable, ROE, was used to measure the banks' performance. The empirical analysis's findings demonstrated that all other variables specified and considered in the model, except for the non-performing loan rate, were statistically significant.

Kola, Gjipali, and Syla (2019) conducted another study that provides insight into the bank-specific internal and external factors that can impact the bank's profitability. Based on quarterly data from 16 commercial banks between 2002 and 2015, it was determined that while the ratio of bad loans had a negative effect on the banks' performance, liquidity had a significant positive impact. GDP and inflation, on the other hand, had a positive correlation with the banks' performance.

However, in the study on the effect of only internal determinants on bank performance, Hallunovi (2022) found that credit risk was inversely connected with bank performance, whereas bad loans and capital adequacy had positive impacts. Nevertheless, Cekrezi (2015), who looked at 16 Albanian commercial banks from 2010 to 2013, concluded that capital adequacy and liquidity were statistically significant variables for the model in determining performance. Although bank size and age, two additional model factors, were not significant in predicting the amount of ROA.

Overall, there is disagreement over the findings of every study conducted in different nations, even in the Albanian case. Therefore, this study aims to examine the impact of bank internal factors on the performance of commercial banks in Albania, utilizing the latest publicly available data.

On the other hand, however, few researchers have determined the effects of COVID-19 on the banking sector. In 64 different countries, Duan et al. (2021) looked into the impact of the COVID-19 pandemic on systemic risk. Through government measures and bank default risk pathways, they demonstrated how COVID-19 contributes to systemic fragility in countries. Nevertheless, this adverse effect varies based on the bank and the nation's diversity.

Çolak and Öztekin (2021) use a sample of banks from 125 countries to assess how the pandemic has affected global bank lending. According to their findings, the nations with the strongest and most advanced financial systems have demonstrated the most resistance to the crisis in terms of loan growth. Xiazi and Shabir (2022) investigate how the COVID-19 pandemic has affected the banking industry's performance, taking into account 1,575 banks across 85 nations. The results show that the COVID-19 pandemic has had a major negative impact on bank performance. Furthermore, how negatively COVID-19 affects a bank's performance varies depending on the bank and the nation.

However, from all studies has been widely accepted that the banking sector has been essential in supporting people and companies and effectively channeling credit into the broader economy, even in the face of the COVID-19 pandemic, so it would be important to assess how it affects Albania's banking sector.

Research Methodology

The main purpose of this paper is to analyze and evaluate the effect of internal factors on the bank performance of commercial banks in Albania. The empirical analysis is based on the data of commercial banks in Albania ranging from 2017 to 2021 with a total of 45 observations and refers to the most commonly used variables in the empirical literature.

This study combines two primary lines of data research. Initially, descriptive statistics are provided for both the independent and dependent variables. The regression model utilized in the analysis relies on panel data, specifically quantitative data that explains the performance of commercial banks through the explanatory variables. After conducting several tests and considering the characteristics of the data, we determined that only the fixed effect model satisfies all necessary assumptions. This econometric model presents a more transparent understanding of the relationships and impacts among the variables.

Theoretical model specification is:

$$ROA_{bt} = \beta_0 + \beta_1 BS_{bt} + \beta_2 ER_{bt} + \beta_3 Ll_{bt} + \beta_4 COVID - 19_{bt} + \mu_t \quad (1)$$

Where:

ROA – Return on assets, as the dependent variable. It is defined as net profit divided by total assets.

BS – Bank size, as the independent variable. It is defined as total assets.

ER- Efficiency ratio, as the independent variable

LR - Liquidity level, as the independent variable. It is defined as total loans divided by total deposits

COVID-19- dummy variable

"bt"- represents the name of the Albanian commercial bank, in the year "t".

u - represents all other potential exogenous variables

Table 1, shows summary statistics of used variables reporting the mean, median, standard deviation, minimum, and maximum.

TABLE 1: Descriptive statistics of the variables

	ROA	LIQUIDITY	EFFICIENCY...	COVID_19	BANK_SIZE
Mean	0.006068	0.756429	0.794592	0.400000	18.85470
Median	0.007800	0.618700	0.698500	0.000000	18.38563
Maximum	0.026700	2.536600	2.724700	1.000000	22.37816
Minimum	-0.025000	0.155500	0.513300	0.000000	12.45671
Std. Dev.	0.010981	0.450190	0.363492	0.495434	2.596068
Skewness	-1.424451	1.819186	3.603809	0.408248	-0.901018
Kurtosis	4.864122	7.031279	18.94040	1.166667	3.924646
Jarque-Bera	21.73349	55.29179	573.8362	7.552083	7.691812
Probability	0.000019	0.000000	0.000000	0.022913	0.021367
Sum	0.273078	34.03930	35.75664	18.00000	848.4614
Sum Sq. Dev.	0.005306	8.917532	5.813558	10.80000	296.5411
Observations	45	45	45	45	45

Source: Author's Calculations

Initially, the descriptive statistics provide the mean, followed by the median, and the minimum and maximum values, which define the range of our variables. Notably, the variable with the largest range is bank size, with values spanning from 12.45 to a maximum of 22.37, indicating significant variability among the banks in the sample. This range might suggest that bank size could be a crucial factor influencing various financial outcomes. In terms of return on assets (ROA), we observe that the mean is 0.6%, which reflects a modest profitability level across the banks analyzed. However, the range of ROA is noteworthy, with a maximum value of 2.6% and a minimum of -2.5%. The presence of a negative ROA might indicate that some banks are facing challenges in generating returns on their assets, which may be a point of concern for investors and stakeholders. Another important data illustrated in the table is the standard deviation, which gives us an idea of how far the data set of each variable is from the corresponding mean values. It is observed that the standard deviation captures the highest values for the variable that expresses the size of the bank, thus indicating that the data for this variable is much more dispersed than the other variables. This wide dispersion in bank size can lead to varying operational efficiencies, risk profiles, and financial strategies across institutions. On the other hand, the standard deviation for ROA captures a very low value of approximately zero, which explains that the data are close to the mean. Such consistency may imply that despite the differences in bank size, there are common factors affecting profitability that warrant further exploration.

Understanding these dynamics between bank size and ROA can provide valuable insights for policymakers, investors, and banking professionals looking to enhance performance and strategically position their institutions in a competitive market.

Analyses And Findings

According to the results of our analysis, all the variables taken in the study, except the Covid-19 pandemic variable, affect bank performance for the period under review. This indicates that the traditional measures and factors influencing bank performance remain robust, even in the context of a global health crisis. The results of the regression analysis are presented below:

TABLE 2: Coefficients of Regression

Dependent Variable: ROA
Method: Panel Least Squares
Date: 05/10/24 Time: 20:50
Sample (adjusted): 2018 2021
Periods included: 4
Cross-sections included: 9
Total panel (balanced) observations: 36

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DBANK	0.001572	0.001418	1.108425	0.0162
EFFICIENCY_RATIO	-0.019309	0.003361	-5.744283	0.0000
LIQUIDITY	0.004470	0.002885	1.549682	0.0314
COVID_19	0.000285	0.002414	0.118256	0.9066
C	0.016824	0.004600	3.657526	0.0009

R-squared	0.884441	Mean dependent var	0.005308
Adjusted R-squared	0.824692	S.D. dependent var	0.010723
S.E. of regression	0.007075	Akaike info criterion	-6.936320
Sum squared resid	0.001552	Schwarz criterion	-6.716387
Log likelihood	129.8538	Hannan-Quinn criter.	-6.859558
F-statistic	12.35069	Durbin-Watson stat	0.701155
Prob(F-statistic)	0.000004		

Source: Author's Calculations

Our model is statistically significant. Adjusted R2 accounts for 82% of the variation in bank performance implying that 82 % of the variation of the bank performance is explained by the factors considered in the model. From the data presented in Table 2, we see that the variables, bank size, efficiency ratio, liquidity level were statistically significant with $p=0.0162<0.05$, $p=0.000<0.01$, and $p=0.0314<0.001$ respectively, and with a 1% confidence interval.

The first variable, the size of the bank, is statistically significant in explaining bank performance. For each unit increase in bank size, ROA is expected to increase by 0.0015 units ceteris paribus. This finding after building the model and related tests, was also consistent with some other studies, including Gul et al. (2011) and Yuan et al. (2022).

The second statistically significant factor in explaining bank performance was the efficiency ratio. It is noted that the result was in line with the expectations before we carried out the analysis and also in the same logical line with the researcher Nouaili et al. (2015) who also found a statistically significant negative relationship between efficiency ratio and bank profitability. For each unit increase in the efficiency ratio, ROA is expected to decrease by 0.019 units ceteris paribus.

Also, the level of liquidity was found to be statistically significant in explaining bank performance. It is positively related to ROA. Similar to the existing literature, liquidity has a direct relationship with bank performance, the higher the liquidity, the better the bank will perform if everything else remains constant (Muhammad & Puah, 2019). For each unit increase in liquidity, ROA is expected to increase by 0.004 unit ceteris paribus.

Despite initial expectations of a negative relationship, the empirical results indicate that the COVID-19 dummy variable did not have a statistically significant impact on bank performance. This conclusion is supported by the probability value associated with the variable in the final model. This could suggest that banks were able to adapt and implement measures to mitigate the risks associated with the pandemic, or it could indicate a lag in the response time required to witness a measurable effect. Further analysis is needed to explore these dynamics in greater detail, particularly focusing on the long-term effects of the pandemic as the banking sector evolves in this new landscape

However, the apparent insignificance of the COVID-19 variable in explaining banking performance can be attributed to the fact that many researchers have viewed the pandemic primarily as a psychological phenomenon affecting individuals, rather than as a direct economic disruption to banking institutions. Notably, the increase in deposits during this period suggests that the pandemic did not undermine public confidence in the country's banking sector. This finding is consistent with the statement by the Bank of Albania (2021) that Albania has not experienced a banking or liquidity crisis since 2008. While temporary liquidity shortfalls may have occurred, the evidence indicates that the country did not face a systemic banking crisis.

Our model takes this form:

$$\boldsymbol{ROA_t = 0.016 + 0.00015 Bank\ size_{bt} - 0.019 Efficency\ ratio_{bt} + 0.044 Liquidity\ ratio_{bt} + u_t}$$

The model stability has been proved. Tests for homoscedasticity, normal distribution of residuals, lack of collinearity, and lack of auto-correlation have been done.

These findings demonstrate that all variables included in the study, except the COVID-19 variable affect bank performance in Albania. These suggestions are in line with the empirical data that the fixed effect model and the study's diagnostic tests have to offer.

Conclusions

Internal factors are fundamental to understanding and enhancing the profitability of commercial banks, which in turn plays a crucial role in overall economic growth. The Albanian banking sector is critical for the country's financial system as a whole. Therefore, the way it performs and fluctuates with the change of different factors is a subject of significant interest. This research paper aimed to identify the internal factors affecting the profitability of Albanian banks, also shedding light on a recent external factor – the Covid-19 pandemic – and determining whether or not it had an effect, on financial stability.

It was found that bank size and liquidity level have positively affected bank performance as measured by return on assets (ROA), while the level of efficiency was negatively related to ROA. Larger banks tend to benefit from economies of scale, allowing them to operate more efficiently and generate higher returns on assets (ROA). This phenomenon highlights the importance of strategic asset management and growth for enhancing financial performance.

Interestingly, the study found that while liquidity positively affects bank performance, efficiency ratios had an adverse relationship with ROA. This suggests that banks may need to focus on optimizing their operational efficiency to improve profitability. By minimizing excess expenditures and streamlining operational processes, banks can improve their bottom line, despite the inherent challenges of maintaining high efficiency ratios.

Furthermore, the impact of the Covid-19 pandemic was evaluated within the context of bank performance. The findings indicated that the pandemic, represented by a dummy variable, did not significantly influence the financial performance of Albanian banks during the analyzed period. This resilience could be attributed to internal policies and operational frameworks that enabled banks to weather external shocks without major disruptions to profitability.

Ultimately, the recommendations underscore the interconnectedness of internal bank dynamics, profitability, and larger economic growth. Banks must continuously adapt and refine their internal policies, paying attention to the internal factors that determine the profitability, and practices to navigate the evolving financial landscape effectively. By doing so, they can secure their role as stable pillars of the Albanian economy, driving growth and resilience in times of both stability and uncertainty.

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"Contingent Convertible Bonds (CoCo bonds) and their market development in Albania.

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Absract

Purpose: *This paper aims to assess the potential contribution of Contingent Convertible Bonds (CoCo) to financial stability within the Albanian banking sector in the context of European Union integration and financial crisis management. As financial shocks continue to challenge global economies, innovative financial instruments such as CoCo bonds have emerged as crucial tools for enhancing banking sector resilience. The study seeks to evaluate the positive effects of CoCo bonds and their feasibility within Albania's financial landscape, addressing the central research question: "How would the utilization of CoCo bonds impact the financial market in Albania during a financial crisis?"*

Methodology: *The research adopts a qualitative approach, combining an extensive literature review with an analysis of Albania's financial regulations, extraordinary interventions, and public offerings. Content analysis of key regulatory frameworks and case studies will help uncover patterns in how CoCo bonds have been employed in other markets and their potential implications for the Albanian banking system. The study will explore regulatory alignment with Basel III requirements and assess the responsiveness of Albania's financial sector to innovative capital instruments.*

Findings: *Preliminary findings suggest that CoCo bonds can significantly contribute to the stability and resilience of Albania's banking system by providing an* *automatic capital buffer during financial crises. However, potential challenges such as shareholder dilution, investor risk perception, and regulatory compliance must be carefully managed. The study highlights the role of CoCo bonds in reducing public debt burdens, improving non-performing loan (NPL) ratios, and enhancing lending capacity, all of which are critical criteria for Albania's EU accession process.*

Value: *This paper contributes to the ongoing discourse on financial crisis management by offering insights into the practical application of CoCo bonds in emerging markets like Albania. The study provides valuable recommendations for policymakers, regulators, and financial institutions regarding the adoption of innovative financial instruments to foster a more resilient and EU-compliant banking sector. By offering a comprehensive examination of CoCo bonds within the Albanian context, this paper aims to inform future strategies for financial sector development and economic integration.*

Literature Review

Historical background

CoCo bonds, or contingent convertibles, combine debt and equity features by activating loss absorption mechanisms when a bank's capital falls below a certain threshold, preventing bankruptcy (Avdjiev et al., 2015; Bolton et al., 2012).Robert Merton conceptualized CoCo bonds in 1990 to provide investor guarantees during financial crises, influencing regulatory changes post-2008 financial crisis (Sundaresan et al., 2010; Pelger, 2012). Lloyds Banking Group (LBG) issued the first CoCo bonds in 2009, addressing challenges from its acquisition of Halifax Bank of Scotland, with subsequent issuances by Credit Suisse, UBS, Rabobank, and Allianz (von Furstenberg, 2011; Financial Times, January 19, 2011; Allianz, July 05, 2011).CoCo bonds gained prominence in 2014 due to Basel III capital requirements but faced scrutiny after Banco Popular Espanol's case in 2017 (Basel III, 2014; Reuters, June 7, 2017).

Hybrid Instruments

Hybrid instruments blend equity and debt features, offering a predictable return with conversion options (Kimmel P., & Warfield T., 1995; Wiedermann-Ondrej, 2006). Hybrids are subordinated to traditional debt but rank above equity in insolvency (Liberadzki, K. & Liberadzki, M., 2016). Hybrid securities are favored for financial protection but can be challenging due to complexity (Johannesen, 2014). Convertible bonds allow conversion into equity, usually with lower coupon rates (De Pomphilis, 2011). They offer potential equity conversion, coupon payments, and tax advantages (Dutordoir, Strong & Ziegan, 2014). Conversion occurs when profits from equity exceed face value and interest payments (Lewis & Verwijmeren, 2011). Convertible bonds benefit young companies with low coupons and tax deductibility (Barone-Adesi, 1995).CoCos differ by converting to equity only when bank capital falls below a threshold

Basel III Regulation

Basel regulations, starting with the 1988 Basel Accord, aimed to increase banks' capital to absorb losses and reduce risky behavior (Baily, Litan & Johnson 2008). The crisis revealed flaws in dealing with complex financial instruments and high bank leverage ratios (Admati & Hellwig, 2014; Koziol & Lawrenz, 2009). Basel III was introduced in the EU to improve loss absorption capacity and address financial vulnerabilities (Basel III, 2014). Lehman Brothers' bankruptcy in 2008 triggered a financial collapse and highlighted the inadequacy of capital standards, exacerbating the crisis (De Haas & Van Horen, 2012; Sorkin, 2010; BCBS, 2010b). Governments globally took unprecedented measures to stabilize the financial system, including providing liquidity and capital support, and established supervisory bodies like the European Banking Authority (EBA) (Lee, 2015; Lybeck, 2011). Basel III, coordinated by the G20, increased capital requirements, introduced measures to mitigate leverage and liquidity risk, and aimed to improve the quality, consistency, and transparency of banking activities. It also sought to reduce procyclicality and prevent government bailouts (BIS, 2013; BIS, 2018). Basel III includes the countercyclical capital buffer to curb credit extension during economic peaks and contingent convertibles as additional Tier 1 capital (BCBS, 2015; Slovik, 2012; Nicolas & Firzli, 2012). Basel III's primary objectives are to limit excessive bank risk-taking, bolster capital reserves, and enhance financial stability to prevent future financial collapses.

CoCo Structure and Design

CoCo Bonds function like regular bonds during prosperous economic periods for the issuing institution but convert into common equity when the capital ratio falls below a specified threshold [De Spiegeleer et al. 2014]. This conversion aims to lower the bank's debt-equity ratio significantly, thus reducing the probability of the bank defaulting. Furthermore, upon conversion, the bank automatically recapitalizes, mitigating bankruptcy costs [De Spiegeleer et al. 2014]. As a result, CoCo Bonds are widely regarded as a valuable regulatory tool for decreasing the likelihood of bank defaults, minimizing bankruptcy expenses, and internalizing the consequences of poor performance [Maes and Schoutens, 2012]. These characteristics, coupled with high expectations, make CoCo Bonds and their structure both economically and politically intriguing for further examination [Maes and Schoutens, 2012].

Design

CoCo bond design significantly influences their intended objectives. Key design elements include the trigger event, threshold value, loss absorption nature, and bond volume [Avdjiev, Kartasheva & Bogdanova, 2013].The trigger event marks when the loss absorption mechanism activates, with one or more triggers possible. Decisions regarding trigger basis (book or market values) and the use of mechanical or supervisory authority-driven triggers are essential [Flannery, 2010]. Mechanical triggers activate when capital falls below a specified ratio of risk-weighted assets, triggering automatic conversion or write-down [Maes and Schoutens 2012]. They are clear and observable but lack consideration of additional information [BCBS, 2015].In contrast, discretionary triggers rely on supervisory judgment of a financial institution's solvency prospects [Gillet & De la Bruslerie, 2012]. They offer flexibility but may suffer from timing uncertainty and market signals [Pazarbasioglu et al., 2011].CoCo bonds can also employ a mix of trigger types, like a mechanical trigger based on specific bank assets coupled with a discretionary trigger considering broader financial system conditions [BCBS, 2015]. In the EU, CoCos typically use accounting value triggers to align with prudential requirements, reflecting regulators' preference [Maes and Schoutens 2012; Glasserman & Nouri, 2012].

Purpose

CoCo bonds serve multiple purposes in the financial industry. They are issued by financial institutions to enhance their loss-absorbing capacity alongside CET1 Capital, allowing banks to bolster their ability to absorb losses before a financial downturn occurs, all while paying a lower market price for risk assumption and without diluting the control of the owners' rights during a crisis [Flannery, 2010].

CoCo bonds are recognized for their cost advantages compared to CET1 capital, helping prevent banks from restricting their lending activities [Pazarbasioglu et al., 2011]. These cost advantages are attributed, among other factors, to the tax deductibility of coupon payments, especially in most European Union countries [Albul, Jaffee & Tchistyi, 2010].

Moreover, the conversion feature of CoCo bonds aims to provide financial institutions with additional CET1 capital when needed, helping to prevent deterioration in the bank's balance sheets [Pennacchi et al., 2011]. The use of CoCo bonds is also intended to enhance supervision and risk management through a customized contractual structure.

The primary purpose of these hybrid instruments is to reduce the risk for individual banks and, consequently, for the entire banking system, lessening the need for government rescue measures at the expense of taxpayers and contributing to stabilizing the overall economy [Glasserman & Nouri, 2012].

Threshold

The CoCo bond threshold determines when conversion or write-down is triggered (Admati & Hellwig, 2014; De Spiegeleer et al., 2014).Many EU CoCo bonds have a 5.125% CET1 ratio threshold, aligning with AT1 capital requirements (Albul, Jaffee & Tchistyi, 2010). Thresholds can be market-based or balance sheet-based, with discretionary triggers involving third-party assessments (Pennacchi et al., 2011; Pazarbasioglu, 2011).Setting the right threshold is complex; a late trigger may render CoCo bonds ineffective, while an early one can cause market disruptions (Deutsche Bundesbank, 2018; Henkel & Kaal, 2012).Ongoing discussions and academic studies question the effectiveness of EU CoCo bonds as loss-absorbing instruments, prompting reconsideration of AT1 eligible CoCo thresholds (Avdjiev, Kartasheva & Bogdanova, 2013).

Loss Absorption Mechanism

CoCo bonds have a crucial loss absorption mechanism determining conversion or write-down outcomes (Martynova & Perotti, 2016). The conversion rate in CoCo bonds is significant, representing the dilution of equity holders' claims and the CET1 capital CoCo bondholders receive (Pennacchi et al., 2011).Dilution involves a shift in control rights and profit/loss distribution, depending on fixed or variable conversion rates, but once conversion occurs, it's irreversible (Avdjiev et al., 2015).Significant dilution redistributes profit and loss claims to CoCo bondholders, possibly prompting original equity holders to avoid conversion by selling their bonds in advance, causing price declines (Albul, Jaffee & Tchistyi, 2010).CoCo bonds encourage better risk management and determining when substantial dilution is needed (Henkel & Kaal, 2012). Regulatory perspective favors substantial dilution to incentivize responsible risk management (Johannesen, 2014).Principal write-down reduces bank debt via CoCo bonds but doesn't grant equity, with options for partial or full write-down specified in the contract. It motivates equity holders and bank management to take risks, leaving control and participation rights unaffected (Pennacchi et al., 2011).CoCo bonds with conversion mechanisms are generally preferred, but contract specifics on full or partial conversion/write-down and gradations are essential (Avdjiev, Kartasheva & Bogdanova, 2013).In European markets, around 49% of CoCo bonds feature principal write-down, likely influenced by bank equity holders' decision-making power (Admati & Hellwig, 2014; Albul, Jaffee & Tchistyi, 2010).

Advantages

CoCo bonds serve as effective instruments for financial market regulation, benefiting both issuers and bondholders. They shift the burden of risk-taking from taxpayers to bank owners and enhance bank stability (Flannery 2005, 2009; Goodhart & Taylor 2006; Pennacchi et al. 2016).The key difference from standard convertible bonds is the trigger mechanism, initially proposed as a single trigger but later studies suggested multiple triggers (Huertas 2009; Albul, Jaffee & Tchistyi 2010; Pennacchi 2011; Plosser 2010).CoCo bonds gained prominence after the financial crisis, addressing the need for a capital buffer and reducing the "too big to fail" problem (Blundell, Wignall & Roulet 2013; Azarmi & Schmidt 2015; Martynova and Perotti 2018).They offer a cost-effective way to recapitalize banks, replacing the bankruptcy process (Bolton & Samama 2012) and improving bank solvency under specific conditions (Jaworski & Liberadzki 2017).Effectiveness depends on managerial caution and supervisory autonomy, and CoCo bonds are seen as a useful instrument when capital needs and regulatory actions are inversely related (Flannery 2014; Chan & van Wijnbergen 2017; Hilscher and Raviv 2014).In summary, CoCo bonds have the potential to enhance financial stability, although their impact may vary depending on circumstances (Flannery 2014).

Disadvantages

CoCo bonds, while praised for their potential to enhance financial stability, face skepticism and concerns in the financial literature. Critics argue that simpler solutions like increased equity may be more effective and that CoCo bonds' complexity can complicate financial systems. Concerns also revolve around the conversion mechanism's potential to spread economic distress and create incentives for risky behavior. Some worry that CoCo bonds may not completely avert bank failure and that their trigger mechanisms may be inefficient. Additionally, they could exacerbate bank weaknesses during crises, lead to destabilizing effects in markets, and generate negative externalities. Overall, CoCo bonds remain a topic of ongoing debate in the financial community.

Development of the CoCo Market in Albania

Introduction

Regarding Albanian legislation, contingent convertible bonds are financial instruments that have not received specific treatment in Albanian law. Not only for CoCos, but for many other financial instruments, Albanian legislation does not anticipate their treatment, as the economic development and the absence of a well-established securities market make them less of a priority. Consequently, since Albania does not have a well-established stock exchange, financial institutions such as banks will find it harder to issue contingent convertible bonds. This is because investors would be hesitant to risk their portfolios for value papers that have a higher probability of being written off than being converted into shares.

Extraordinary Intervention

The regulation of extraordinary intervention outlines how banks and investors should handle dematerialized bonds in cases of extraordinary intervention. The custodian plays a crucial role in this process and has the right not to pay the bonds until their issuer has fulfilled its obligations. The regulation requires custodians to inform their investors about the purchase and sale prices of dematerialized bonds in over-the-counter markets, including any commission or fee. This information is crucial for investors to make informed decisions regarding their bonds. The regulation also specifies the criteria and procedures for converting liabilities into capital for banks. This is an important tool for recapitalizing banks when needed to maintain financial stability. It sets the criteria and minimum requirements that banks must meet to ensure an adequate level of regulatory capital and accepted liabilities. This is a crucial aspect of bank supervision to mitigate financial risks. It sets the criteria and conditions that must be met to recognize financial instruments as accepted liabilities. This process ensures that the instruments banks use to fulfill their obligations are reliable and meet necessary standards. If banks meet the minimum requirements for regulatory capital and accepted liabilities using first-tier capital instruments, they can fulfill the macroprudential capital buffers. The Extraordinary Intervention Authority is responsible for developing and updating methodologies and policies related to meeting the minimum capital and accepted liability requirements. This ensures continuous updates and effective intervention by authorities in the banking sector. Overall, extraordinary intervention in Albanian banks is essential to ensure financial stability and protect the interests of investors and depositors. The defined regulations and procedures are the primary means to achieve these goals.

Minimum Requirements for Regulatory Capital Instruments and Accepted Liabilities

According to Regulation No. 78/2020 of the Bank of Albania, a minimum requirement for the levels of bank capital and accepted liabilities has been established. This requirement concerns the absorption of losses and the need for recapitalization. For banks that, according to the extraordinary intervention scenario, will not face mandatory liquidation, there is a value to absorb losses. This assessment represents the losses that the bank must be able to withstand, reaching the regulatory capital requirement. At the same time, there is also a recapitalization value, which is the amount of capital the bank must hold (after extraordinary intervention) to ensure compliance with licensing conditions and continue licensed operations. Banks that, according to the extraordinary intervention scenario, will be subject to mandatory liquidation, must primarily fulfill the absorption of losses requirement, but they are not required to fulfill the recapitalization value.

In accordance with Article 6 of Regulation No. 78/2020, the value for absorbing losses is calculated as follows: Loss Absorption Value = Risk-weighted Exposures t-1 * (Capital Adequacy Ratio (12%)t + Additional Capital Buffer Rate (%)t

In accordance with Article 7 of Regulation No. 78/2020, the value for recapitalization is calculated as follows: Recapitalization Value = Risk-weighted Exposures t-1 * (Capital Adequacy Ratio (12%)t + Additional Capital Buffer Rate (%)t)

According to Regulation No. 78/2020, the Bank of Albania has the possibility to adjust the recapitalization value by considering a significant reduction in the bank's balance sheet size after an extraordinary intervention, as well as restructuring plans and measures. This adjustment is based on a detailed analysis for each bank. One of the methods to consider the reduction in the bank's balance sheet size is by incorporating the credit risk magnitude into the bank's overall risk profile. For example, if the bank's repayment ability is affected by credit risk losses, the bank may have a smaller balance sheet. The impact of reducing the balance sheet size on the regulatory capital requirement is more significant when credit risk has a substantial contribution. However, the reduction in the balance sheet size should not exceed 10% of the total bank assets. Reducing the balance sheet size through divestments and planned sales in restructuring plans can be considered to adjust the recapitalization value by removing high-risk-weighted assets from the balance sheet. This activity is appropriate when the bank is not in default. If the planned restructuring actions are mandatory and have restricted timelines, the Bank of Albania may influence the determination of the recapitalization value. The Bank of Albania has the right to regulate the bank's balance sheet size based on recovery plans, in extraordinary cases and in accordance with the specified conditions. Recovery measures can be considered only if they are seen as reliable, achievable, and immediate after the extraordinary intervention, with a positive impact on loss scenarios. The Bank of Albania has the possibility to intervene to reduce the balance sheet size after an extraordinary intervention, reducing it by up to 5% of the balance sheet size.

Issuing of Bonds

According to the issuance guidelines by the Government of the Republic of Albania, in force since 25.01.2014, bonds have the following characteristics:

- Have a maturity period of more than one year, issued in the local currency (Lek), as well as foreign currencies (USD/EUR).
- Are sold in auctions conducted by the Bank of Albania, in the name and on behalf of the government represented by the Ministry of Finance.
- Are issued at par value, meaning the purchase price is 100% of the nominal value, excluding bonds issued in reopened auctions.

The coupon (interest earned from investing in bonds) is paid every 6 months and calculated as:

C = Vn * i * 180/360

C- coupon

Vn- nominal value

i- interest

In the secondary market, bonds have a 30/360 basis for coupon calculation and price.

Reopened bonds are calculated as:

Price = Clean price + Accrued interest

It is worth noting that the variable interest of the bonds is determined by the average of the 3 yields of the last 3 auctions (held before the auction of these bonds) of treasury bonds with a maturity of up to one year. If the maturity date is a holiday, the payment is postponed to the next working day without adding interest or incurring additional delay charges. Entities eligible to participate in the auction are individuals and legal entities, who can be domestic or foreign, and their requests can be competitive or non-competitive. The minimum value for participation in the auction is 500,000 Lek in the national currency and 3,000 Eur/USD in foreign currency. If the demand is equal to or greater than 50,000,000 Lek or 100,000 Eur/USD, the demand will be classified as competitive regardless of the entity. As for taxation on income from bonds, it is retained at the source for individual investors and non-profit subjects. Tax resident entities that are subject to income tax and entities registered as local tax-paying subjects for small businesses are not withheld at the source, as they are recorded as income in the balance sheet. Exempt from tax or those with concessions are those with disabled status (according to the respective law), except in cases where the investment is made through economic activities.

The Ministry of Finance exempts itself from liability for delays in bond redemptions or negative market impacts due to the following cases:

- Natural disasters
- Actions caused by other authorities (threat of war, war, or popular uprisings)
- Events affecting the continuity of the Ministry of Finance's work
- Other major forces with widespread impact

All securities are sold in the primary market, which is the auction conducted by the Bank of Albania. The secondary market, or the retail market, includes any transactions carried out on these securities after they have been traded once in the primary market. In the Republic of Albania, we can mention these secondary markets: the interbank market for government securities, the retail market for government securities, and the market on the Tirana Stock Exchange.

Transactions that can be conducted by financial institutions and other licensed entities in the capital market are as follows:

1. Acquisition of treasury bonds in the primary market (through auction) by the investor through a bank or licensed entity.
2. Sale of government securities to the investor from the bank's portfolio or licensed entity.
3. Purchase of government securities by the bank or licensed entity before the maturity date from any investor, regardless of whether previous transactions were not conducted by the same bank or licensed entity.
4. Use of government securities as collateral for other loans or other financial transactions.
5. Redemption of the nominal value of government securities on the maturity date.

Public Offering

A public offering of securities is considered public when it is made to more than 100 individuals (Financial Supervisory Authority).

Companies with a public offering are companies that distribute their shares to the public through stock exchanges or other legal means. The need to increase capital is associated with the goal of expanding activities and improving technology, aiming to become strong competitors in the market. One of the ways to increase capital is by issuing and selling securities by the company. These new issuances, which can be shares, bonds, or securities, are usually traded publicly in what is known as the primary market.

Offerings in the primary market can be offered for sale in two ways:

- Public offering, which includes a public offer to communicate to the public the distribution of securities to a minimum of 100 individuals (based on the Securities Law).
- Direct allocation, which includes an offer to distribute securities only to a small group of large investors or a limited number of institutional investors.

To consider an issuance as public, the following conditions must be met:

1. The offer must be distributed to more than 100 investors.
2. The company must be listed simultaneously on the Stock Exchange to enable small investors to convert their investment into liquidity.
3. During the initial public offering, an advertising campaign must commence in the media.

Companies aiming to finance their business activities by involving the public must be organized as publicly traded companies. This results in a complex set of additional rules related to publication, transparency, control, and other aspects of public company management.

The "Traders and Companies" Law stipulates that private offering companies must have a minimum registered capital of 2 million lekë, while those with a public offering must have this minimum capital of at least 10 million lekë (Article 1052). On the other hand, the "Securities Law" in Article 105 defines public companies as those that register shares within 30 days from the date of issuance in a public offering. Public offerings can be either initial (IPO) or secondary (SPO).

Initial Public Offering (IPO) involves the distribution of a private company's shares to the public for the first time and their listing on the stock exchange to raise capital as an effective way of financing operations. IPO is an obligation for the company offering shares to the public and allows investors to convert shares into liquidity if they wish to exit their investment after a specified period. This is a common way for companies to secure additional funding by distributing portions of their ownership to the public.

Secondary Public Offering (SPO) is the distribution of securities of a company that has previously distributed securities in a public offering. The purpose of this offering is to increase capital to make investments in the company or to fund previous debt. The securities distributed through an SPO are also listed on the stock exchange to create liquidity for their investors. The procedures for conducting an IPO include several important steps, starting with the gathering of shareholders, selecting the form of the registration statement, preparing the necessary documentation, and approving the prospectus. After these steps, the marketing period begins, along with the sale of shares on the capital market. If market conditions are favorable, IPOs can be an efficient way for companies to secure the necessary funding to develop their business activities and increase the company's value.

If contingent convertible bonds were to be issued in Albania, a complete restructuring of legislation would be necessary, also supported by "Basel III Agreement". However, considering what happened with these bonds at Credit Suisse Bank, their implementation in Albania would be even more challenging. Investors would not be eager to enrich their portfolios with these high-risk bonds, regardless of the yield they possess. Furthermore, to invest in contingent convertible bonds, institutional investors would be needed, who must have a well-diversified portfolio.

Another difficulty encountered in the Albanian market is that banks in Albania cannot yet offer public offerings. A public offering brings improvements in financial conditions by ensuring permanent funds that improve the financial situation. The company benefits from the distributed shares as public information about products and services is higher. It increases access to secure capital, thus increasing financing resources and making it easier to obtain loans on favorable terms. Public offerings bring facilities for securing additional capital from banks, offers of shares and bonds, and use easier registration forms for additional capital. Since banks cannot offer public offerings, they cannot issue contingent convertible bonds either.

For a country like Albania, the implementation of contingent convertible bonds would increase the minimum regulatory capital requirement and contribute to the development of the banking network. It would provide security for bank depositors and taxpayers because immediate government intervention would not be needed in case of bankruptcy. The bank would be "rescued" from these bonds. Other benefits that the bank will have are: increasing the first-tier capital, higher valuation of shares during the life of the CoCos, improving liquidity position during banking stress periods, and strengthening the bank's balance sheet.

Conclusions and Recommendations

Conclusions

1. Albanian legislation has not specifically addressed contingent convertible obligations and many other financial instruments. This has rendered these instruments unenforceable in the financial practice of Albania.
2. The absence of a well-established securities market has made it difficult for financial institutions, such as banks, to issue contingent convertible bonds

and other securities. Investors are not inclined to risk their portfolio with securities that do not have a developed market.
3. Regulations and procedures related to extraordinary interventions in the banking sector are crucial to ensure financial stability and protect the interests of investors and depositors in emergency situations.
4. Naming government bonds is an important and well-regulated process, where the nominal value, coupons, and payment conditions are clearly defined.
5. The limitation in the Albanian banking sector, where banks are unable to offer public offerings and contingent convertible bonds, poses a significant obstacle. This restriction hinders the improvement of financial conditions, access to secure capital, and favorable loan terms. It also restricts the distribution of shares and the ability to capitalize on public awareness of products and services.

Recommendations

1. Improvement of Albanian legislation to specifically address contingent convertible bonds and other financial instruments. This would aid in the development of the securities market and increase interest in such investments.
2. Encouragement of establishing a fully functional securities exchange in Albania to facilitate the issuance and trading of various securities. This would make investments in securities more attractive and help increase available capital for financial institutions.
3. Continued improvement of regulations and procedures related to extraordinary interventions in the banking sector to ensure they align with international standards and maintain financial stability.
4. Encouragement of banks and financial institutions to explore the possibility of investing in contingent convertible bonds, viewing them as a means to raise capital and strengthen their position in the financial market. This could be done through incentives and rewards for institutions that utilize these instruments with long-term maturity.
5. Advocate for regulatory reforms that allow Albanian banks to conduct public offerings and issue contingent convertible bonds. These changes would enable banks to enhance their financial stability, access additional capital, and improve their overall financial situation. Additionally, it would facilitate the dissemination of public information about their offerings, attracting more investors and contributing to a more robust financial market.

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Strengthening Albania's Innovation Ecosystem: Strategic Investment and Collaborative Approaches in Scientific Research and University-Industry Partnerships

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Abstract

Purpose: *The purpose of this paper is to examine the efforts undertaken by Albania to strengthen its research and innovation framework in alignment with European standards. Specifically, it seeks to evaluate the initiatives and strategies launched by the Albanian government to enhance performance in scientific research, foster innovation, and promote collaboration between universities and industry, as well as to incorporate the research of higher education institutions and research institutions into the European Research Area, through the examination of* *several strategic documents from the European Commission, OECD, RCC, and the Albanian government. In 2018, the European Commission, in its Strategy for the Western Balkans, highlighted education, scientific research, and innovation as key factors for fostering economic development, competition, and social cohesion in the region. Albania's obligation to undertake political, legal, institutional, and financial initiatives to support the consolidation of the research and innovation system stems from the Stabilization and Association Agreement (SAA). Within this framework, the Albanian government has initiated a series of actions, allocated budgets, intervened in structures, and launched informative and awareness-raising campaigns regarding applications for EU funds, particularly in Horizon 2020.*

Methodology: *This paper adopts a qualitative research methodology, drawing on a range of reports, strategic documents, and legal frameworks produced over the past five years. The analysis is structured around key themes such as innovation, scientific research, university-business collaboration, and the broader innovation ecosystem, with the research utilizing these focal keywords to identify and evaluate relevant materials.*

Findings: *In Albania, innovation ecosystem faces coordination challenges due to fragmented responsibilities across ministries, limiting effective resource allocation and support for enterprises. Strengthened collaboration between academia and industry is needed to boost innovation and technology transfer.*

Value: *The paper contributes to the existing literature by proposing a comprehensive action plan that prioritizes research infrastructure, enhances the legal framework, and provides targeted services to support technology absorption, all of which would bolster Albania's innovation ecosystem.*

Keywords: *scientific research, innovation, university-industry collaboration, innovation ecosystem*

Introduction

The social and economic development of a region is linked to its capacity to generate and effectively translate knowledge into innovation, a process that requires the active engagement of key institutional agents, including universities, businesses, and government entities. The promotion of a knowledge-based economy and the fostering of innovation have emerged as critical priorities for countries in Western Balkans and beyond. In this context, universities play a central role in the production of knowledge, which is essential not only for driving economic and social progress but also for facilitating the transfer of this knowledge across various sectors. By bridging the gap between research and practical application, universities serve as key actors in the broader innovation ecosystem, contributing significantly to the region's competitive advantage and long-term development. (Etzkowitz, 2004, Guerrero-Cano, Urbano, & Kirby, 2006).

This paper draws upon a comprehensive analysis of strategic documents issued by a range of influential bodies, including the Albanian government, the European Commission, the Organisation for Economic Co-operation and Development (OECD), the World Bank, and the Regional Cooperation Council, among others. These documents collectively address key themes such as scientific research, innovation, the integration of higher education institutions into the European Research Area (ERA), and their broader contribution to the economic development of Albania. By critically examining these strategic frameworks, the paper aims to explore the role of policy in shaping the landscape of research and innovation in Albania, particularly in the context of its efforts to align with European standards and enhance its economic competitiveness. Albania's obligation to undertake political, legal, institutional, and financial initiatives to support the consolidation of the research system stems from Article 109 of the Stabilization and Association Agreement (SAA)[1], which defines the pillars of cooperation between Albania and the European Union in the fields of scientific research and technological development. Meanwhile, the 2018 Strategy of the European Commission for the Western Balkans highlights that 'education, culture, youth, and sports, together with scientific research and innovation' constitute the key areas for fostering the economic development of the region (OECD, 2020).

One of the obligations of the Albanian government for the year 2022-2023, according to the 2021 Progress Report (European Commission, 2021), was to increase investments in scientific research in accordance with the principles and priorities of the European Research Area. Investment in research and development is essential for enhancing the country's competitiveness in both the domestic and international markets and for promoting innovative development in industry and the services sector. The indicators reveal that collaboration between business and academia continues to remain weak; the percentage of companies investing in 'Research and Development' in Albania is low, approximately 18%, and accounts for only 0.03% of Gross Domestic Product (European Commision, 2021).

Small and Medium-sized Enterprises (SMEs) are integral to the Albanian economy, accounting for approximately two-thirds of total employment and playing an important role in driving economic growth and social development (INSTAT, 2022). To enhance their productivity and generate higher-wage employment opportunities, SMEs must invest strategically in skills development, digitalization, and innovation (OECD, 2022). However, despite these imperatives, progress in fostering innovation within Albanian SMEs has been limited. According to the OECD, Albania ranks the last after Bosnia and Hercegovina in the Western Balkans region in terms of innovation performance.

[1] https://www.dap.gov.al/publikime/dokumenta-strategjik/61-marreveshja-e-stabilizim-asociimit

In 2023, Albania's innovative capacity remains limited, further exalarated by the absence of comprehensive and reliable statistical data, which hinders an accurate evaluation of the country's innovation performance and its broader implications for economic development. Recent governmental initiatives have sought to align Albanian scientific research with international standards for the 2022-2024[2] period, drawing upon strategic frameworks such as the European Framework Program for Research and Innovation, Horizon Europe, etc. This alignment is guided by a suite of foundational documents, including the Western Balkans Agenda for Innovation, Research, Education, Culture, Youth, and Sports[3]; the European Global Approach for Scientific Research and Innovation; the European Strategy for International Cooperation in a Changing World; the European Strategy for Research and Innovation (2020-2024); the EU Strategic Plan for Research and Innovation (2020-2024); the Principles of the European Research Area; and the European Research Area Policy Agenda: Overview of Actions Infrastructure Consortium (ERIC)[4]. Together, these frameworks underscore Albania's commitment to enhancing its research and innovation capacity through closer integration with European standards and priorities.

This paper seeks to provide a comprehensive analysis of key documents at the international, European, and Albanian levels that address Albania's performance in scientific research, innovation, university-industry collaboration, and the integration of Albanian higher education institutions into the European Research Area.

The objectives of this study are as follows:

- To critically examine the legal frameworks, strategic initiatives, and national projects that pertain to research, innovation, and university-industry collaboration in Albania.
- To conduct an in-depth analysis of documents and reports published by the European Commission and the Regional Cooperation Council, specifically focusing on scientific research and innovation in the Western Balkans, with an emphasis on Albania.
- To review international reports from organizations such as the OECD and the World Bank that assess the current state of innovation, scientific research, and university-industry collaboration in Albania.

The central research question guiding this study is: *How is Albania performing in the domains of scientific research, innovation, and university-business collaboration?*

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[2] https://research-and-innovation.ec.europa.eu/system/files/2021-11/ec_rtd_era-policy-agenda-2021.pdf

[3] International cooperation with the Western Balkans in research and innovation (europa.eu)

[4] https://research-and-innovation.ec.europa.eu/strategy/strategy-2020-2024/our-digital-future/european-research-infrastructures/eric_en

To further refine the analysis, the study also explores several subsidiary questions: a) *What legal, structural, and financial interventions has the Albanian government implemented to support these areas?* b) *What tangible outcomes have emerged from these interventions?* This paper adopts a qualitative research methodology, drawing on a range of reports, strategic documents, and legal frameworks produced over the past five years. The analysis is structured around key themes such as innovation, scientific research, university-business collaboration, and the broader innovation ecosystem, with the research utilizing these focal keywords to identify and evaluate relevant materials. Through this approach, the study seeks to provide an in-depth understanding of Albania's current standing and progress in these critical areas of economic and social development.

This paper is not exhaustive in scope, as it does not aim to review all relevant publications within the last five years. Rather, its primary contribution lies in shedding light on the framework through which Albania seeks to advance scientific research and innovation, underscoring the critical role of universities in formulating effective research strategies and institutional action plans. For researchers, this study provides an understanding of current top-down policies, aiding in the alignment of their work with national and European priorities. By fostering a gradual transformation of researchers into academic intrapreneurs, the paper highlights the "third mission" of universities—encompassing activities such as patenting, startup creation, industry collaboration, and student engagement—thereby facilitating economic and social development.

Literature review

Core concepts

This section introduces key foundational concepts pertinent to scientific research, innovation, and university-industry collaboration, based on Law No. 80/2015, *On Higher Education and Scientific Research in Higher Education Institutions in the Republic of Albania.*

Research activities are conducted in higher education institutions; inter-institutional research and development institutes and centers; research and development institutes affiliated with ministries, as well as other institutions, whose activities are regulated by specific legislation[5].

Higher Education Institutions are legal entities that provide higher education or vocational training beyond secondary education and depending on the type of

[5] https://www.unitir.edu.al/images/dokumenta/Legjislacion/Ligj_80-2015_22.07.2015.pdf; pg. 32

institution, conduct scientific research as part of the established higher education system. They operate in accordance with the applicable legal and sub-legal acts[6].

Basic scientific research is a research activity aimed primarily at expanding, deepening, reconceptualizing, and reintegrating scientific knowledge about studied phenomena and enhancing theoretical understanding of the interactions among various actors and the processes through which they influence one another[7].

Applied scientific research is the research activity aimed at finding practical and specific solutions, with the primary objective of utilizing theoretical knowledge for implementation in practice[8] .

The Council of Higher Education and Scientific Research (KALKSH) is a consultative body for policies concerning higher education and scientific research, operating under the authority of the minister responsible for education[9]

The National Agency for Scientific Research and Innovation (NASRI) is a public institution under the ministry responsible for education and science, with the primary task of allocating funds for scientific research programs based on projects submitted by higher education institutions and research institutions[10]

The national database for scientific research in higher education includes: a list of defended doctoral theses and their corresponding abstracts; a list of master's and bachelor's theses that have been defended, along with their respective abstracts; and an updated list of the scientific contributions of the academic and research staff of higher education institutions and research institutions, which is administered and updated by NASRI[11].

Research Infrastructures - are facilities, resources and services that are used by the research communities to conduct research and foster innovation in their fields. They include major scientific equipment, knowledge-based resources such as collections, archives and scientific data, e-infrastructures, such as data and computing systems and communication networks and any other tools that are essential to achieve excellence in research and innovation (Regional Cooperation Council, 2022).

The entrepreneurial university – this concept integrates the economic development at the university as an academic function along with teaching and research. It is this "knowledge capitalization" that is the heart of a new mission for the university, connecting universities with knowledge users more strongly and establishing the university as an economic actor in itself (Etzkowitz & Zhou, 2017). The entrepreneurial university means offering technology transfer offices

6 https://www.unitir.edu.al/images/dokumenta/Legjislacion/Ligj_80-2015_22.07.2015.pdf; pg. 3
7 https://www.unitir.edu.al/images/dokumenta/Legjislacion/Ligj_80-2015_22.07.2015.pdf; pg.3
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10 https://www.unitir.edu.al/images/dokumenta/Legjislacion/Ligj_80-2015_22.07.2015.pdfl; pg. 6
11 https://www.unitir.edu.al/images/dokumenta/Legjislacion/Ligj_80-2015_22.07.2015.pdf; pg. 6

and science parks, it provides an emerging perspective that aims to provide a broader social and economic benefit to the university ecosystem, with the creation of entrepreneurial thinking for job generation. These involve students, alumni and entrepreneurs, as they also provide entrepreneurship centres, accelerators, student business plan competitions, collaboration networks with industry and alumni (Siegel & Wright, 2015).

Third mission of the university - it consists of wide-ranging and recurring concepts such as the 'entrepreneurial university', 'technology transfer' and 'Triple Helix Model partnerships' (Trencher et al., 2014) . Furthermore, the Third Mission refers to an extensive array of activities performed by higher education institutions which seek to transfer knowledge to society in general and to organizations, as well as to promote entrepreneurial skills, innovation, social welfare and the formation of skills and competences.

Triple Helix Model – This model establishes an interactive relationship between universities, companies and government, so that each link has a responsibility: the university is responsible for developing knowledge while companies are responsible for the practical application (production of goods and services) and the government for developing public policies to finance and reduce the difficulties encountered during the development of a culture of innovation (Etzkowitz & Leydesdorff, 1997)..

Quadruple helix Model- the approach that investigates the interactions between university-government-enterprise - civil society and the media (Carayannis & Campbell, 2009). In this way, the Quadruple Helix Model of innovation recognizes four major actors in the innovation system: science, policy, industry, and society. In keeping with this model, more and more governments are prioritizing greater public involvement in innovation processes.

The Current Situation of Innovation Ecosystem in Albania

The business environment in Albania, according to the European Commission, continues to exhibit several structural weaknesses, primarily related to a lack of knowledge, a high level of informality, and limited financial literacy, which create few opportunities for business financing (European Commision, 2021). While corruption continues to be a real problem for businesses across the Western Balkans, Albania's position in Transparency International's Corruption Perception Index has worsened since 2016, ranking it among the lowest in the region alongside Bosnia and Herzegovina (Transparency International, 2022). According to OECD (2022), the energy infrastructure and the fiscal system represent another significant problem, compounded by the gap in human resource capabilities, a consequence of the quality of the education system, and the still low budget allocation for education, which hinders economic improvement and diversification of the economy, as well as limits the continuing education of employees in Albanian companies.

Although SMEs play a significant role in job creation and economic growth, according to the World Bank, they must invest in skills, digitalization, and innovation to increase productivity and ensure higher wages for employees. SMEs often lack the resources to invest in training for employees; therefore, the government needs to intervene to minimize the skills gap and upskill the workforce (World Bank, 2022). The skills gap in Albania is increasingly deepening compared to the Western Balkans region in recent years, largely due to the massive emigration of high skilled individuals. This has significantly and continuously impacted both society and the economy, highlighting the urgent need to support entrepreneurial skills.

For this reason, the government is increasingly emphasizing the creation of a favorable environment for innovation and knowledge development, supporting entrepreneurship and startups, with a particular focus on enhancing innovation capacity at the firm level (OECD, 2022). It should also be noted that some improvements have been made in enhancing the innovation framework and government institutional support services for innovative SMEs.

A comprehensive assessment of Albania's economic performance in terms of innovation remains challenging due to the lack of complete statistical data. While there are concrete steps being taken toward innovation policies in Albania, implementation is hindered by limited funding and the large number of implementing bodies. There are now three line ministries and three agencies Albanian Investment Development Agency (AIDA), the National Agency for Scientific Research and Innovation (NASRI) and the National Agency of Information Society (NAIS) that share responsibility for policy implementation, which has led to an unclear definition of competencies, a lack of ownership, overlapping support measures and ineffective budget allocation (OECD, 2022).

Progress has been made in improving legislation for the protection of intellectual property, which will gradually impact the quality of scientific research. Particularly, the National Strategy for Intellectual Property 2022–2025[12] , includes among its political objectives "the development and strengthening of institutions involved in the enforcement of intellectual property rights," with the aim of "increasing the quality level of services provided by the State Agency for Intellectual Property (DPPI) and the Copyright Directorate". Another important objective is 'the establishment of technology transfer centers' with a goal to complete the establishment of centers in public higher education institutions by 2025; however, Albania is still far from realizing this goal (OECD, 2022).

[12] https://ishmt.gov.al/wp-content/uploads/2022/06/STRATEGJIA-IP-2022-2025-E-MIRATUAR-4.pdf

Simultaneously, the Strategy for Business and Investment Development in Albania (2021-2027)[13] places a strong emphasis on innovation in SMEs and the links between industry and academia to stimulate economic growth. Albania has made some progress in developing the Smart Specialization Strategy and is adopting a positive approach to creating an innovative ecosystem, primarily focused on startups and dedicated legislation for their establishment. However, according to the OECD, coordination in the implementation of the innovation policy framework remains problematic (OECD, 2022).

Although there have been efforts in recent years to support startups by public[14] and private organizations [15,16,17], these initiatives have primarily focused on acceleration programs, technical assistance, mentoring, and training on investor relations, with some offering the possibility of small-scale monetary awards. However, support for SMEs in innovative activities remains very limited, particularly following the efforts of the Albanian Investment Development Agency (AIDA) and certain funds dedicated to SMEs, which were disrupted after the November 2019 earthquake and the extraordinary situation of COVID-19.

Furthermore, efforts to stimulate collaboration between academia, research institutions, and industry remain minimal. It is sufficient to highlight that, according to the European Commission's Progress Report, R&D expenditures in 2020 amounted to 0.3% of GDP, significantly below the government's target of 1% of GDP by 2022. (European Commision, 2021). Financial incentives to promote business-academia collaboration remain largely nonexistent. In 2022 for the first time, the National Agency for Scientific Research and Innovation (NASRI) allocated funds for projects dedicated to collaborations between academia and industry[18].

Regarding the data collection at the national level, despite some improvements made by the Institute of Statistics, Albania continues to face deficiencies that limit the extent to which the implementation of innovation policies can be effectively monitored and evaluated. Furthermore, this issue has hindered Albania's ability to participate with complete data in major international initiatives, such as the European Innovation Scoreboard (OECD, 2022).

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13 https://financa.gov.al/wp-content/uploads/2021/10/Strategjia-e-Zhvillimit-t%C3%AB-Biznesit-dhe-Investimeve.pdf

14 https://sipermarrja.gov.al/java-globale-e-sipermarrjes-2022/

15 https://junior-albania.org/programs/ja-be-entrepreneurial/

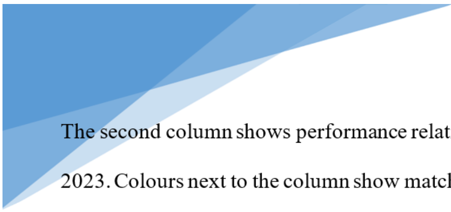
16 https://junior-albania.org/programs/junior-up/

17 https://uplift.al/

18 http://nasri.gov.al/wp-content/uploads/2023/08/VENDIM-NR.-11-DAT%C3%8B-21.07.2023-MIRATIMIN-E-FINANCIMIT-T%C3%8B-PROJEKTEVE-FITUESE-T%C3%8B-TEKNOLOGJIS%C3%8B-DHE-INOVACIONIT-Q%C3%8B-VIJN%C3%8B-SI-BASHK%C3%8BPUNIM-I-UNIVERSITETEVE-ME-BIZNESININDUSTRIN%C3%8B-P%C3%8BR-VITIN-2023.pdf

For the first time, Albania was included in the 'European Innovation Scoreboard' report in 2022[19]. According to the classification of this report, Albania is classified as an Emerging Innovator, with a performance level of 41.7% of the EU average. This performance is below the average of Emerging Innovators (50.0%). Additionally, performance is increasing at a rate of 5.1 percentage points, which is lower than the EU's rate of 9.9 percentage points. As a result, the performance gap between Albania and the EU is widening (European Commission, 2022). If we refer to the data from the 2023 report (Tab. 1), Albania's performance stands at 41.1% of the EU average, remaining below the average for Emerging Innovators[20].

TABLE 1: Summary Innovation Index, Albania



The second column shows performance relative to that of the EU in 2023. Colours next to the column show matching colour codes: dark green: above 125% of the performance of the EU in 2023; light green: between 100% and 125%; light orange: between 70% and 100%; dark orange: below 70%.

The next columns show performance change over time between 2016 and 2023 and between 2022 and 2023, with scores relative to those of the EU in 2016. Positive (negative) performance changes are shown in green (red).

* Results for Albania are less reliable due to limited data availability.

In analyzing the data in Table 1, we can observe that Albania in 2023 demonstrates several relatively strong factors, including: environment-related technologies, sales of innovative products, product innovation, lifelong learning, and the proportion of the population with tertiary education. To further underscore the previously discussed weaknesses, these areas are distinctly highlighted in the Innovation Index 2023: individuals with above-basic overall digital skills, R&D expenditures in both the public and business sectors, exports of medium and high-tech goods, and public-private co-publications.

Comparing the factors for improvement since 2016 (Table 2), significant contributors emerge, including environment-related technologies, the increase

[19] https://wbc-rti.info/object/news/23208

[20] https://ec.europa.eu/assets/rtd/eis/2023/ec_rtd_eis-country-profile-al.pdf

in population with tertiary education—an outcome of the Bologna System's implementation in Albanian higher education—and a rise in highly cited publications, attributed to reforms introduced by Law No. 80/2015[21] on Higher Education. This legislation has influenced scientific output, established new criteria for achieving academic titles, and advanced digitalization efforts.

In terms of declining factors since 2016, the decrease in foreign doctoral students can be attributed to the suspension of doctoral programs in Albania from 2013 to 2021 due to higher education reforms, impacting both domestic and international students. A persistent challenge is the limited collaboration between SMEs and other actors, including academia and research centers, which is influenced by prevailing attitudes, macroeconomic constraints, public policy limitations, the quality of scientific research, and restricted funding opportunities (Çabiri & Qosja, 2023). The factor related to product innovation is also limited by the business models of SMEs and the sectors they operate in, which are predominantly in services and retail (INSTAT, 2022).

TABLE 2: Factors that have improved and deteriorated - Innovation index

Relative strengths	Relative weaknesses
Environment-related technologies Sales of innovative products Product innovators Lifelong learning Population with tertiary education	People with above basic overall digital skills R&D expenditures in the public sector R&D expenditure in the business sector Medium and high-tech goods exports Public-private co-publications
Strong increases since 2016	**Strong decreases since 2016**
Environment-related technologies Population with tertiary education Most cited publications	Foreign doctorate students Innovative SMEs collaborating with others Product innovators
Strong increases since 2022	**Strong decreases since 2022**
Design applications Most cited publications	Innovative SMEs collaborating with others Knowledge-intensive services exports Product innovators

Research Infrastructure

Albania is making significant effords in promoting international research cooperation and fostering research excellence. A critical component in this effort is investment in research infrastructure, supported by a legal and policy framework that includes the National Strategy of Scientific Research, Technology,

[21] https://www.unitir.edu.al/images/dokumenta/Legjislacion/Ligj_80-2015_22.07.2015.pdf

and Innovation 2017-2022[22] , Law No. 80/2015 on Higher Education and Scientific Research in Higher Education Institutions in Albania, and Law No. 53/2019 on the Academy of Sciences[23] .

However, Albania still needs a considerable increase of investments in scientific research and other measures to strengthen research and innovation capacity at the national level. For this reason, in addition to funding that finances laboratories for European projects, NASRI has supported public universities in the last three years with substantial funds for the establishment of research laboratories.[24] .

Mapping of. research infrastructures is an very important process, which provides the basis for analyzing research potential and selecting the research areas in which Albania has the strongest potential. By offering insights into the current state of research infrastructures and identifying the scientific thematic areas with the greatest scientific opportunities, Albania can advance the implementation of the Smart Specialization[25]

The Regional Cooperation Council (RCC) has supported the development of Albania's Research Infrastructure Roadmap (Regional Cooperation Council, 2022). A key finding from the report indicates that, although there has been a notable increase in national resources allocated to research and innovation, funding levels remain significantly below the established targets. Although Albania's participation in Horizon 2020 has shown a positive trend over the last three years, the overall performance remains low. Private sector participation in the programme continues is also low. It appears that the areas with significant contributions are: Health, demographic change and wellbeing; Advanced materials; Europe in a changing world-inclusive, innovative and reflective Societies; Secure, clean and efficient energy; Climate action, environment, resource efficiency and raw materials. Albania has managed to absorb €5.27 million from the European Commission, positioning itself ahead of Montenegro and Kosovo. However, it remains considerably behind Serbia, which leads the region with €128.6 million (Regional Cooperation Council, 2022).

The report underscores the limited engagement of universities in reporting on research infrastructure, pointing to a lack of awareness about its importance, insufficient commitment to these processes, and a persistent need for reporting to be recognized as a legal and routine obligation.

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22 https://arsimi.gov.al/wp-content/uploads/2023/03/Draft-Strategjia-Komb%C3%ABtare-p%C3%ABr-Shkenc%C3%ABn-Teknologjin%C3%AB-dhe-Inovacionin.pdf

23 https://akad.gov.al/ash/pdf/ligj_nr_53.pdf

24 https://nasri.gov.al/wp-content/uploads/2023/04/4.Thirrje-per-projekt-propozime_PIKSH_24.03.23_rev-1.pdf

25 https://s3platform.jrc.ec.europa.eu/albania

Higher Education Institutions

Higher education institutions have been making efforts for several years to transform themselves in accordance with the Law on Higher Education [26] , National Strategy of Scientific Research, Technology and Innovation 2017-2022[27] , The Education Strategy 2021-2026[28] , Strategies covering entrepreneurial learning in Albania[29] ; Digital Agenda of Albania and the Action Plan 2022–2026[30] ; Smart Specialisation Strategy; Strategy for Scientific Research for the Period 2023-2030[31].

On this basis, higher education institutions aim to: Promote excellence in teaching, Entrepreneurial learning; Increase and widen the quality of research in Albania based on OECD indicators; Integration of the Albanian scientific research in the European Research Area (ERA) through active participation in all European research and development programmes; Improve the quality of research and steering scientific research to match market needs by strengthening the links between the existing national and international research and innovation programmes with private businesses; Internationalization of higher education and integration into the European Higher Education Area (EHEA); Advancement of ICT infrastructure and digital services for public higher education institutions; Digital education and digital skills: transformation of learning and teaching; Collaboration between enterprises with technological capacities and higher education institutions through joint projects funded by national and international programs; Establishment of technology transfer centers within public higher education institutions.

Discussions and conclusions

Efforts to build Albania's innovation ecosystem are ongoing through the development of legal frameworks, policy formulation, institution-building, and financial resource allocation, complemented by incubators supported by various private and public initiatives. However, support for enterprises throughout this

[26] https://www.unitir.edu.al/images/dokumenta/Legjislacion/Ligj_80-2015_22.07.2015.pdf
[27] https://arsimi.gov.al/wp-content/uploads/2023/03/Draft-Strategjia-Komb%C3%ABtare-p%C3%ABr-Shkenc%C3%ABn-Teknologjin%C3%AB-dhe-Inovacionin.pdf
[28] https://arsimi.gov.al/wp-content/uploads/2021/05/Draft-Strategjia-per-Arsimin-2021-2026.pdf
[29] https://www.etf.europa.eu/sites/default/files/m/40EC73142B671AF5C12578D300530453_Entrepreneurial%20learning_Albania.pdf
[30] https://akshi.gov.al/axhenda-dixhitale/
[31] https://arsimi.gov.al/wp-content/uploads/2023/03/Draft-Strategjia-Komb%C3%ABtare-p%C3%ABr-Shkenc%C3%ABn-Teknologjin%C3%AB-dhe-Inovacionin.pdf

process remains limited. Under these conditions, bridging the gap between the legal framework and its effective implementation becomes increasingly essential.

The distribution of competencies and budgets among three ministries and several agencies exacerbates coordination issues, focus, and the achievement of desired results. The innovative ecosystem needs to be built beyond startups and should include targeted services to support truly innovative ideas with the capacity for absorption of technology.

Collaboration between the business sector and academia remains limited; therefore, it is essential for the government to identify existing barriers and work to strengthen the relationship between scientific research, academic institutions, and the broader institutional framework for innovation.

The size and economic potential of Western Balkan countries should motivate governments to enhance regional cooperation within the framework of Smart Specialization, as regional disparities are increasingly evident in innovation policy development. Albania, with its small but open economy, stands to benefit significantly from intensified inter-regional and international collaboration to advance its innovation agenda, build regional innovation systems, and foster cross-border cooperation that strengthens research and development efforts.

Albania should prioritize the creation of an Action Plan for the development of research infrastructures. Key actions within this plan should include increasing investment levels in research infrastructure, enhancing mobility and institutional cooperation among higher education institutions within the Western Balkan region and strengthening the legal framework. Additionally, improving the visibility of research infrastructures by establishing a comprehensive database of facilities and equipment, refining the Access Policy to facilitate broader utilization, and implementing a two-way communication system with the research community are essential steps for fostering a robust and accessible research environment.

Albania should continue to prioritize partnership development to support entrepreneurial learning and to bridge the gap between the designation of entrepreneurship as a cross-curricular key competence and its practical visibility in the learner experience. Implementation remains limited at the higher education level, where a stronger emphasis on entrepreneurship as a core competence is needed. Additionally, vocational education and training (VET) would benefit from a broader approach to entrepreneurship beyond business creation, fostering a comprehensive skill set that prepares students for diverse entrepreneurial opportunities.

In terms of scientific research, Albania must focus on enhancing and broadening research quality in alignment with OECD indicators. This includes increasing budget allocations, further integrating Albanian research within the European Research Area (ERA) through active participation in European research and development programs, and elevating research quality to better align with market needs. Strengthening connections between national and international research, innovation programs and private industry, along with monitoring research quality, is essential. Additionally, establishing technology transfer centers, addressing brain drain and brain circulation challenges, and actively engaging the Albanian scientific diaspora are critical steps to building a more robust and globally integrated research environment. It is essential that financial resources be allocated in a balanced and well-coordinated manner across AIDA, NASRI, the Ministry of Defense, and the Ministry of Enterprise to maximize synergy and impact. Additionally, reaching a funding level of 1% of GDP for research, technology, and innovation is crucial for strengthening Albania's innovation capacity and supporting sustainable economic growth.

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The impact of financial education and financial culture on the decision-making process of individuals in Albania

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Abstract

Purpose: *The main purpose of this study is to analyse how financial education and culture influence the decision-making process of individuals in Albania. Financial education of individuals has gained great importance in recent years. This process has a wide impact, as a good level of financial education not only affects personal financial stability, but also has significant impacts on the stability of society and the economic growth of the country. Various studies have shown that individuals with a high level of financial education are close to informed and sustainable decisions in the financial field. Also, financial culture, which includes saving practices, time payments, and risk management, play an important role in these decisions.*

__Methodology:__ The main hypothesis of this study is that financial education and culture have a positive impact on the decision-making process of individuals in Albania. The methodology used for this study is a questionnaire, through which we aim to collect primary and original data related to this topic. This research aims to show the importance of financial education and its great impact on decision-making, encouraging a deeper discussion on ways to promote and improve financial education in all layers of Albanian society.

__Findings:__ In Albania, financial education and culture have a significant impact on the way individuals make financial decisions.

__Value:__ the paper contributes to the existing literature on the impact of financial education and financial culture on the decision-making process of individuals in Albania.

__Keywords:__ financial inclusion, financial education, decision making, financial products, financial behaviour.

Introduction

In a constantly evolving environment, the need to acquire new knowledge is important for everyone. Individuals want to make efficient decisions, especially in the field of finance, where financial knowledge is extremely important for those who want to make responsible and efficient decisions. Financial education is the process by which individuals acquire the knowledge and skills to manage their finances efficiently. This process has a profound impact on individuals' decision-making, allowing them to make carefully managed income choices, successfully manage family debt, and plan for future retirement savings. Financial education is important not only for individuals, but also for society. A population with advanced financial literacy contributes to sustainable economic growth and a strong economic market. In this study, it is intended to investigate the impact of financial education and culture on the decisions made by individuals in Albania. An important aspect of the study will be the comparison of the current results with those of a previous study in 2015, to assess the growth of financial culture among individuals.

Literature review

Financial education is the process of learning and developing financial knowledge related to income management, personal finances, and individuals' decision-making on investment. This includes knowledge of budget planning (Olano, et al., 2023) personal finance planning (Danes, Huddleston-Casas, & Boyce, 1999) knowledge and use of financial products, as well as risk distribution (Ceca, Koleniço, Isaku, & Haxhimusaj, 2014) (Augustin & Terrance K. Martin, 2023) . Financial literacy includes individuals' abilities to use their financial information and knowledge to manage resources efficiently and make appropriate financial decisions (President's Advisory Council, 2009) (Isaku, Ceca, & Koleniço, 2019). Studies have shown that with increased financial literacy, individuals make better and more sustainable financial decisions. Increasing financial knowledge helps individuals make better financial decisions throughout life (Mitchell & Lusardi, 2011) (Peng, Bartholomae, Fox, & Cravener, 2007)dhe rritja e edukimit and increasing effective financial education in high school positively affects financial futures of students (Mandell & Klein, 2007) (Walstad, Rebeck, & MacDonald, 2010) (Mandell & Hanson, 2009) (Malaj, Mema, & Hida, 2005, p. 3). Financial decision-making is the process by which the family, individual or investor chooses between different alternatives and implements decisions related to money management to enable the achievement of short-term and long-term objectives (Lleshaj, Alinj, Poppa, & Qato, 2017) (Castel, et al., 2011) (Henager & Cude, 2016) (Campbell L, 2006).

Financial inclusion has to do with the fact that financial products are known and used by the individuals of a country (Dushku, 2022). However, in Albania in 2011 only 54% of individuals know at least 5 financial products, while in OECD member countries this level is 86% (Prawitz & Cohart, 2014). (Lleshaj, Alinj, Poppa, & Qato, 2017). Saving is the process of collecting money for a specific purpose in the future. The level of savings is an important indicator of the appropriate financial capability that consumers possess (Lyons, Yunhee Chang, & Erik M. Scherpf, 2013) (Bell & Robert Lerman, 2005) (Palm, 2014). A high level of saving in an economy leads to increased investment and high levels of output (Turan & Gjergji , 2014) (Agarwal, Amromin, Ben-David, Chomsisenghet, & Evanoff, 2011) (Mitchell & Utkus, Pension design and structure, 2003). Personal finance is that part of finance that deals with the management of money or wealth of an individual or family, including the management of income, expenses, debt, investment and budgeting (Bajtelsmit, 2024) (Garman, 1999, p. 64).

Budgeting is a plan that details the expected income and expenses of a family or an individual, providing a picture of how families or individuals manage their financial resources in order to achieve financial objectives such as: buying a house, carrying out a major consumer purchase, saving for children's education, saving for retirement . (Olano, et al., 2023)t (Çera & Tuzi , 2019). Investment is the process of committing money or using other productive resources, in the present moment with the aim of realizing profit in the future. (J & S, 2015) (Hung, Parker, & Yoong, 2009) (Chakraborty & Digal, 2012) (Wood & Zaichkowsky, 2004). Interest rate is a basic financial concept which is a percentage that an individual or company receives when it deposits money and pays when it takes out a loan. According to the results made in 2011 in Albania by the OECD, it turns out that only 37.6% of the individuals who responded know how to correctly calculate the amount of money they will have at the end of the year if they deposit money in a banking institution, where they receive a certain percentage of interest (Ceca, Koleniço, Isaku, & Haxhimusaj, 2014) (Isaku, Ceca, & Koleniço, 2019).

Methodology

This research aims to examine the impact of financial education and culture on the decision-making of individuals in Albania, as well as to reach some conclusions about the financial knowledge that individuals in Albania possess, so that some valuable recommendations can be drawn from this paper on how to improve the financial education of individuals in Albania. The objectives of this research paper are to understand and evaluate the impact of education and financial culture on the decision-making of individuals in Albania and to evaluate and analyse whether the financial knowledge of individuals has progressed or not by comparing the results of this project with the results published by the OECD in 2015. The methodological tool used to generate data is a structured questionnaire, created in Google Forms, which is based on the works of the authors Kliti Ceca, Arlinda Koleniço, Egnis Isaku & Borana Haxhimusaj; who used the questionnaire created by INFE in order to measure the education and financial culture that individuals of a certain country possess. Completion of this questionnaire was made possible through the Google Forms platform, the link of which is randomly given to different individuals to participate in the study.

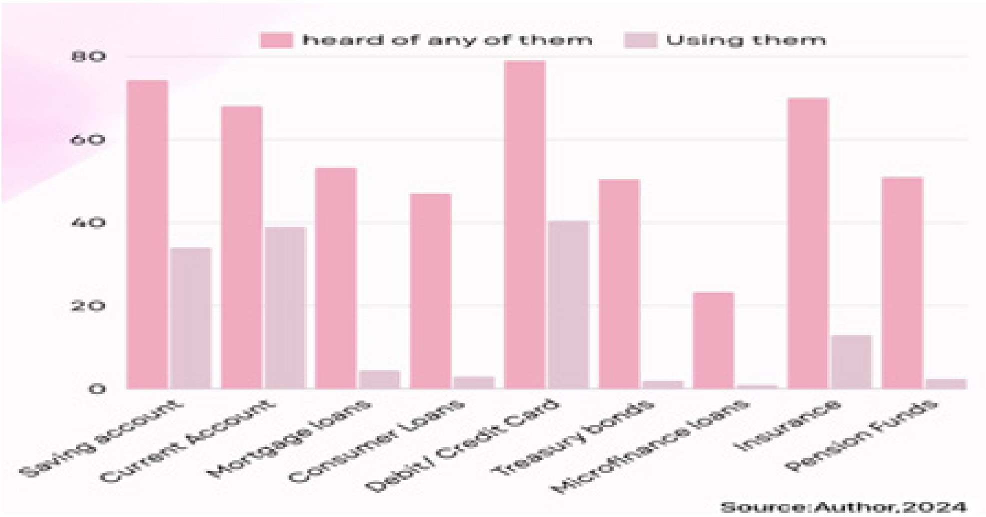
Empirical analyses

The socio-demographic category gives us a clearer picture of the main characteristics of the respondents. 75% of respondents are women while the rest are men. According to the collected data, 83.3% of the surveyed individuals belong to the age group of 18-30 years, 6.2% belong to the age group of 31-45 years, 8.6% belong to the age group of 46-64 years

and 1.9% are over 65 years old. According to the collected data, it turns out that 86.7% of the respondents have a higher education, 9.5% have completed secondary education and only 3.8% have a lower education. Regarding the employment status, it turns out that 50% of the respondents are students, 35.1% are employed and 12.9% are unemployed. In terms of income level, incomes under 40,000 ALL prevail with 48.6%, 33.8% of respondents have incomes from 40,001-80,000 ALL, 80,001-120,000 are 11.9% of respondents and 5.7% have incomes over 120,000

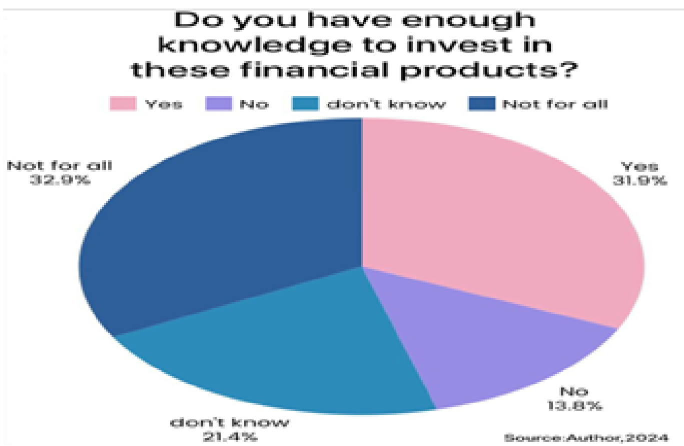
ALL. This predominance in the low level of income comes because 50% of respondents are students and do not work.

GRAPHIC 1: Have you ever heard, and have you used any of the following financial products?



Financial inclusion has to do with the fact that financial products are known and used by individuals in a country. From the analysis of the responses of the respondents, the most popular and used financial products are debit/credit card, current account and savings account, while the least known and used product is the microfinance loan. This result of not knowing and not using microfinance loans may have come because of the young age group surveyed, who are less familiar with loan products.

GRAPHIC 2: Financial knowledge.



From the analysis of this graph, we see that only 31.9% of the respondents have the knowledge to invest in these financial products, and 32.9% do not have sufficient knowledge for all financial products.

TABLE 1: Chi-Square test and Correlation coefficient.

	The level of knowledge in financial products			
	Have knowledge	Have some knowledge but not enough	Have no knowledge	Total
Female	42	50	48	140
Male	21	18	21	60
Total	63	68	69	200
	Expected values			
	Have knowledge	Have some knowledge but not enough	Have no knowledge	Total
Female	44.1	47.6	48.3	140
Male	18.9	20.4	20.7	60
Total	63	68	69	200
	Chi Square	**0.689731471**		
	Pearson	**0.990698204**		

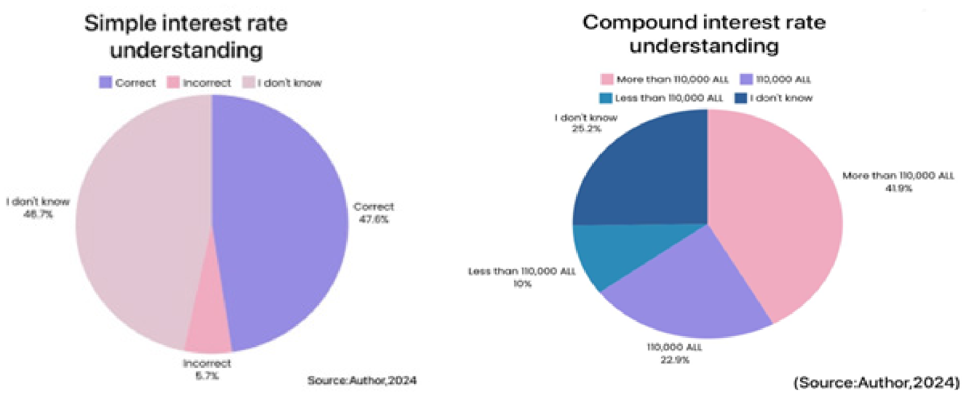
Source: Author, 2024.

From the analysis of the Chi-Square test and the correlation coefficient, in which the independent variable was the gender, and the dependent variable was the level of knowledge to invest in these financial products, the Chi-Square is 0.689731471. since it is greater than p-value 0.05, it is concluded that there is no statistically significant relationship between these two variables, so gender does not affect the level of knowledge.

A very important component of financial culture is that individuals possess basic financial knowledge and use it appropriately and accurately. A good level of financial knowledge possessed by the individual helps them to compare and find the differences between financial products and make the right choices. To understand the ability of individuals to calculate the simple interest rate, individuals were asked in this way: "Suppose you have placed 100,000 ALL in a savings account with a guaranteed interest of 2% per year. If you don't make other payments or withdraw money from the account, what will be the amount in the account at the end of the first year, after the interest payment has been made?". The results showed that 47.6% of respondents answered correctly, 5.7%

answered incorrectly and 46.7% answered “I don’t know”. From the analysis of the answers according to employment status, we notice that students, employed and self-employed mostly answered correctly, while the unemployed and retired individuals answered more with “I don’t know”. While according to age groups, the over 65 age group possesses less knowledge about the simple interest rate as only 25% of the over 65 age group have calculated it correctly. The age group that has the highest percentage of financial knowledge is the age group of 46-65 years with 83.3% correct answer.

GRAPHIC 3: Simple interest rate understanding
and Compound interest rate understanding:

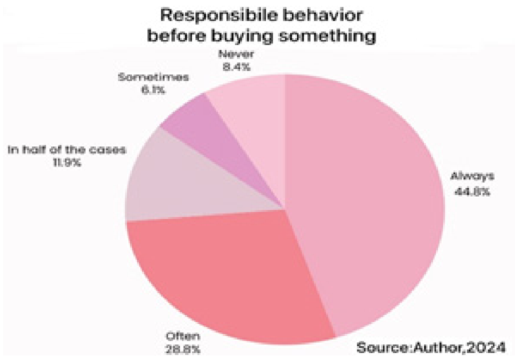


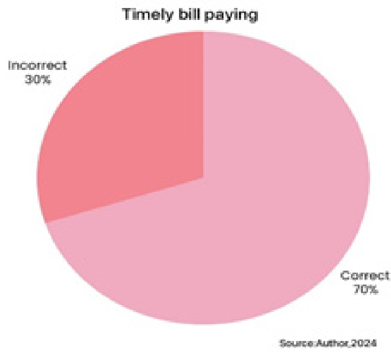
According to the socio-demographic characteristics, the age group of 31-45 years has the highest percentage of the correct answer about compound interest rate. The over 65 age group has the highest percentage of those who do not know the answer at 50%. This result happened because this age group showed that there was less knowledge about financial products. On average, 40% of the 18-65 age group think that the correct answer is ALL 110,000, which shows that individuals in Albania confuse the simple rate with the compound interest rate.

Other important financial concepts that will be addressed in this paper are diversification, inflation and risk. in the questionnaire, the following 3 statements are set, and individuals must answer with Correct or Incorrect. “An investment with high interest (profit) is likely to present high risk.” “High inflation means the cost of living is rising fast”, “If you save in 2 or more ways, you will be less likely to lose your money”. The analysis of the answers shows that about 80% of the respondents answered correctly to these concepts. so, we conclude that individuals in Albania understand precisely and clearly these three concepts. By analysing the answers given in relation to the age group, it’s notice that individuals over 65 years old are the ones who make the most mistakes in relation to these financial concepts.

A key component of financial culture is financial behaviour. It is very important to analyse how individuals behave in their daily lives regarding financial matters, decision-making and managing their money, which has a clear impact on their financial well-being.

GRAPHIC 5: Responsible behaviour before buying something.





Responsible behaviour before buying something, refers to the cautious approach of individuals to the purchase decision-making process. Not following a responsible behaviour before buying or spending can endanger the stability of personal or family finances and can have impacts on their short-term and long-term objectives. In the questionnaire, respondents were asked if they consider income before making a purchase. Based on the survey results, 70% of participants always consider if they can afford it financially a purchase, while 21% do this "often". On the other hand, only 9% take this into consideration. Timely payment of invoices is a very important indicator for measuring financial behaviour, since non-payment of invoices affects personal finances and therefore the behaviour of individuals. 75.2% of respondents always pay their bills on time, while 3.3% of them say they do it "sometimes" and only 0.5% say they never pay them on time. The study did not identify any differences in the behaviour of individuals to pay bills on time based on gender, employment status or income level.

TABLE 2: Chi-Square Test and Pearson coefficient:

	Always	Often	Sometimes	Maybe	Never	Total
Less than 40 000 ALL	73	22	1	6	0	102
Over 120 000 ALL	8	0	1	3	0	12
80 001- 120 000 ALL	18	5	0	2	0	25
40 000 - 80 000 ALL	48	17	4	17	0	61
Total	147	44	6	28	0	210
	Always	Often	Sometimes	Maybe	Never	Total
Less than 40 000 ALL	66.64	19.94	2.72	12.69	0	101.99
Over 120 000 ALL	7.84	2.34	0.32	1.49	0	11.99
80 001- 120 000 ALL	16.33	4.88	0.66	3.11	0	24.98
40 000 - 80 000 ALL	56.1	16.81	2.29	10.7	0	60.9
Total	146.91	43.97	5.99	27.99	0	209.86
		Chi Square	**0.03357598**			
		Pearson	**0.98381321**			

Source: Author, 2024.

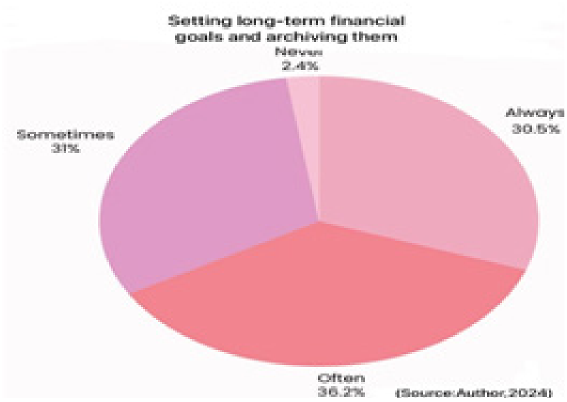
The independent variable is income level, and the dependent variable is the responsible behaviour of individuals before buying, and the result of the test is Chi-Square 0.03357598 and the Pearson coefficient 0.98381321. In our case, Chi Square < 0.05, which means that there is a statistically significant relationship between the level of income and the decision to buy considering the income they have available. This means that generally individuals try to manage their money well. In terms of the Pearson correlation coefficient, which is 0.98381321, which means there is a strong positive correlation between these two variables.

An emergency fund is a reserve fund of money saved to cover unexpected expenses, which gives the individual financial security in case of emergencies and helps to avoid debts. the question asked in the questionnaire was: "how important is it for you to have an emergency fund for unexpected expenses?" The results show that 91% of the respondents consider the creation of an emergency fund as important. While 8.1% of respondents expressed "neutral"; This is because these individuals are unsure of the importance of an emergency fund or do not consider it a priority. So, from this result we say that individuals in Albania are aware of the importance of financial security.

Another important question, part of the questionnaire is the question: "Do you have a structured plan to achieve your long-term financial goals?".

It is very important for individuals to have a structured plan to achieve their financial objectives because this plan defines personal objectives, planning how these objectives will be achieved. Also, the drafting of this plan brings a better management of finances, improvement of financial decisions, reduction of risks as well as discipline. So, financial planning is an important tool to achieve financial stability and the realization of financial objectives.

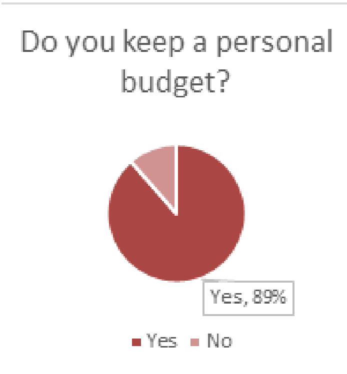
GRAPHIC 7: Setting long-term financial goals and archiving them:

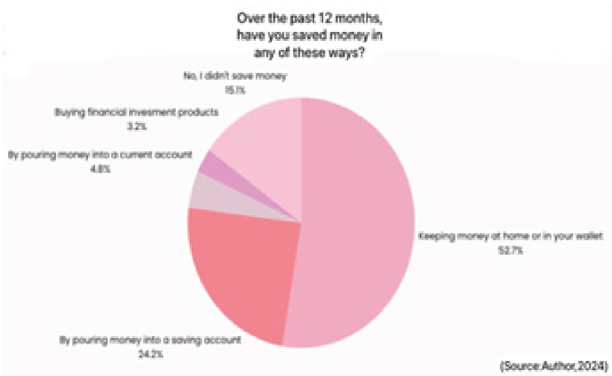


According to the results, 30.5% answered with "Always" and 36.2% answered with "Often", while 31% with "Sometimes" and 2.3% with "Never". So about 65% of individuals in Albania are inclined to have a plan to fulfil their financial objectives. When we group the data according to some socio-demographic indicators, we notice that gender does not affect the results, as both genders have rated about 62% "Always" and "Often". When we group the data by income level, we notice that there is a direct relationship between income level and the structured plan to achieve financial objectives.

Keeping a personal budget is an essential practice for effective personal finance management. It is very important for the individuals of a country to maintain personal or family budgets as this brings savings and investment incentives, economic stability, poverty reduction and increases responsibility in consumption. The question addressed to the respondents is: "Do you keep a personal budget?", where 88.6% answered "Yes", and 11.4% answered "No". This result shows that keeping a personal budget is a common behaviour of individuals in Albania.

GRAPHIC 8: Do you keep a personal budget? Over the past 12 months have you saved money in any of these ways?



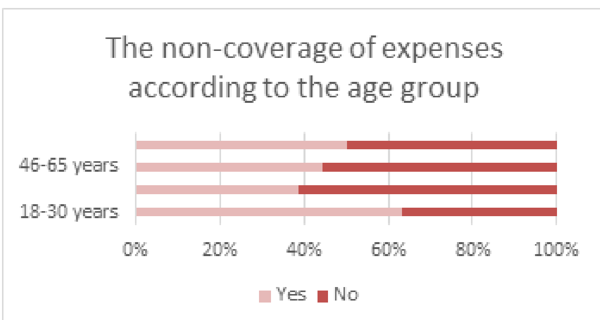


According to the analysis using socio-demographic factors, it turns out that there are no significant differences between men and women. Divided according to employment status, it turns out that the lowest percentage of keeping personal budgets is the unemployed with 33%, and then students with 10%. It also results that for incomes less than 80,000 ALL we have 90% of individuals holding personal budgets, and with the increase in the level of income this percentage of keeping personal budgets by individuals in Albania also increases, so there is a positive relationship between them.

The question of measuring the behaviour of individuals will give us a clearer picture of budgeting skills and financial management. The first question addressed is: "Sometimes it happens that the income we have at our disposal is not enough to meet the monthly expenses. Has this happened to you in the last 12 months?".

According to the results, 60% of the respondents, which are 126 people, answered with "Yes", that is, during the last 12 months, there were cases when their income was not enough to cover expenses.

GRAPHIC 10: The non-coverage of expenses according to the age group:



Source: Author, 2024.

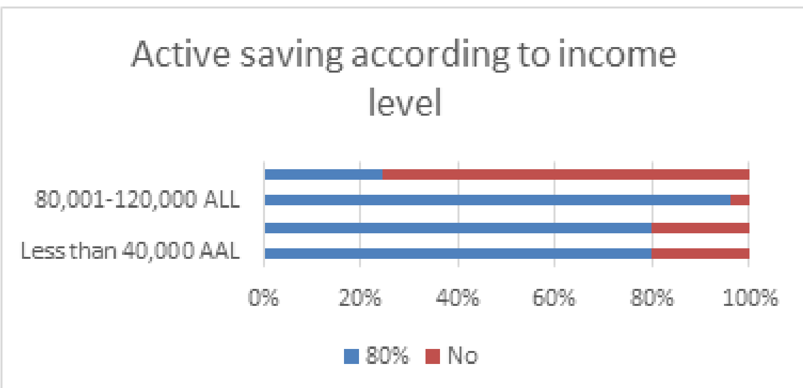
As we can see the group that has faced this situation more during the 12 months is the age group of 18-30 years old who were students, while the age group that has faced this situation the least is the age group of 31-45 years old, who are employed and receive significant income.

The follow-up question was: "If the answer to the question above is "YES", how did you act to get out of this situation?". 54.7% answered that at least once they received money from parents or relatives and 4.1% sold something of value. These two indicators show that usually individuals in Albania tend to borrow money from their relatives. 31.1% withdrew money from a savings account and 8.1% used a credit card to withdraw money. About 20.3% worked overtime to increase their income to cover monthly expenses. And about 2.8% have received an individual loan or have used or are using a border loan agreement.

Another very important indicator of financial behaviour is saving, which is a very good measure of the financial culture of a society. Saving has a direct impact on increasing financial security, reducing debt, encouraging smart investments and impacting the fulfilment of long-term financial objectives. Since individuals save at different time periods and in different ways to achieve certain future goals, this study focuses only on whether respondents save money within a one-year period, and in what way.

According to the results, 15.7% have not saved money during the last 12 months, while 84.3% have saved during this period. In terms of ways of saving: 54.8% of respondents saved by keeping money at home, 25.2% saved by pouring money into savings accounts, 3.3% saved by buying financial investment products, and 1% poured money into current account. This high percentage of savings by keeping money at home may be a result of short-term savings. We can say that individuals in Albania save mainly in the traditional way by keeping money at home or pouring money into savings accounts.

GRAPHIC 11: Active saving according to income level:



Source: Author, 2024.

Regarding the level of income, we say that individuals with an income of 80,001-120,000 ALL are the most active savers in society. While individuals with an income of less than 40,000ALL are fewer active savers, this is because this amount of money is also the minimum income to live in Albania, and this makes active saving impossible.

Comparative analysis of Financial Education in Albania in 2015 and 2024.

The financial inclusion of individuals is important in the economy of a country and is the object of study in the use of financial products. In 2015, the most popular financial product was the savings account, while in 2024 the credit card took first place. According to the results of this study, credit cards are now recognized by 79% of respondents, a very noticeable increase compared to 47.4% in 2015. Credit card usage has also increased from 23.6% in 2015 to 40.5% in 2024. This shows that credit cards have become more popular and used by individuals in Albania during these years. On the other hand, the savings account in 2015 is known by 78.6% of respondents and used by 50.9% of them, while in 2024 it is known by 74.3% of respondents and used by 34.3% of them. This decline in savings account usage can be explained by the increased use of other savings methods. Other financial products such as current accounts, mortgage loans, consumer loans, insurance, Treasury bonds and pension funds have made progress in their knowledge and use by individuals in Albania. However, the microfinance loan remains the least known and used financial product in 2015 and in 2024. Another essential concept analysed in both papers is the simple and compound interest rate. The results of 2015 and 2024 show that about half of the respondents know exactly how to calculate an interest rate, which indicates a lack of improved knowledge on this concept. For the compound interest rate, in 2015, only 29% of individuals answered exactly, while in 2024, about 41.9% of respondents know exactly. This shows an increase in the understanding of the concept of the compound interest rate. other financial concepts treated in both papers are inflation, diversification and risk. By comparing the results of this paper with the results of 2015, we conclude that the knowledge of individuals about these concepts has increased. Financial behaviour is a very important component of financial culture. From the comparison of the results, we notice that the behaviour of individuals before purchases remains the same in 2024 compared to the results of 2015. Individuals show a better financial behaviour in 2024 in relation to the timely payment of bills and the setting of financial objectives as well as the fulfilment theirs. In terms of active saving, in 2015, only 43.3% of the respondents were active savers, while in 2024, this figure went to 84.3%. This shows an increase in active savings, which shows how individuals in Albania are better managing their income and expenses, minimizing debts and increasing their investments. So, in conclusion, we notice that the level of financial efficiency and financial culture has increased.

Conclusions

This study aims to identify the level of culture and financial education of individuals. After testing the raised hypothesis, the obtained results confirmed that financial education and culture have a positive impact on safe decision-making regarding financial products by individuals. This study provides an accurate reflection of the level of culture and financial education among individuals. Individuals in Albania know and use some of the financial products, and the least known financial product is the microfinance loan. And by the Chi-Square test, it's proved that gender does not affect the level of financial knowledge. Based on the results found, individuals in Albania have good knowledge of financial concepts. However, a significant number of individuals confuse the simple interest rate with the compound interest rate. In addition, individuals in Albania show a positive attitude towards purchases, spending, payments, budgeting and saving, indicating a high level of financial culture in relation to financial behaviour. Also, it is important to emphasize that the level of income is a key factor in determining the financial behaviour of individuals in Albania. The main source of money in the case of not covering expenses is taking a debt to relatives or withdrawing money from the savings account. Also, by comparing the results of this paper with those of 2015, we concluded that the knowledge and financial education of individuals in Albania have improved.

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Private Equity and Venture Capital. Market Evolution and Operational Profiles: The Role of Financial Intermediariess

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Abstract

Purpose: *This paper investigates risk capital investment activities, in particular Private Equity and Venture Capital in the Italian financial system in comparison with the Albanian reality. It looks like a topic that apparently seems complex, but it is a simple mechanism that has spread, especially in recent years,*

Methodology: *The paper is a descriptive study of the literature of private equity and venture capital. Qualitative methods are used in the development of the paper, browsing mainly foreign literature, by reviewing different scientific papers. Firstly, the authors address the topic of Private Equity and its importance in the market, the improvement and the development of this concept, the relevant investor categories* *and the main types. After this description, the author will analyze the investment process of Private Equity, comparing the Italian market which is very developed and the Albanian market which has only introduced various initiatives at an institutional level concerning banks and businesses.*

Findings: *Comparing to Italian financial system the authors conclude that in the Albanian financial system these investments are still very rare, in fact only a few banks and ALSE carry them out. This is mainly due to the distrust that exists between people but also to the lack of familiarity with using these tools.*

Value: *This study can serve as a starting point for more in-depth studies in this field. The study also, contributes to a better understanding of this type of investments which in Albania are very rare but we think it is time to use them as an alternative to traditional forms of investment.*

Keywords: *Private Equity, Venture capital, Sustainable finance, financial market.*

Introduction

Risk capital can be defined as the portion of a company's capital contributed as equity by the entrepreneur (or by the partners in the case of a company). Since it is representative of participation in the entrepreneurial project it is also fully subject to business risk. According to Forestieri, M (2009) it can be distinguished from debt capital since the latter refers to the portion of a company's capital made up of credits granted by third parties. Risk capital does not have a minimum remuneration associated with it. According to Liuc Papers the remuneration of risk capital (for example shares) depends on the operating result achieved, while bonds give the right to reimbursement of capital and the payment of interest regardless of the operating result of the company. Furthermore, in the event of significant losses of the company with the consequent start of the liquidation procedure, first are reimbursed the creditors (for example the bondholders) and then, with the residual means, the holders of the risk capital are reimbursed (for example the shareholders). For this reason, it is stated that risk capital holders have residual rights, as their satisfaction with the company's value occurs only after the satisfaction of other capital holders. An increasing role for risk capital is essential for the prospect of consolidation of the financial structure of companies. The breadth of the unlisted venture capital circuit is made up of venture capital and private equity. By venture capital we mean the investment in the risk capital of newly established companies, while the term private equity defines the case of already existing companies when the financing is used for the strengthening of the company, the reorganization of the ownership structure or the acquisition of new businesses.

Literature review

Within this phase the following moments can be identified:

- deal flow: research and screening of investment opportunities by the operator, thanks to the support of the business plan.
- due diligence: in-depth evaluation of the company.
- closing: signing of the investment contract and shareholder agreements.
- monitoring of investment.

The deal flow

The first phase is called deal flow, according to *Strategy Punk* (2021), also known as deal origination, consists in the process of identifying investment opportunities. It's about choosing the most suitable target, so it is essential to have a consistent number of possible options, and then select the company that truly proves to be the most suitable, based on subsequent analyses. By carrying out an initial search for companies it is possible to find investment targets.

The research process, selection and identification of potential investment opportunities represents a vitally important step in the development of your business. In fact, it represents the first fundamental prerequisite of the activity itself, as, in the absence of concrete investment opportunities, it cannot be carried out.

The generation of a constant deal flow therefore constitutes an activity in which the private equity operator must regularly invest a significant amount of time and resources.

The identification of profitable investment opportunities is a very challenging and difficult objective to achieve, also because the selection process in the private equity market is typically very severe.

Investors must analyze the market, in search of companies that match the selection criteria and are willing to open their shareholding to institutional investors. Companies willing to let an institutional investor join the company decides based on the characteristics of the new possible shareholder.

In this regard, a very important factor is given by the subjective qualities of the operator-financier such as the image, notoriety and consideration he enjoys in the reference market, as well as the experience gained.

These subjective characteristics derive from the track record attributable to the operator, i.e. from the quantity, quality and type of operations carried out in the past.

The track record constitutes the fundamental element on which the investor builds his credibility in the market. In fact, a private equity operator is unlikely to be considered capable and reliable by the market in the absence of an important wealth of positive experience.

However, other factors such as the size of the intermediary or the number of shares desired by it are less important in the choice.

A good track record, however, is a necessary but not sufficient condition to generate a significant deal flow: in fact, the ability to effectively communicate and explain one's experiences and successes to the market through an adequate marketing process is extremely important.

In the research conducted by *Querci, F. (2009)* an important aspect to maximize origination capacity is the nature of the geographic market in which you intend to operate. If you intend to operate internationally, the characteristics of the management team must be perceived and recognized even outside the home.

The Business Plan is drawn up by the target company.

The Business Plan is in fact a document aimed at representing the entrepreneurial development project from a prospective perspective, with the aim of evaluating its feasibility, in relation both to the corporate structure in which this project is inserted and to the context in which the proposing company operates., and to analyze the possible repercussions on the main company choices and on its economic-financial results.

The Business Plan (or industrial plan) is the document that illustrates the strategic objectives of the entrepreneur and management, the action plans aimed at achieving these objectives and the evolution of the prospective economic and financial results. The industrial plan must also include hypotheses regarding three possible scenarios: an optimistic scenario, an average scenario and a pessimistic scenario.

It represents the first tool for contact with the institutional investor, through which the entrepreneur brings the project to the attention of the investor. For this reason, its drafting requires particular attention.

The due diligence

The second phase means an activity of acquiring the information necessary for the preparation of the documentation required by operational practice and by legislation regarding a financial instrument issuance operation.

Due diligence is a process that characterizes one of the most delicate phases of a capital market access operation (issuance); the term itself underlines the care and confidentiality with which it must be carried out.

Cheffins, B & Armour, J. (2007) illustrates further that the objective of due diligence is to bring together two opposing interests: that of the company, which, in order to acquire new resources, must make the subscription of its securities interesting, and that of institutional and retail investors, who need to evaluate the profile risk-return, but they do not have all the information.

Conducting due diligence is different in a share placement transaction than in a bond placement transaction.

In the first case it is aimed at highlighting the increase in value that can be achieved with the capital raised, and the potential critical issues, while from the bondholder's point of view it tends to underline the stability of the cash flows produced by the issuer and the low volatility of its characteristic activity.

Due diligence is carried out by the lead manager, with the collaboration of the issuer, lawyers, auditors and advisors and requires careful investigations aimed at guaranteeing the market that all relevant information regarding the company is true and complete.

As articulated by *Michelini, C.* (2021) exists a various type of due diligence can be distinguished and in particular:

- Due Diligence Management consists of a series of meetings with the company's management staff to find out the main operational and financial aspects of the business as well as future plan.
- Legal Due Diligence, carried out by the investment bank's lawyers with the coordination of the issuer's lawyers, in which everything of legal relevance is examined.
- Financial Due Diligence, aimed at analyzing, with the issuer's audit firm, the quality and sustainability of the financial data, as well as the adequacy of their representation in the offering documents.
- Fiscal Due Diligence verifies tax liabilities and makes suggestions for the tax structure of the operation.
- Environmental Due Diligence identifies potential liabilities in the environmental area, analyzes compliance with the legislation in force and the internal procedures required by law.

From a procedural point of view with reference to due diligence, two fundamental moments can be distinguished: the drafting of the due diligence check list and the data room procedure.

Due diligence is in all respects a real risk management tool, which generates its positive effects over time. It should be noted that superficial due diligence can lead to ignoring potential risks arising from the deal and the failure of the operation.

Bentivogli, C et al. (2006), in the private equity sector, conclude that due diligence takes even more importance due to the physiological lack of in-depth information publicly available on the target company. For these reasons, although costly in terms of time, in-depth due diligence brings out any critical issues and their sources in detail, ensuring greater flexibility in correcting such problems. In-depth due diligence allows the parties to arrive at the negotiating table with a comprehensive information framework and to be able to carry out a negotiation in a professional manner based on objective and independently verified data and information.

In the research conducted by *Campanella G. & Ricciotti W.* (2019) if the final due diligence report highlights unexpected issues, hidden liabilities, or excessive risks, it could lead to substantial revisions to the company's price or, in extreme cases, the termination of negotiations.

To avoid the onset of disputes after signing the contract, it is advisable to carry out due diligence in advance, even if it is often not possible to have complete access and full disclosure of sensitive data in the per-contractual phase.

The internal rate of return equals the present value of expected cash outflows to the present value of expected cash inflows. It is therefore that rate that makes the net present value (or Net Present Value, NPV) equal to 0.

The calculation of the internal rate of return is used to evaluate the convenience or otherwise of an investment: the internal rate of return is compared with a threshold rate of return, called the acceptance rate or cut-off rate. It is worth making the investment if the internal rate of return is greater than the acceptance rate.

The IRR calculation involves the use of an iterative procedure.

The closing

Closing refers to the final phase of the investment process.

A key phase of the investment process in private equity operations is represented by the evaluation of the target company. The attribution of a specific value to it represents the starting point of the subsequent negotiation between buyer and seller, which ultimately results in the price at which the deal closes.

Once the most suitable company has been selected according to the parameters that have been set out, the next step is the definition of the purchase price: the sale value of the company, as expressed by the actual price, is generally different from the relative value of economic capital due to the negotiation and bargaining power of the parties.

There is, in fact, a notable difference between the value of the economic capital and the transfer value (expressed by the price): the value of the economic capital represents the theoretical value estimated based on the current conditions of the company and the development forecasts relating to the strategy currently pursued ; on the contrary, the transfer value is a certain data since it expresses the actual transaction price as a result of the negotiation.

According to A.Gervasoni and *F.L.Sattin* (2022)The value of the economic capital, although different from the transfer value, represents the basis for determining the latter.

As regards the definition of the transfer value, it also depends on the trading conditions. Therefore, after having estimated the value of the economic capital, the transfer price is defined through negotiation between the parties based on the relative contractual strength and specific interests.

The final selling price is established at the end of the buying and selling process.

It is possible to state that in most cases the final sales price can be placed between the value of the economic capital of the company and the value given by the sum between the value of the economic capital of the company and the value of the benefits for the buyer.

The positioning of the selling price within the range depends on the bargaining power of the seller and the buyer.

The greater the contractual strength of one of the two counterparts, the more the final sales price will be in favor of the latter.

Having said this, it is also important to underline that an intrinsically objective evaluation does not exist, just as there is no single and unambiguous value; a certain degree of subjectivity is in fact physiological in the evaluation, as the various methods proposed by the theory presuppose a series of hypotheses, assumptions, estimates and conjectures, which have at least partly a subjective content.

During the closing phase, the introduction of price-related instruments is negotiated and the shareholder agreements to be introduced in the statute are drawn up. This is a delicate phase that affects the success of the negotiation, the relationships between the entrepreneur partner and the institutional investor and above all the future of the target company.

If a minority shareholding is acquired there are pre-emption agreements, but if the acquired shareholding is a majority shareholding there are:

- governance agreements.
- disinvestment agreements.

Monitoring of the investment

This phase is extremely important since the private equity investor must monitor the investment in order to enhance the value of the stake held.

The level and methods of monitoring private equity investors are different based on the orientation of the investor himself: some investors are limited involved in the management of the invested company, while others present a gradually increasing degree of involvement. Based on these differences, the focus of the contribution shifts from the financial aspect to the more managerial one, through participation in the formulation and evaluation of strategies.

This distinction is also reflected with reference to the type of operation: depending on the life cycle phase that the invested company is going through, a different type of intervention will be necessary.

The advantages of investing in PE

- Investments in Private Equity (PE) have on average outperformed the stock market indices.
- Absolute return: managers aim for absolute return and their form of incentive, over performance, carried interest, is aimed at maximizing the return for investors.
- Portfolio diversification: PE returns and stock index returns have a low correlation.

The disadvantages of investing in PE

- Liquidity risk: the investor does not have the possibility of disinvesting his share before maturity
- High commitment: the minimum investment required can make the investment opportunity unattractive for most private investors.
- Very wide dispersion of returns: in certainty in choosing the fund in which to invest.

Divestment

Divestment consists of the total or partial transfer of the stake held by the investor, who, in some cases, may also decide to retain a minimum share of capital in the company on a more permanent basis.

More and more often, however, investors try to predict, at the time of purchasing the shareholding, any exit channels and realization times, in order to better plan this final phase of the operation as well.

In successful cases, disinvestment is made when the company has reached the expected level of development and the value of the company, and therefore of the shareholding, has consequently increased.

According to *Giorgio DI GIORGIO, Massimo DI EDOARDO*(2008) in the event that the initiative fails, because, for example, the new product or new technology fails to establish itself on the market, disinvestment is made when the conviction matures that it is no longer possible to resolve the crisis situation that has been created.

In both situations, the times and methods of disinvestment are usually defined with the agreement of all shareholders.

There are different methods of disinvestment, depending both on the type of business and operation previously implemented, and on the results achieved.

Methodology

This study is descriptive qualitative research based on secondary sources. Making a comparison between the Albanian financial system and the Italian one whose data were taken from the Italian Association of Private Equity, Venture Capital and Private Debt in recent years there is a tendency for this sector to develop more and more unlike Albania who have not experienced any typical operation of private equity funds, at least in the form known and applied in the United States, or anywhere in the world.

Indeed, there are substantial institutional elements that have been missing and are currently missing and the lack of an established and functioning stock exchange in Albania can be perceived as an obstacle to the creation and operation of such initiatives, within the financial market.

Normally, the presence of PE/VC requires a functioning capital market or stock exchange, as should be the destination of companies financed and supported by PE/VC, and at the same time, the market is the best evaluator of their performance.

Research questions:

1. How has the Albanian financial system evolved over the years and why invest in risk capital?
2. What are the instruments used to invest?

Venture Capital, and Albanian financial system

The "early stage financing" phase refers to:

- the period prior to the creation of the company in which the capital is used to finance an idea or project yet to be tested ("seed financing" or "incubator");
- at the subsequent moment of its birth in which, having already developed the product as a prototype and tested with appropriate market research, its production activity begins in line with the forecasts of a business plan ("start-up financing") ;
- at the very first stage of development in which the commercial validity of the product/service is fully assessed ("first stage financing").

In the innovation process characterizing this stage, the investor's financial, managerial and above all technical-scientific skills contribution is fundamental, contributing significantly to the creation of new products/processes or the improvement of existing ones, sharing the high business risk.

To illustrate further, Dell'Acqua A and Previtero A(2006) , the "expansion financing phase" (also called "growth stage financing" or "development capital"), has as its objective is to promote the development of the company:

- internally, increasing or diversifying its production capacity;
- externally, by acquiring other companies or business branches;
- through vertical or horizontal integration with other companies, characterized by the potential inter-dependencies that can be achieved in terms of products or markets ("cluster ventures").

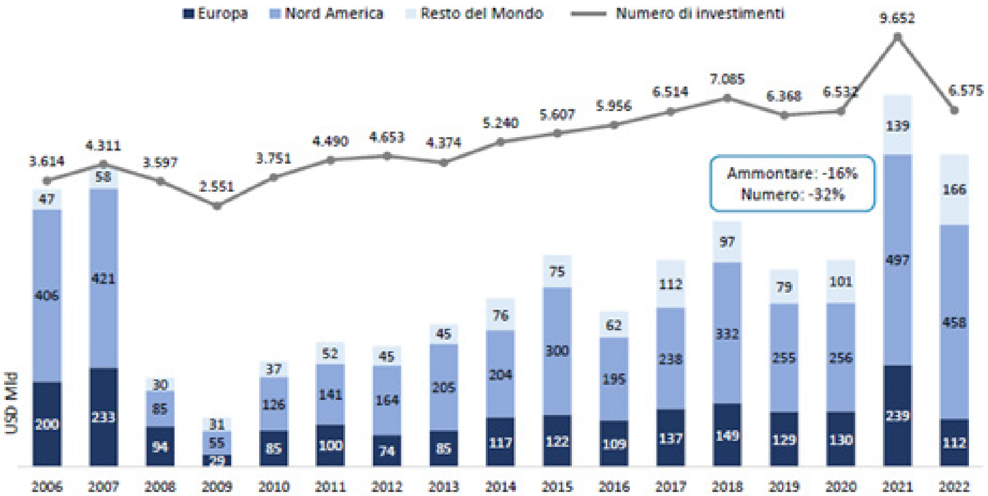
The prerequisite for such interventions according to Giordano L, Modena M(2017) is the validity of the entrepreneur and the sustainability of the company's development plan, which, as a rule, is agreed upon entry. A further requirement for such interventions is represented by the rapid growth prospects of the company or business in question and the presence of an entrepreneur with valid development projects and/or patents that need to be marketed.

The benefits for companies of a venture capital intervention are summarized in the economic effects it produces.

The peculiar characteristics of Venture Capital activity, understood in its narrowest sense (referring only to the start-up and initial development phases), are:

- participation in the equity of a company that has a high development potential thanks to the creation of new goods, services or production processes;
- the achievement of a high capital gain that allows the high risk that the investor has taken on to be remunerated;
- the temporary nature of the investment, even if with a medium-long term perspective;
- the contribution by the investor not only of financial capital, but also of managerial know-how and technical-scientific knowledge that favor the achievement of growth objectives. Furthermore, the company that is financed by an institutional investor can take advantage of a vast network of contacts and collaborations to which it would not normally have had access, as well as gaining credibility in front of all its stakeholders and any possible interlocutor.

FIGURE 2. Evolution of the amount invested (international)



Source : AIFI

As we can see, this latest graph illustrates the situation of international investments in the period between 2006 and 2022 even if in the last year they have decreased in Europe and North America even if they have increased in the rest of the world.

By making a comparison between the Italian and Albanian financial systems it is possible to glimpse that the Italian one is much more developed and articulated and that many investments have been made which have produced a lot of profits even if it is a young phenomenon but one which is reaching great importance. However, in the Albanian financial system these investments are still very rare, in fact only a few banks and some companies such as the ALSE sh.a stock exchange carry them out, this is mainly due to the distrust that exists between people but also to the lack of familiarity in using of these tools.

Albania and its respective financial system have not experienced any typical operation of private equity funds, at least in the form known and applied in the United States, or anywhere in the world.

Indeed, there is a lack of substantial institutional elements that have been and are currently missing and the lack of a consolidated and functioning stock exchange in Albania can be perceived as an obstacle to the creation and functioning of such initiatives, within the financial market.

Normally, the presence of PE/VC requires a functioning capital market or stock exchange, as should be the destination of companies financed and supported by PE/VC, and at the same time, the market is the best evaluator of PE performance /VC.

However, several initiatives have been introduced at an institutional level in the Albanian financial market.

Many studies such as Elvin Meka (2021), show that the Albanian Reconstruction Equity Fund (AREF) was established by the EBRD and the Italian government, with a total capital of $14 million to support the restructuring and expansion of private businesses (OECD 2003).

Additionally, the Albanian American Enterprise Fund (AAEF), funded by the US government through a USAID grant, provides financing to medium and large-sized businesses ($30 million).

Although incorporated as a non-profit organization, the AAEF is managed as a private investment fund to maximize risk-adjusted returns.

During its activity in Albania, the AAEF has invested in a wide range of private businesses.

Additionally, AAEF provides its portfolio investments with training to establish best business practices that incorporate acceptable financial data reporting standards, as well as guidelines for improving management capabilities, recruitment of qualified personnel and strategic planning.

However, the most successful PE initiatives in Albania were those related to the purchase of BKT (known as the National Bank of Commerce), the establishment of the American Bank of Albania (now part of Intesa Sanpaolo Bank – Albania and the American Investment Bank.

Elvis Bregu (2019) it shows that in 2017 the ALSE sh.a Securities Exchange becomes the first Albanian private equity company authorized in our country.

Sustainable And Responsible Investment

By "sustainable and responsible investment" we mean "an investment strategy oriented to the medium-long term which, in the evaluation of companies and institutions, integrates financial analysis with environmental, social and good governance analysis, in order to create value for the investor and for society as a whole.

Sustainable and Responsible Investment strategies

Below we report the six strategies present in the Italian market:

Exclusions

Approach that provides for the explicit exclusion of individual issuers or sectors or countries from the investable universe, based on certain principles and values. Among the most used criteria: weapons, pornography, tobacco, tests on animals.

International conventions

Selection of investments based on compliance with international norms and standards. The most used standards are those defined by the OECD, UN or by

UN agencies (including ILO, UNEP, UNICEF, UNHCR). Examples include: the Global Compact, the OECD Guidelines on multinationals, the International Labor Organization Conventions.

Best in class

Approach that selects or weights the issuers in the portfolio according to environmental, social and governance criteria, favoring the best issuers within a universe, a category or an asset class.

Thematic investments

Approach that selects the issuers in the portfolio according to environmental, social and governance criteria, focusing on one or more themes. Some examples: climate change, energy efficiency, health.

Engagement

Activity that takes the form of dialogue with the company on sustainability issues and the exercise of voting rights connected to participation in the share capital. This is a long-term process, aimed at positively influencing the company's behavior and increasing the degree of transparency.

Impact investing

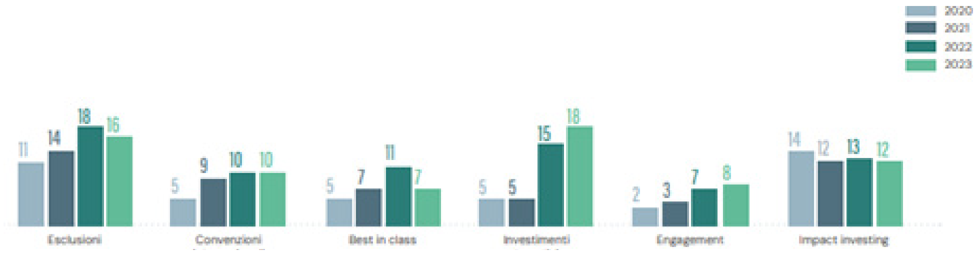
Investments in businesses, organizations or funds with the intention of achieving a positive environmental and/or social impact, together with a financial return. It can be implemented in both emerging and developed countries.

Some examples: investments in microfinance, social housing, renewable energy

When accounting for the SRI strategies adopted, it must first be reiterated that the inclusion of ESG criteria can occur according to multiple strategies: they are not self-excluding and can be applied to the same investment portfolio in the different asset classes. Furthermore, it is noted that, among the 29 Foundations active in the SRI (Socially Responsible Investment) field, one entity is not able to provide detailed information regarding the strategies adopted for the different asset classes and another, despite including ESG criteria in its investments, has not yet defined specific sustainability strategies. Therefore, the two respondents were not included in the analysis relating to this section of the questionnaire.

Thematic investments are the most used strategy by Foundations (cited by 18 institutions), especially in alternative asset classes; Next, the strategy from the exclusions is indicated.

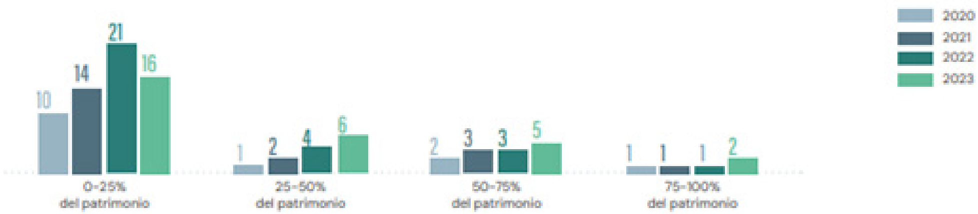
FIGURE 3. SRI strategies adopted



Source:Forum for Sustainable Finance

The majority of Foundations active in the SRI field (55% - 16 out of 29) limit sustainable investments to a minority share of assets under management; however, the figure is decreasing compared at the 2022 edition, in which they stood at 72% (21 out of 29). Conversely, the number of Foundations that adopt SRI strategies on a portion of assets exceeding 25% is increasing. In particular, 6 institutions extend sustainable investments to a share between 25% and 50%, another 5 Foundations hold sustainable investments at 50%-75% of the assets and 2 institutions extend the SRI quota to almost the entire portfolio, with a coverage rate between 75% and 100%

FIGURE 4. Coverage rate of sustainable investments



Source:Forum for Sustainable Finance

Conclusion

In conclusion, investment activities in risk capital, therefore Private Equity and Venture Capital funds, will not be limited to a simple financial contribution but their commitment will go further by acting as a real support to the entrepreneur.

But there are also disadvantages, 1) liquidity risk: the investor does not have the possibility of disinvesting his share before the maturity, 2) the high commitment: the minimum investment required can making the investment opportunity unattractive for most private investors and 3) the dispersion of returns very wide: uncertainty in choosing the fund in which to invest.

By making a comparison between the Italian and Albanian financial systems it is possible to glimpse that the Italian one is much more developed and articulated and that many investments have been made which have produced a lot of profits even if it is a young phenomenon but one which is reaching great importance.

The absolute certainty remains of the decisive influence of these funds in the companies in which they decide to invest and of the multiple possibilities they give these to survive, grow and expand in an economic context like today's.

Usually when we talk about risk we think of something negative and that no one wants to take on but as we have seen there are various advantages that can be obtained from these investments: an absolute return, in fact managers aim for absolute return and their form of incentive, to out performance, carried interest is aimed at maximizing the return for investors, there is a diversification of the portfolio: the returns of Private Equity and the returns of stock indices have a low correlation, it can facilitate the growth of SMEs, favoring the access to financial markets or accompany generational change and contribute to the strengthening of the managerial structure.

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