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*Proceeding Paper*

## CHALLENGES AND FACTORS AFFECTING THE SUSTAINABLE DEVELOPMENT OF SME-s IN ALBANIA

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**Abstract.** Small and medium-sized enterprises (SMEs) are crucial for the economic development of a country, playing an important role in job creation, poverty alleviation and economic growth. SMEs play a major role in most economies, particularly in developing countries. SMEs account for the majority of businesses worldwide and are important contributors to job creation and global economic development.

In Albania, SMEs represent more than 99% of the total number of enterprises and the percentage of employees in this sector is 82% (INSTAT, 2023). For this reason, identifying factors affecting the development of SMEs in Albania is very important, in order to take all the necessary steps to reduce barriers as well as create opportunities and facilities for supporting this sector. Small and medium-sized enterprises play an important role in the development of the national economy, influencing sustainable growth in the agriculture, services, trade, and production sectors. They are major contributors to value creation across all sectors.

The development of SMEs, especially in transition countries faces several difficulties such as limited access to finance, increased competition, low research and development costs, high levels of exposure to risk, technological change, and capacity constraints related to knowledge and innovation. As an important factor for economic growth and employment, it is important to evaluate the performance of SMEs in the country as well as the constraints and challenges they face.

The purpose of this study is to analyze and evaluate the factors that affect the sustainable development of the SMEs sector. The findings of the study are relevant to government, policymakers and managers to address these challenges, to encourage and offer support to SMEs' development through their strategies.

**Keywords:** SMEs; challenges; sustainable development; competitiveness, strategies.

**JEL Classification:** D24; L22

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### Introduction

Small and medium enterprises (SMEs) are an important driver of economic development, in most economies across the world, particularly in developing countries (Ndiaye et al., 2018). SMEs are important for all developing countries, especially those facing major employment and income distribution challenges.

Small and medium enterprises operate in the agriculture, services, trade, transport, accommodation and manufacturing sectors. It is important to emphasize the importance of small

enterprises in the economy, referred to their contribution to employment, innovation and economic growth.

The development of the SME, associated is with several problems related to the financing of their activity, diversification of products and services, increased productivity, low research and development costs, high levels of exposure to risk, human resources management and implementation of new and innovative technologies (Tomorri et al., 2018). Promoting entrepreneurship, improving the business environment, and facilitating access to finance, constitute some of the main directions for the development of the private sector. Economic stability is essential in improving access to SME financing and creating a friendly climate to business activity.

According to INSTAT (2023), SMEs constitute the largest part of businesses over 99% and significantly affect the economic development of the country and the number of employees. International Finance Corporation (IFC, 2017), argues that the state should promote SMEs because of the great benefits of their economy compared with large enterprises in terms of creating jobs, efficiency and economic growth.

The development of the SME sector is considered one of the most efficient sectors for the Albanian economy that generates sustainable economic growth, increases employment rate and reduces poverty levels. Our country has experienced rapid growth in lending in recent years, but banks prefer to lend to large businesses with a positive experience in the field of lending and who have sufficient collateral. However, SMEs have limited access to financing their activity from financial institutions, due to the lack of collateral, weak solvency, bank-borrower relations, and transaction costs (Asai, 2019).

Small and medium enterprises are considered as a source of innovation because they are flexible, dynamic and sensitive to market demand compared with large businesses. In contrast to large corporations, SMEs are much more flexible in terms of income distribution and better adaptability to market fluctuations and new customer demands, while their organizational structure allows for faster decision-making.

According to the SME Policy Index: Western Balkans and Turkey 2022, Albania has made good progress in implementing the Small Business Act (SBA). Thus, through national policies, and start-up financing programs or business incubators, SMEs have been encouraged and stimulated to develop, grow and support the economy and local, regional and national activities. Albania's operational environment for SMEs remains the most advanced in the region. Albania has achieved its highest average scores in the following areas: institutional and regulatory framework for SME policy making; operational environment for SMEs; public procurement; standards and technical regulations; and internationalisation of SMEs (OECD, 2022). Creating a positive climate affects the development of the SME sector by encouraging their competitiveness in the regional and global markets.

Considering the importance of SMEs in transition economies, the government, policymakers and other stakeholders should work intensively to strengthen the role and development of SMEs in the national economy.

The objectives of this study are:

- Evaluation of the role of small and medium-sized enterprises in the economic development of the country.
- Evaluation of SMEs contribution to economic growth and employment level in the Albanian economy,
- Identification of factors as well as challenges for the development of the SME sector in the future.

### **Literature Review**

Small and medium enterprises (SMEs) are vital to most economies across the world, particularly in developing countries. In recent years, the role of economic enterprises, especially small and medium-sized enterprises in developing countries, has increased. They are considered the most dynamic and vulnerable businesses in the global economy and are critical to the development of a country because they play an important role in economic growth, the number of employees and the reduction of poverty (Ayyagari et al., 2014).

The development of the SME sector is considered an effective instrument in transition economies, which generates sustainable economic growth, creation of added value, increasing the number of employees and reducing poverty.

SMEs are not only an important source of job creation in developing countries, but they can also become a source of innovation and increased productivity (Hansjörg & Zeynep, 2018). SMEs significantly contribute to the development of communities in rural economies in countries all over the world. The role of SMEs in enhancing local development is more important to overcome poverty, inequality, and unemployment in rural areas (Fiseha & Oyelana, 2015).

The importance of entrepreneurial SMEs is recognized globally, but their role is particularly important in developing economies (Karadag, 2016). SMEs contribute to the economy by stimulating employment, increasing production, transferring new technologies, etc (Rehman et al., 2019).

SMEs in transition economies reduce the surplus in labour development, restructure economies in different sectors and transform the social structure. It is important to acknowledge the problems facing growth among entrepreneurial SME businesses in developing countries because they are fundamentally different from those faced by developed countries (Khan, 2022).

SMEs make up over 90% of business and comprise more than 50% of the workforce worldwide (World Bank, 2020). Across the world, entrepreneurial small and medium-sized enterprises (SMEs) contribute greatly to national economies. A wide range of studies has indicated the crucial contribution of entrepreneurial SMEs as drivers of social and economic development. A strong entrepreneurial SME sector significantly contributes to a country's economy, adding to GDP by lowering the concentration of poverty and reducing the level of unemployment, and entrepreneurial SMEs play a vital role in developing a country (Sarwar et al., 2021).

Small and medium-sized enterprises (SMEs) make crucial contributions to job creation and income generation (Endris & Kassegn, 2022). Research studies have highlighted that SMEs are faced with issues such as ineffective leadership, entrepreneurship education and training, lack of proper infrastructure and lack of marketing strategy that are barriers to SME growth. The promotion of SMEs has been a key area of intervention in recent years given the major employment challenges (ILO, 2015).

According to Wang (2016), several factors are identified that influence the development of SMEs. Lack of access to finance is seen as one of the important factors hindering SME innovation. The main limitations of financing are high interest rates, complex application procedures and collateral requirements.

The most challenging barriers to SMEs are access to finance and lack of adequate training and consultancy from the relevant agencies (Agheli, 2017). Other factors are lack of managerial skills: as a result, entrepreneurs may not be prepared for changes in the business environment and innovative developments, the regulatory environment, etc. As a result of the limited resources of SMEs to invest, Binek and Al-Muhannadi (2020), highlight that support from government policies and powerful market players can help small and medium-sized businesses learn more about market advantages that the European Community (EC) has to offer.

Small and medium enterprises are becoming increasingly important for the creation and development of a modern, dynamic and knowledge-based economy. This is because of their capacity to promote entrepreneurship and entrepreneurial skills, and because of their ability to be flexible and adapt quickly to a changing market, and to generate new jobs (Govori, 2013).

Small and medium enterprises have embraced technological innovations in creating new opportunities as well as expanding their businesses. Sustainability performance improvement is a problem for small and medium-sized enterprises (SMEs) due to limited resources. By implementing innovation, SMEs can take advantage of external resources to innovate in their operations, thus increasing sustainability performance (Kurniawati et al., 2022).

Along with industrial development and the improvement of the knowledge society, the use of knowledge has become the new important economic resource, which changes the approach to the performance and competitiveness of SMEs. Innovation focuses on collaboration between research and businesses, due to the need to finalize research through practical results related to technical and

technological developments (Gherghina et al., 2020). The provision of financing sources for SMEs is positively related to product innovation at the firm level and process technology (Wellalage & Fernandez, 2019).

The problems related to management are human resources, leadership, managerial skills and lack of experience, which are considered the main obstacles to the success of businesses, especially small businesses (Khan & Burki, 2020). Since SMEs play an important role in the country’s economic growth, it is essential to study and find the drivers and barriers to their sustainable development.

In the last two decades, with the development of modern technologies, there have been changes in production, communication, management skills, production methods and the distribution and organizational structure of businesses. The role of SMEs in economic development has been one of the most important discussions among government, policymakers, academics, researchers and experts in this sector (Myslimi & Kaçani, 2016).

The increase in small and medium enterprises and their impact on economic development is related to their structure and size. The SME sector has been structured over the years and is one of the most important sectors of the national economy. Small and medium enterprises differ by their size but also by their structures and business operations.

In recent years, Albania has made significant progress in terms of facilitating the procedures for opening a business in time and at low cost, support schemes, regulatory reforms, reduction of administrative barriers, tax system, etc.

In Albania, the SME sector is regulated according to Law No. 43/2022, “For the development of micro, small and medium-sized enterprises. According to this law, the classification of small and medium enterprises is made taking into consideration two criteria: i) number of employees; ii) annual turnover or total assets in the balance sheet. The enterprises are classified into: microenterprises, small enterprises and medium enterprises.

**Table 1. Map of the professional skills and competencies of the employee of the HR service of the enterprise**

	<b>EU definition</b>	<b>Albania definition</b>
<b>Micro</b>	< 10 employees EUR 2 million turnover or balance sheet	< 10 employees ALL 10 million turnover or balance sheet
<b>Small</b>	< 50 employees EUR 10 million turnover or balance sheet	< 50 employees ALL 50 million turnover or balance sheet
<b>Medium-sized</b>	250 employees EUR 50 million turnover EUR 43 million balance sheet	< 250 employees ALL 250 million turnover or balance sheet

Source: Republic of Albania, 2022

**Methods**

Small and medium-sized enterprises (SMEs) play an important role in the economic development of most economies worldwide, especially in developing countries. They are considered the most dynamic and vulnerable businesses in the global economy and are critical to the development of a country because they play an important role in economic growth, the number of employees and the reduction of poverty.

By the objectives of this study, regarding the evaluation of the role of small and medium enterprises in the economic development of the country, the challenges and factors affecting the sustainable development of the SME sector, we have used a descriptive and analytical approach about the purpose of the study.

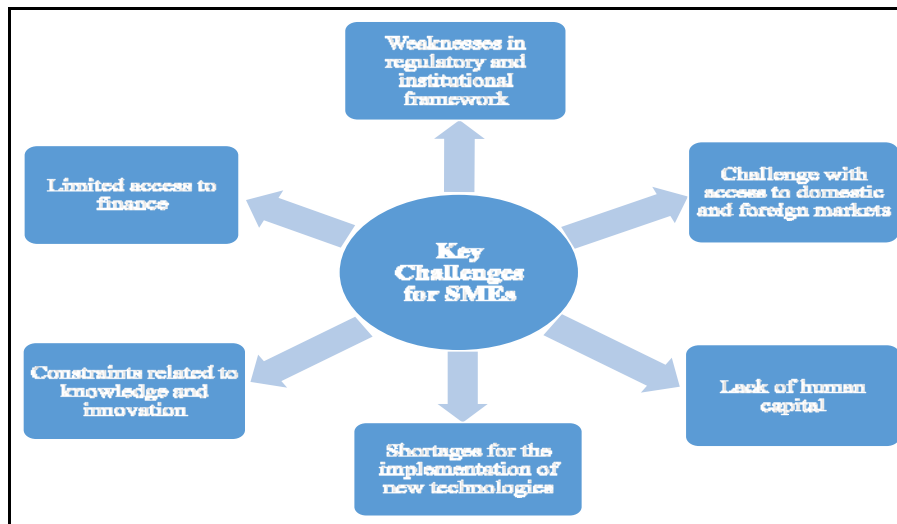
The methodology used for this study includes three phases:

- The first phase included a systematic literature review related to the purpose of the paper, which includes, research articles, papers, reports, and books from domestic and foreign authors;
- The second phase includes the collection of data published by national and international institutions such as (Institute of Statistics, Bank of Albania, EU, World Bank, OECD, ILO, etc.);

- The last phase consists of data analysis, which is structured on the logic of issues and available resources, related to the challenges and factors that affect the sustainable development of the SME sector.

We are focused on the use of the analysis method, through the collection, processing, and interpretation of data and statistical indicators related to the SME sector in the country, the problems and challenges they face, as well as conclusions and recommendations for sustainable development of this sector in the future.

The conceptual framework used for this study is based on various studies already conducted. The key challenges faced by SMEs in Albania are presented in (Figure 1).



**Figure 1. Key challenges for SMEs**

*Source: Authors' composition, 2023*

These challenges are the following: a) weakness in regulatory and institutional framework; b) challenges accessing domestic and foreign markets; c) lack of human capital; d) limited access to finance; e) shortages for the implementation of new technologies; and f) constraints related to knowledge and innovation, such as low skill levels, gender gap and leadership capacity of SMEs' entrepreneurs.

According to the SME Policy Index: Western Balkans and Turkey 2022, Albania has made good progress in implementing the Small Business Act (SBA). Thus, through national policies, and start-up financing programs or business incubators, SMEs have been encouraged and stimulated to develop, grow and support the economy and local, regional and national activities.

The economy continues to provide an environment conducive to business and is receptive to the needs of small and medium-sized enterprises (SMEs). Albania has achieved its highest average scores in the following areas: institutional and regulatory framework for SME policy making; operational environment for SMEs; public procurement; standards and technical regulations; and internationalisation of SMEs (OECD, 2022)

### **Results and Discussion**

SMEs contribute to economic development as an integral part of the national economy. Small and medium enterprises represent the main part of the entrepreneurial structure in EU countries. Through national policies and start-up financing programs, SMEs have been encouraged and stimulated to develop, grow and support the economy and local, regional and national activities. Albania's operational environment for SMEs remains the most advanced in the region.

Globalization of the economy, increased competition and changes in the external environment dictate new challenges for the development of this sector, related to the creation of innovative and competitive enterprises. Global competition has been identified as a key challenge for SMEs that makes a significant impact on business competition (Ahmedova, 2015).

In the current conditions of the Albanian economy, while the market is increasingly competitive, one of the important problems of SME development is the financing of their activity. On the other hand, the integration of Albania into the European Union dictates new challenges for

the development of this sector in terms of providing products and services, improving the infrastructure, implementing new technologies, innovative approaches, management skills, and increasing competition.

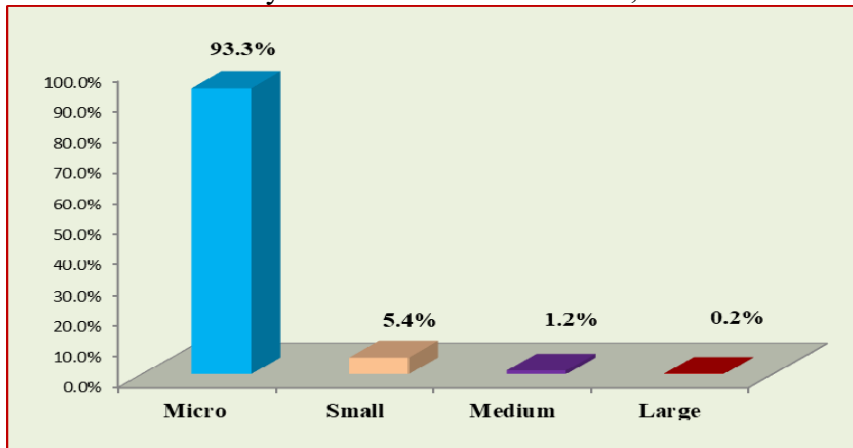
**Table 2. Data for number of enterprises, number of employed and value added by size, 2021**

No	Enterprises by size	No of enterprises	%	No of employed	%	Value added (mln ALL)	%
1	Micro (1-9 employed)	97,022	93.3%	191,250	36.8%	151,693	22.8%
2	Small (10-49 employed)	5,608	5.4%	111,318	21.4%	179,338	27.0%
3	Medium-sized (50-249 employed)	1,227	1.2%	121,002	23.3%	174,155	26.2%
*	<b>SMEs (1-249 employed)</b>	<b>103,857</b>	<b>99.8%</b>	<b>423,570</b>	<b>81.6%</b>	<b>505,186</b>	<b>76.1%</b>
4	Large (250+ employed)	174	0.2%	95,669	18.4%	159,031	23.9%
***	<b>Total</b>	<b>104,031</b>	<b>100%</b>	<b>519,240</b>	<b>100%</b>	<b>664,217</b>	<b>100%</b>

Source: Authors' composition based on data from INSAT, 2023

According to data from (INSTAT, 2023), the structure of the three main indicators of SMEs in Albania compared to the EU for 2021 are:

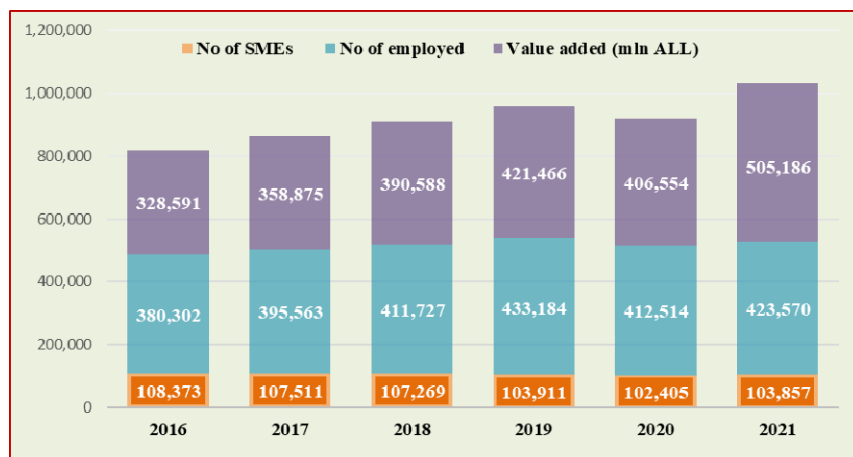
- a) The percentage of SMEs is 99.8%, the same as the EU;
- b) The percentage of employees for this group of enterprises is 81.6% in Albania, from 64.4% in the EU;
- c) The added value realized by SMEs in Albania is 76.1%, from 51.8% in the EU.



**Figure 2. Data for enterprises by size, 2021**

Source: Authors' composition based on data from INSAT, 2023

Referring to the above data, it is noted that about 93.3% of the total enterprises for the year 2021 in Albania are micro, 5.4% small, 1.2% medium and 0.2% large enterprises. Small and medium-sized enterprises (SMEs) account for about 99.8% of the total number of enterprises in 2021.



**Figure 3. Data for number of enterprises, number of employed and value added (mln ALL), 2016-2021**

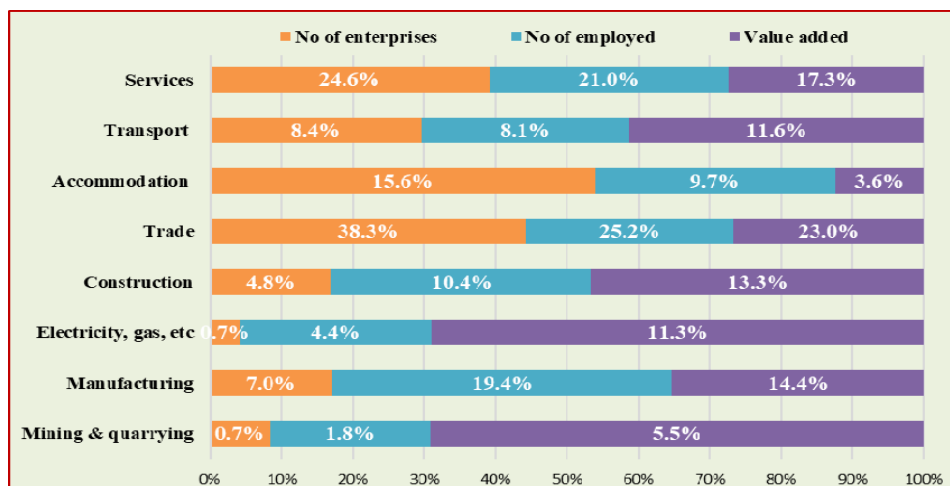
Source: Authors' composition based on data from INSAT, 2023

Referring to the data, no of SMEs for 2016 was 108,373 while for 2021 it is 103,857, no of employed for 2016 was 380,302 while for 2021 it is 423,570 and value added for 2016 was 328,591 million ALL while for 2021 it is 505,186 million ALL.

**Table 3. Data for number of SMEs, number of employed and value added by economic activity, 2021**

No	Economic Activity	No of enterprises	No of employed	Value added (mln ALL)
1	Mining & quarrying	691	9,355	32,995
2	Manufacturing	7,288	100,669	102,425
3	Electricity, gas, etc	720	22,822	47,839
4	Construction	5,035	53,874	91,024
5	Trade	39,798	130,679	151,090
6	Accommodation	16,216	50,354	30,595
7	Transport	8,691	42,302	76,532
8	Services	25,593	109,184	131,717
*	<b>Total</b>	<b>104,031</b>	<b>519,240</b>	<b>664,217</b>

Source: Authors' composition based on data from INSAT, 2023



**Figure 4. Data in % for no of SMEs, no of employed and value added by economic activity, 2021**

Source: Authors' composition based on data from INSAT, 2023

In the structure of small and medium-sized enterprises (SMEs) according to economic activity for 2021, the largest number of enterprises are concentrated in the trade, services, accommodation and manufacturing sectors.

Referring to the data on the number of employees for SMEs according to economic activity for 2021, the largest number of employed are in the trade, services, manufacturing and construction sectors.

Regarding the added value for SMEs according to the economic activity for 2021, it shows that the trade, services, manufacturing and construction sectors have the highest percentage of this indicator.

Referring to the analysis of the above data, the SME sector is considered as one of the most important sectors for the Albanian economy, contributing to economic growth, the number of employed and the reduction of the poverty level.

Small and medium-sized enterprises have priority, with large businesses deriving from their business characteristics. There is a constant debate among experts about what can now be considered the main sectors in the economy that can serve as generators of economic growth in the country. Small and medium enterprises are considered a source of innovation because they are flexible, dynamic and sensitive to changes in market demand by offering new products and services, being an important factor for economic growth in the country.

The main challenges for increasing the competitiveness and productivity of SMEs, in the conditions of the globalization of the economy, are the improvement of the investment climate, financing of their activities, diversification of products and services, costs related to their creation, financial risk, management skills and implementation of new and innovative technologies.

Financing is one of the main obstacles that SMEs face and that has a significant impact on their performance. As is known, it has a low level of attractiveness by financial institutions in terms of financing for small and medium enterprises. There are several obstacles related to the financing of SMEs such as lack of collateral and guarantees to meet the requirements of banks to finance their activities, high interest rates, long administrative procedures, costs and financial risks associated with these businesses, positive experience in lending, poor financial knowledge and skills, etc.

In the current conditions, when traditional sources of financing are not widely accessible for Albanian micro and medium enterprises, new approaches can be considered suitable to improve access to finance. In recent years, leasing companies and microfinance institutions have provided funding sources for small and medium enterprises, whose access to financing from the banking sector is limited. This is related to competitive interest rates, simpler administrative procedures, and lower fees and commissions.

Stronger development of the non-banking sector can support financial inclusion as well as access to finance for SMEs. Government support will be important to make this initiative a success on a national scale. To increase access to financing for SMEs, in recent years have been taken measures, mainly through the introduction of credit guarantee schemes for SMEs.

The support programs to facilitate access to finance for SMEs in Albania are offered by EBRD's Albania Agribusiness Support Facility, funded by the Government of Albania; the Albanian-Italian Programme for the Development of Albanian SMEs; and the European Fund for Southeast Europe. However, active measures will have to be taken by the Government and the respective responsible institutions to support easier access to finance for SMEs and new enterprises in Albania. This is the reason why the competition of SMEs affects the competition of the national economy. Their development and performance, within the global economy, is a real challenge.

The strategic priorities for the development of this sector are; harmonizing with the sector strategies that have impact on the SME sector; ensuring transparency of decision-making, actions and measures taken which affect the business environment; identification of competitive advantages and entrepreneurial management skills; ensuring the fair competitiveness and supporting the integration of SMEs in the global market.

The government in Albania has continued to implement reforms under a whole-of-government approach and has made progress both in increasing the availability of digital government services and in directing them to better suit the needs of users. Albania has simplified one-stop company registration and licensing (National Business Center, QKB) through digital services, which speeds up the process, increases transparency and reduces administrative burden and costs for SMEs.

With the approval of the new Business Development and Investment Strategy (2021-2027), Albania increases support for SMEs, especially in improving the business environment, but also in adapting services support services to SMEs' needs. This strategy, is led by the Albanian Investment and Development Agency (AIDA) in coordination with all relevant government and external stakeholders. Through this strategy, it provides a strong strategic framework for providing public and private support services for SMEs. Also through Albania's Digital Agenda (2015-2020) and Business and Investment Development Strategy (2021-2027), the government has made progress in strengthening its strategic framework for promoting e-commerce practices among SMEs and the general public. Significant progress has been made in the area of public procurement by increasingly aligning its regulatory framework with EU requirements.

Albania has made considerable progress in supporting SME internationalisation. By developing export support services, the government has advanced in creating an enabling environment that enhances competitiveness and innovation. Increase financial support for SMEs to encourage investment in innovation and research



For the SME sector, the sustainable development of their activity should be considered an important part of the long transition of the economy and society towards the country's EU membership. It is important that the Albanian government draft strategies that will help businesses to consolidate their activities.

This vision should focus on:

- continuous improvement of business and investment climate, reduction of administrative barriers and financial costs;
- increasing access to financing of the SME sector by financial and non-financial institutions, providing financial support grants, and extension of credit guarantee schemes;
- increasing the institutional capacities of institutions responsible for the development and implementation of policies in support of SMEs;
- increasing the competitiveness of SMEs in the regional and global market, through diversification of products and services, investment and implementation of new technologies;
- increasing support to stimulate e-commerce practices among SMEs and promoting new support programs for the internationalization of the SME sector globally;
- creating a conducive business environment for SME digitalisation and e-commerce adoption;
- development and design of strategies for the prevention of insolvency of SMEs, including a comprehensive early warning system;
- strengthening professional capacities, through the management of human resources, training and other supporting programs;
- increasing support for innovation and knowledge transfer to SMEs through the collaboration of public agencies, business associations, research centers and academia.

### **Conclusion**

The purpose of this study was to identify factors that influence the growth and development of small and medium enterprises (SMEs) in Albania. This research work aims to contribute to the economic literature by analyzing the main challenges faced by small and medium-sized enterprises.

Considering the analyzed data, we conclude that small and medium enterprises (SMEs) constitute about 99.8% of the total number of enterprises in the country for the year 2021. Small and medium-sized enterprises (SMEs) play an important role in the economic development of most economies worldwide, especially in developing countries.

SMEs have a significant impact on economic development, contributing to economic growth, job creation, technological innovation, increased competitiveness, and poverty reduction. Small and medium enterprises operate in the agriculture, services, trade, transport, accommodation and manufacturing sectors.

Globalization of the economy, increased competition and changes in the external environment require the SME sector in Albania to become more competitive. The development of the SME sector faces several problems related to the financing of their activity, diversification of products and services, increased productivity, low research and development costs, high levels of exposure to risk, human resources management and implementation of new and innovative technologies.

The main components that influence the consolidation of the SME sector are increased access to financing, the use of new technologies and information, a friendly business environment, better infrastructure, the development of human resources capacity, management skills, etc.

In recent years in Albania, a series of institutional reforms have been undertaken by the government in cooperation with international institutions to support the development of SMEs. Some of the reforms that have improved the climate and development of SMEs are: business registration, permits and licenses, e-government, ICT support, provision of schemes and financial support, training, growth of e-commerce, etc. All these reforms have brought concrete results in improving the business climate.

Policymakers need to go beyond basic measures to improve access to finance and enhance the institutional support that would allow small and medium enterprises and local economies to

thrive independently. Public agencies should prioritize comprehensive financing schemes that support SME development. Another issue that can affect the performance of SMEs is the growth of entrepreneurial and managerial skills of owners and managers that help consolidate businesses, and provide greater employment opportunities.

Government and other non-governmental agencies should support the organization of regular training programs for potential and actual SME entrepreneurs, where they should be educated on how to plan, organize, manage and control their businesses.

Increasing cooperation between government agencies, universities, research centers and the SME sector in the direction of exchange and transfer of knowledge, innovation and technological developments. Governments should also promote the use of technology and innovation to stimulate SMEs' performance by encouraging increased investments in R&D.

Updating teaching curricula and study programs in vocational schools and universities, to provide knowledge and managerial skills with a focus on practical entrepreneurship.

Diversification of products and services offered by small and medium enterprises increases competitiveness in the market, through the implementation of new and innovative technologies.

Promotion of small and medium-sized enterprises in the rural sector, agribusiness, as well as in the tourism sector would constitute a high development potential for this sector.

The future challenges must be addressed in supporting SMEs to develop skills, knowledge and sustainability initiatives to be competitive in national and global markets.

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**Conflicts of Interest:** The authors declare that no potential conflicts of interest in publishing this work. Furthermore, the authors have witnessed ethical issues such as plagiarism, informed consent, misconduct, data fabrication, double publication or submission, and redundancy.

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