

# STABILITY PACT

## SOUTH EAST EUROPE COMPACT FOR REFORM, INVESTMENT, INTEGRITY AND GROWTH



**ALBANIA**

### **ENTERPRISE POLICY PERFORMANCE ASSESSMENT**

Prepared by

**ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT  
AND EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT**

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**ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT**

**The Stability Pact for South Eastern Europe** is a political declaration and framework agreement adopted in June 1999 to encourage and strengthen co-operation among the countries of South East Europe (SEE) and to facilitate, co-ordinate and streamline efforts to ensure stability and economic growth in the region. (see [www.stabilitypact.org](http://www.stabilitypact.org))

**The South East Europe Compact for Reform, Investment, Integrity and Growth ("The Investment Compact")** is a key component of the Stability Pact under Working Table II on Economic Reconstruction, Development and Co-operation. Private investment is essential to facilitate the transition to market economy structures and to underpin social and economic development. The Investment Compact promotes and supports policy reforms that aim to improve the investment climate in South East Europe and thereby encourage investment and the development of a strong private sector. The main objectives of the Investment Compact are to:

- Improve the climate for business and investment.
- Attract and encourage private investment.
- Ensure private sector involvement in the reform process.
- Instigate and monitor the implementation of reform.

The participating SEE countries in the Investment Compact are: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania and Serbia and Montenegro. Building on the core principle of the Investment Compact that "ownership" of reform rests within the region itself, the Investment Compact seeks to share the long experience of OECD countries. It provides region-wide peer review and capacity building through dialogue on successful policy development and ensures identification of practical steps to implement reform and transition.

The work of the Investment Compact is actively supported and financed by seventeen OECD Member countries: **Austria, Belgium, Czech Republic, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Norway, Sweden, Switzerland, Turkey, United Kingdom and United States.** (see [www.investmentcompact.org](http://www.investmentcompact.org))

This report has been jointly produced by the OECD Investment Compact Team and the EBRD Office of the Chief Economist in co-operation with expert regional consultants. It draws on the extensive experience and work of both organisations in transition economies including the countries of South East Europe. The Enterprise Policy Performance Assessment process, highlighting feedback from SMEs as a key element of the analysis and assessment, was instigated by Declan Murphy, Programme Director of the Investment Compact (OECD) with support from Antonio Fanelli (Principal Administrator, OECD) and Ricardo Pinto (Administrator, OECD).

Background research and information was provided by Public-Private Finance Institute, Albania in partnership with the Regional Development Agency Network (RDAN), Albania who prepared the first draft of the report. The analysis, assessment and preparation of the final report were undertaken by Ricardo Pinto (OECD), Francesca Pissarides (EBRD) and Anita Taci (EBRD) with advice from other colleagues in the OECD and EBRD. The final editing was undertaken by Declan Murphy, OECD and Georgiana Pop, OECD. The assessments and views expressed in this report are those of the Investment Compact Team of the OECD secretariat and the EBRD Office of the Chief Economist and do not necessarily reflect the views of the institutions participating in preparing this report or of OECD and EBRD member countries.

## FOREWORD

Starting a business in today's environment brings opportunities and challenges. Changing lifestyles demand greater choice of products and services. New technologies and greater access to global markets have provided increased business opportunities. At the same time increased competition, insistence on quality and unremitting pressure for lower costs, just to mention some issues, represent major challenges for business. For Small and Medium-sized Enterprises (SMEs) the challenge is greater. They lack scale, resources and the capacity to handle complex business management. Typically, less than half survive more than five years and only a small proportion go on to become large companies. Entrepreneurship and enterprise development are important elements in creating dynamic market economies. SMEs are a vital source of new jobs, exports and economic contribution to countries. How to ensure the growth of the SME sector - a fundamental feature of all developed and growing economies - is a major policy challenge for all countries.

This Enterprise Policy Performance Assessment (EPPA) on Albania seeks to help address that challenge. SMEs are a vital source of new jobs, exports and economic contribution to countries. The South East Europe (SEE) Compact for Reform, Investment, Integrity and Growth (Investment Compact), a key component of the Stability Pact, has consistently affirmed that the economic revitalisation of South East Europe is primarily dependent on private sector investment. Through the Investment Compact process, Stability Pact partners support and promote the structural policy reforms that will improve the climate for private enterprise and increase investment. This assessment aims to assist SEE countries in stimulating entrepreneurship and enterprise development. Measurable progress has been and continues to be made in various areas, such as the creation of the Business Promotion Department at the Ministry of Economy, the approval of a national SME strategy, the adoption of an SME Law and the proposal to establish an agency to implement SME policy and strategy. Nevertheless, the report shows that the environment for creating and sustaining businesses remains underdeveloped in Albania, with improvements needed in the general business environment, the complexity, delay and cost associated with business entry, and the extensive number of prepaid taxes, etc. Reforming and improving the environment for entrepreneurship remains a priority.

The EPPA draws on the practical experience and views of Albanian SME representatives, expert advisors and the complementary experience and skills of the Organisation for Economic Co-operation and Development (OECD) and the European Bank for Reconstruction and Development (EBRD), two Stability Pact partner organisations that have been closely involved in the reform process in transition countries.

The analysis and assessments made in this report provide valuable insights into the key issues confronting the government in Albania, based primarily on research with SME owners and managers. The Stability Pact, through the Investment Compact for South East Europe, will continue to contribute to establishing this framework in Albania and in the region as a whole through regular up-dates of the information contained in this report.



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## **SUMMARY CONCLUSIONS AND RECOMMENDATIONS**

### **1.1. Summary Conclusions**

After progress in privatisation, banking reform and other areas of transition reform throughout the 1990s, Albania experienced a severe setback in 1997 in the wake of the “pyramid” scheme financial crisis. The progress was shown to have been fragile, undermined by large-scale fraud, an under-developed financial sector and inadequate restructuring and investment in manufacturing industries. With a large number of people affected by the financial crisis and unemployment rising, the potential for social unrest emerged as a serious concern. Recognising the need for reforms, the economic programme for 2000 stressed the government's intention to maintain economic stability, accelerate structural reform and step-up the fight against crime and corruption. The government's commitment to follow through with its ambitious reform programme and the ability of the international community to provide supportive financial and technical assistance will be important determinants of success.

Small and medium-sized enterprises (SMEs) have a crucial role in the transition process. SMEs already make up the vast majority of private businesses operating in Albania and because of their size and adaptability are likely to be the main source of employment generation in the future. As in mature market economies, a vibrant SME sector will eventually become not only a provider of employment, but also a key source of innovation, entrepreneurship and productivity growth. For these reasons, improving the business environment for SME development is a key objective of the policy framework in Albania. The Albanian authorities are increasing the support given to the SME sector, in recognition of the growing importance of SMEs to the national economy. This political support is manifested in developments such as:

- The approval of a medium term-strategy for SME development.
- The efforts to improve the legal and institutional framework for the business sector.
- The efforts to create a Small Business Development Agency.

This Enterprise Policy Performance Assessment (EPPA) highlights a number of issues, grounded on insights from SME owners and managers, and builds on other published OECD-EBRD reports (see EBRD, 2002). It identifies a number of actions needed in order to build further on the progress already made in improving the policy environment for SMEs.

In overall terms, the study finds that good progress has been made by the Government of Albania and Ministry of Economy in setting out and beginning implementation of new policies to support the growth and development of SMEs, however, a stronger outreach and partnership with SMEs is needed if the opportunities for growth of the sector are to be maximised.

In line with experience in other countries at a similar stage of transition to a market-based economy, there are issues emerging relating to policy implementation. It will take a persistent and determined effort to ensure that implementation is kept on track and momentum maintained. The best way to do this is with regular progress reviews to obtain feedback to identify areas requiring renewed focus.

The main issues identified in this assessment can be summarised as relating to the practicalities of:

- Communicating and consulting effectively with SMEs spread throughout the country.
- Co-ordinating the activities of the various bodies working to support SME development.
- Reducing complexity and ensuring coherency and consistency in policy, laws, regulations, procedures and support programmes, particularly between fiscal and developmental policies.
- Avoiding unnecessary changes in laws, regulations and programmes to facilitate planning of investments.

## **1.2. Summary Recommendations**

The main challenges associated with the development of the private sector, in particular SMEs, are the relatively poor investment climate and the level of corruption. Poor law enforcement, very weak corporate governance, both at the macro and at the enterprise levels, a lack of management skills, as well as underdeveloped banking systems and crumbling infrastructure, constitute major impediments to the development of the private economy and the attraction of foreign direct investment (FDI). The enterprise sector in Albania has shown great flexibility and resilience through the various crises faced by the country in recent years. Although it is mainly comprised of micro and newly-created companies, the small enterprise sector is widely recognised as the driving force of the Albanian economy. Nevertheless, most firms do not yet possess the required skills to compete with western European markets and are facing a number of constraints that, if not addressed, will continue to prevent the SMEs from achieving their full potential.

### ***Institutional Framework***

#### ***Small Business Development Agency (SBDA)***

- Move rapidly to implement and develop the SBDA.
- Secure adequate financial resources, commensurate with its task.
- Ensure that financial sustainability is secured for the medium to long-term.
- Clarify the relationship between SBDA and the Ministry of Economy to secure accountability.
- Ensure that the Supervisory Board is selected on the basis of merit and experience.
- Ensure that any regional structure is financially sustainable and accountable.
- Ensure that the SBDA (and possible regional) staff obtain technical assistance and make use of best practice established elsewhere in the SEE region, so as to avoid common mistakes and deficiencies.

#### ***SME Strategy***

- Ensure that the SME strategy and other key documentation of relevance to SMEs, such as laws, rules and regulations, policies, programmes and funding opportunities are disseminated widely, including to the more remote regions.
- Review the SME strategy once the SBDA has been established in order to ensure that the SBDA takes “ownership” of the strategy, that it has the capacity to be implemented and that it follows a due process of consultation with relevant stakeholders.

#### ***Consultation and Dialogue***

- Review the Business Advisory Council (BAC) to ensure that it is a representative, regular and effective mechanism for government-business dialogue and representation.
- Ensure that the SBDA establishes a representative consultative body, focusing specifically on small enterprise issues.

### ***Regulatory Environment***

#### ***Business Registration***

- Consider moving away from the highly centralised Tirana District Court registration system by evaluating and introducing a “one-stop-shop” system, as in the case of other parts of the SEE region, such as Romania (see OECD-EBRD, 2002).
- Assess the scope for moving away from active court approval for company registration in order to streamline the process and reduce costs to enterprises.

- Evaluate the possibility of introducing a single registration form and “on-line” registration of enterprises.

#### ***Business Simplification***

- Introduce a Government approved Action Plan for Reducing Administrative Barriers to Business, building on the FIAS analysis of the administrative barriers to investment in Albania (2003)
- Establish a Working Group on Reducing Administrative Barriers to co-ordinate and oversee the process. This Working Group should include relevant stakeholders, including business representatives.
- Ensure that the Working Group is adequately resourced, staffed and consults with the business community in the implementation of the resulting Action Plan.
- Ensure a greater focus on a proactive and enabling approach by introducing the principle of “silence is consent” as soon as practical. “Silence is consent” is where if the relevant public body fails to answer within a prescribed period, it will be deemed that consent has been given.

#### ***Public Procurement***

- Make it easier for SMEs to participate in public procurement tenders, as the current procedures appear to be unnecessarily complex and biased towards large enterprises.

#### ***Tax Policy for Small Businesses***

##### ***Policy Principles***

Encourage the Ministry of Finance, in co-operation with Ministry of Economy and the wider SME policy community, to work together to ensure that:

- Tax policy is simple, stable and clear with respect to small enterprises.
- Fiscal administration is sensitised to the needs of the SME sector.
- Amalgamation of taxes remains a continuing priority.
- Consultation with SMEs and their nominated representatives is a priority.
- Availability of regular, simple and up-to-date information explaining the tax system is a priority.

##### ***Tax Payment***

- Evaluate and minimise the number of taxes that must be prepaid by small enterprises.
- Ensure that where taxes must be prepaid, these are based on historic information (e.g. on profits).
- Move towards a system where enterprise taxes are paid at year end, once profits are known.
- Enable enterprises to submit tax returns electronically through the Internet.

##### ***VAT***

- Review the VAT refund system to ensure that claims are processed and paid within one month of being submitted by firms.
- Review the complex criteria for eligibility for VAT refunds.

##### ***Direct Information and Payment from Banks***

- Abolish the system where tax authorities can demand both information and payment of tax liabilities directly from banks without prior discussion and agreement with enterprises.

#### ***Financial Instruments for Fostering New and Small Businesses***

##### ***Strengthening Competition in the Banking Sector***

- Privatisation of the main commercial bank, the Savings Bank, is essential for fostering competition in the banking sector and increasing the private sector's (SMEs' in particular) access to finance. The Savings Bank, accounts for 60% of the sector's assets, 64% of deposits and enjoys the most extensive bank branch network in the country. Despite its favourable position in the sector, it has extended no new loans to the private sector since its pre-privatisation restructuring was initiated in 1998.

### ***Improving Bank Intermediation of Emigrants' Remittances***

- Lowering the administrative barriers and costs to transfer migrants' remittances from abroad into the Albanian banking system is essential to increasing access to finance for new investments. Commercial banks in Albania, as in the rest of the world, prefer to lend to large enterprises and households than to small businesses. SMEs' access to bank lending outside the dedicated programmes set up by International Financial Institutions (IFIs) and donors is, however, very limited in Albania. Yet, given the very large inflows of remittances into the country, partly used to finance SMEs' needs, enterprises rate the financial constraint as less important than any other constraint to business activity. Their reliance on internal funds is great. As the majority of these remittances is channelled into the country outside the banking sector, a large potential source of funds for investment runs the risk of being either used to finance household consumption or not being efficiently intermediated.

### ***Creating Effective Land Registries and Cadastres***

- The lack of effective land registries and cadastres precludes firms from using property as collateral. As a consequence commercial banks require high levels of collateral, thus affecting the ability of firms to borrow from formal channels.

### ***Advisory Services Supplied to New and Small Businesses***

#### ***Financial Sustainability***

- Continue to prioritise support to SMEs through national policy focusing on subsidised business support services, especially targeting start-ups. In the longer term, competitive private provision of advisory services may reduce the need for government or donor-funded initiatives to address market failure.
- Consider extending the network of business support services to areas of the country which are currently not covered, possibly through the SBDA.

#### ***Co-ordination of International Support***

- Review the plethora of existing and proposed enterprise development initiatives and ensure co-ordination of initiatives to increase the scope for financial sustainability.

#### ***Quality and Accreditation***

- Introduce a system of certification and accreditation of advisory bodies to set international quality standards and improve confidence in the benefits of services. This should be carried out by a credible representative body, linked to the relevant international body.
- Encourage business advisory centres to develop and publish customer charters, setting out the range of services provided, the costs and the standards they undertake to adhere to. Entrepreneurs need to be aware of the potential benefits of receiving professional advice before they become more willing to pay for them.

### ***The Implementation of Business Incubators***

#### ***National Policy***

- Evaluate the possibility of transferring policy responsibility for business incubators to the Ministry of Economy from the Ministry of Labour for synergistic reasons, including the co-ordination of international funds for the creation of business incubators.
- Develop a formal policy/strategy with respect to the development of a network of business incubators and secure commensurate national and international resources in order to develop business incubators effectively.
- Evaluate the possibility of using business incubators to support the agribusiness and high-tech sectors.
- Disseminate information and promote the role of business incubators to BiH entrepreneurs with departments and ministries of economy, as well as leaders of business associations, such as Chambers of Commerce and others.

- Evaluate effectiveness and financial sustainability of small business incubators of less than 2,000 m<sup>2</sup>.
- Develop training and education programmes for business incubator managers in order to ensure greater compliance with best practice in transition and OECD member countries.



## *Chapter 2.*

### **INTRODUCTION**

Private investment by Small and Medium-sized Enterprises (SMEs)<sup>1</sup> is a key generator of economic growth and social change in OECD member country economies. In most countries, over 90% of all enterprises are SMEs. It is now widely accepted that the contribution of SMEs to new jobs, exports, innovation and regional development is vital to national development. How to benefit from and maximise this contribution is a continuous challenge for all countries. This Enterprise Policy Performance Assessment seeks to help address that question for Albania and highlight issues that require attention and priority action.

The State has a fundamental role to play in providing a favourable framework and environment for private sector development in OECD member countries. In the transition economies of South East Europe (SEE), where private investment levels lag behind those of developed countries, the necessity to create an enabling environment for SMEs and private investment is more urgent. Reform of the business and investment environment leading to the creation of a dynamic entrepreneurial culture is crucial to drive the process of change in industrial structures and the transition to market economy structures.

The OECD and the EBRD have undertaken a series of Enterprise Policy Performance Assessments (EPPAs) in all SEE countries in order to monitor the development of policies and infrastructures to support the SME sector. Substantial emphasis has been placed in eliciting the views of private SMEs on their past experience and perception of the key barriers to business and new investment, and their assessment of progress in implementing policies to encourage the development of SMEs.

Previous OECD research has identified six broad dimensions of the framework and environment supporting SME growth and development, which are particularly important for governments to get right:

- Institutional framework for SME policy.
- Rule of law and the regulatory environment.
- Tax policy for small businesses.
- Financial instruments for fostering small businesses.
- Advisory services supplied to new and small businesses.
- Implementation of business incubators.

Albania has gone through a decade of democratic, economic and social transition. The Investment Compact, endorsed by the countries of SEE including Albania, explicitly acknowledges that the revitalisation of the SEE region must rely primarily on private sector development and investment (Investment Compact Charter, 2001). This EPPA captures private sector insights measured against the above six dimensions of good practice. They present views on performance and progress made on the basis of good practice indicators developed for transition economies and take into account other OECD and EBRD studies for Albania and other countries moving towards market based economies (e.g. see EBRD, 2002).

The EPPA research provides a qualitative “snap-shot” of the SME perceptions of the business and investment environment. It highlights issues in need of policy attention and indicates a number of recommended actions. This report is presented as a contribution to enhance policy dialogue between the

key SME representative associations and the supporting state institutions. It will be up-dated on an annual basis, thus allowing a fuller picture of progress to be developed over time.

The methodology employed in the EPPAs is set out in box 2-1.

#### Box 2-1. EPPA Methodology

- I. The EPPA methodology has been designed to provide insights and assessments of the performance in the *implementation* of policies to improve the investment environment for business. The EPPAs have been conducted on a standard basis in all countries of the region and provide a benchmark for (a) highlighting key reform issues (b) measuring private sector insights and assessments of the business environment (c) assessing progress on a country by country basis and (d) comparative cross-country review for the SEE region.
- II. The main components of the EPPA undertaken in Albania are as follows:
  - A question template was derived from extensive case study work on good practice in transition economies and OECD country experience (OECD-UNIDO, 1999) and used in the research.
  - Country-based experts/consultants were selected for their enterprise policy knowledge and experience.
  - Focus group research: focus group discussions were held with SME representatives.
  - Individual SME interviews: to validate the focus group research and to provide insights on key issues.
  - Expert interviews: to cross reference information from the focus groups and contribute to views.
  - Desk research: examination of existing reports, databases, documents, etc. for Albania.
  - Expertise from OECD, EBRD and experts from OECD countries.
- III. Under the guidance of OECD, the focus group research with the private sector in Albania was carried out by local consultants, the *Public-Private Finance Institute* and the *Regional Development Agency Network*, using a structured brief and template of questions developed by OECD and EBRD. The focus group research commenced in mid-2002 and other interviews and desk research extended into early 2003. It focused on six dimensions of good practice in the following policy areas:
  - The Institutional Framework for SME policy.
  - Rule of Law and the Regulatory Environment.
  - Tax Policy for Small Businesses.
  - Financial Instruments for Fostering New and Small Businesses.
  - Advisory Services Supplied to New and Small Businesses.
  - The Implementation of Business Incubators.
- IV. Three focus group discussions took place in Tirana (capital city), Vlora (economically dynamic area) and Shkodra (economically depressed area). In all, 31 entrepreneurs took part in the detailed focus group discussions, covering the following sectors of activity: manufacturing, services and trade-oriented companies. The participants included representatives of micro, small and medium-sized companies, ranging from start-ups to well established firms. Standard templates were used for discussion and ratings.

**Box 2-1. EPPA Methodology (cont.)**

- V. Individual interviews with six institutions, including the Business Promotion Department (Ministry of Economy), Ministry of Finance, Chamber of Commerce and other SME-related institutions were carried out, allowing for a wider perspective than the focus group discussions and to cross reference the information that was obtained in the focus group discussions.
- VI. The findings from the focus groups and interviews obtained were complemented with additional information provided by the EBRD. The EBRD's Office of the Chief Economist has assessed progress in structural and institutional reform across the region since 1994. The EBRD jointly with the World Bank launched the Business Environment and Enterprise Performance Survey (BEEPS) in 1999. The BEEPS asks enterprises to evaluate economic governance and state institutions and assess the extent to which the business environment creates obstacles to the operation and growth of their businesses. In 2002, a second stage of the BEEPS was undertaken, surveying close to 6,000 firms across 26 countries of the region.
- VII. The analysis in this EPPA is based on the methodologies described above (focus group research, expert interviews, secondary data collection) and is complemented by the EBRD assessment and the BEEPS 2002 results. All information has been analysed by the OECD and EBRD, resulting in the assessment presented in this EPPA.

**NOTE**

1. The notations SME and small enterprise in this report also include micro-enterprises, which according to the EU definition ([http://europa.eu.int/comm/enterprise/enterprise\\_policy/sme\\_definition/index\\_en.htm](http://europa.eu.int/comm/enterprise/enterprise_policy/sme_definition/index_en.htm)) are independent enterprises with up to 9 employees and whose turnover or balance sheet asset value are  $\leq$  €2 million. Small enterprise are likewise defined as having between 10 and 49 employees and turnover or balance sheet asset value of  $\leq$  €10 million and medium sized companies as having between 50 and 250 employees and turnover of  $\leq$  €50 million or balance sheet asset value of  $\leq$  €43 million.



## INSIGHTS FROM SME OWNERS, MANAGERS AND REPRESENTATIVE BODIES

### 3.1. Introduction

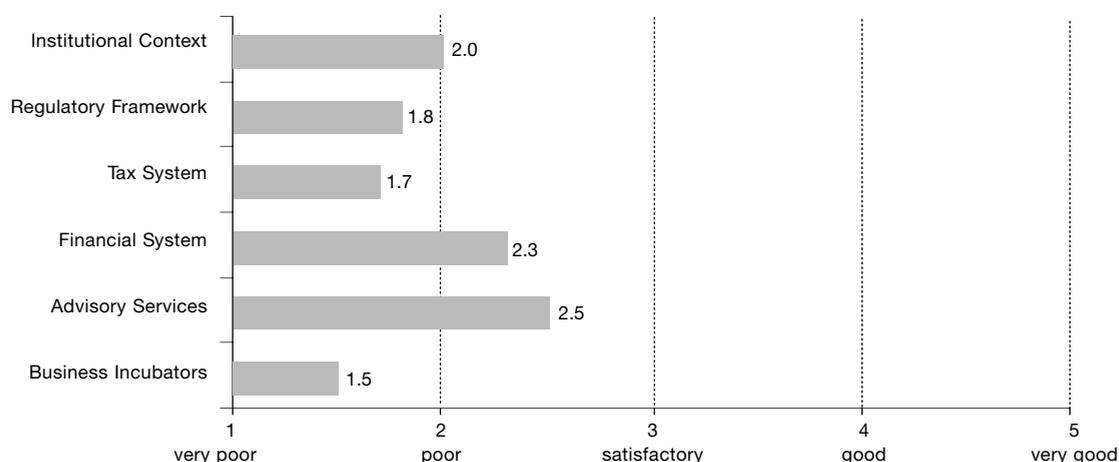
The analysis of the results of the research with the SME focus groups is presented under six framework dimensions of good practice for the business environment:

- Institutional framework for SME policy.
- Rule of law and the regulatory environment.
- Tax policy for small businesses.
- Financial instruments for fostering small businesses.
- Advisory services supplied to new and small businesses.
- Implementation of business incubators.

The analysis highlights the main issues arising from the discussion with the private SMEs participating in the EPPA research. The key questions dealt with in the focus group research are summarised at the beginning of each section. The average ratings used to represent the views of the entrepreneurs range from 1 to 5 and can be read as follows: 1 = very poor, 2 = poor, 3 = satisfactory, 4 = good and 5 = very good.

The average ratings per dimension of good practice are highlighted in figure 3-1. In general, the ratings are low, with Business Incubators, Tax System and Regulatory Framework rated the poorest of all (ratings: 1.5, 1.7 and 1.8 - i.e. between “very poor” and “poor”). Business Advisory Services and the Financial System obtained the highest ratings (2.5 and 2.3) i.e. between “poor” and “satisfactory”.

**Figure 3-1. Average Ratings of the Six Dimensions of Good Practice by SME Owners and Managers**



The main points made by the participants during the focus groups are reported verbatim and the quotations most relevant to the analysis are highlighted. Each section concludes with a summary of the issues emerging from the research.

In addition, this chapter presents selected analysis of the Business Environment and Enterprise Performance Survey (BEEPS) 2002 survey. The BEEPS is a survey of 170 Albanian enterprises and, like the focus groups, was carried out in 2002. Of these, 152 were considered to be SMEs (of which 32% micro, 47% small and 20% medium-sized) according to the EU definition for employment (i.e. they had less than 250 employees). The results presented in this document refer only to the responses provided by the SME sub-sample. The BEEPS research is based on a sample survey and is not directly comparable with the focus group research. The BEEPS analysis is presented in separate text boxes (for example, see box 3-1. below) and a summary of main results is contained in Appendix 1.

**Box 3-1. Obstacles to Doing Business (BEEPS, 2002)**

The entrepreneurs were asked to rate the severity of obstacles pertaining to several aspects of the business environment (the scores can be interpreted as follows: 1 = no obstacle; 2 = minor obstacle; 3 = moderate obstacle; 4 = major obstacle). Three areas of analysis overlap with the areas investigated through the focus groups methodology: regulation, taxation and provision of finance. On average they are rated respectively between minor and moderate obstacles. A direct numerical comparison between the two types of analysis is not possible, due to the very different formulations of questions asked, however, the results from both sources are broadly consistent. It should be noted that the BEEPS included other areas of investigation in which obstacles of greater severity were identified, such as crime, land (title and access), labour regulations, etc.

**3.2. Institutional Framework for SME Policy**

The issues researched under this heading:

1. Clear assignment of organisational responsibility for the development of SME policy.
2. The effectiveness of organisation/s in developing an environment to encourage entrepreneurship and the development of SMEs.
3. The quality and effectiveness of the SME development strategy.
4. The local and regional governments' mandate and resources (funding, people and skills) to promote SME development.
5. The information provided and awareness by business people of the government's institutions, policy and programmes to support new entrepreneurs and develop existing SMEs.
6. The quality and regularity of consultation between government and the private sector on SME policy and its performance and assessment.

**Organisational Responsibility**

|  |    |
|--|----|
| 1. Has the government assigned clear <b>organisational responsibility</b> for the development of SME policy? | No |
|--|----|

An institutional framework for the development of SME policy in Albania exists in the form of the Ministry of Economy. In addition new legislation is leading to the introduction of an institution, the Small Business Development Agency (SBDA), designed specifically to focus on the implementation of SME policy and strategy. Nevertheless, taking into account the discussions with SME owners and managers in the focus groups, as well as the interviews with SME experts, there was a lack of conviction that the government has created a clear and well-developed national institutional structure whose main purpose and mission is to support SMEs. An entrepreneur said:

***"There is a total lack of clarity regarding responsibility for SME policy amongst the government institutions."***

Two-thirds of the participants feel that government has yet to assign clear organisational responsibility for the development of SME policy. As the SBDA promotes its role this situation should gradually improve.

**Issues:** Despite initiatives on the part of government to strengthen the institutional structure for SME development, such as assigning this responsibility to the Ministry of Economy and the creation of the SBDA, entrepreneurs remain unconvinced that a clear structure exists at present.

### **Effectiveness of the Organisation/s**

|  |     |
|--|-----|
| 2. Rating given to the <b>effectiveness of the organisation/s</b> in developing an environment to encourage entrepreneurship and the development of SMEs | 2.1 |
|--|-----|

The effectiveness of these institutions in developing an environment capable of encouraging SME growth are also thought to be "poor" by the great majority of those participating in the research. According to the representatives of SME enterprises in the focus groups, this lack of effectiveness reflects first and foremost the low levels of qualification and relevant experience of the responsible civil servants in Albania:

***"The staff ... [in these] institutions lack the qualifications to do the job properly."***

***"In addition to the lack of competence, the practices heavily undermine the environment in which businesses operate."***

There is agreement on this point in all three locations of the research, Tirana, Vlora and Shkodra. The entrepreneurs from the latter location are particularly concerned that:

***"Central government is not securing an appropriate climate for business activity. On the contrary, it is making it less favourable in the District of Shkodra. The resulting political instability is forcing many important businesses to relocate."***

**Issues:** The effectiveness of the institutions charged with stimulating SME development is assessed as being "poor", mainly because of the perception that the relevant staff are still inadequately qualified and lack appropriate experience, suggesting a need for capacity building and human resource development.

### **SME Development Strategy**

|   |     |
|---|-----|
| 3. Rating given to the <b>quality and effectiveness</b> of the SME development strategy | 2.4 |
|---|-----|

Participants rate the quality and effectiveness of the SME strategy better, awarding it a rating between "poor" and "satisfactory". Although this is the highest rating in the institutional part of the research, based on the discussions, the dissemination and implementation of the SME strategy itself, is regarded being in need of improvement. In the entrepreneurs' opinion:

***"Businesses totally lack information about the SME strategy."***

**Issues:** Respondents maintain that there is very little information and knowledge about the SME strategy, something which could be addressed through better communication and dissemination. The few that are aware of the SME strategy consider it to be fairly good, but perceive a gap in its implementation.

### Local and Regional Governments

|   |     |
|---|-----|
| 4. Rating given to the <b>local and regional governments' mandate and resources</b> (funding, people and skills) to promote SME development | 2.0 |
|---|-----|

Regional authorities and local government have a mandate to promote SME development in Albania, however, both are assessed by private sector representatives as having limited legal powers and even more limited resources to promote these activities, resulting in a "poor" rating. Indeed, the perception of the participants is that:

***"Local government does not have the remit or the tools to affect SME development..."***

***"Local authorities completely ignore the existence of SMEs."***

These perceptions are accentuated by the lack of communication and dialogue with enterprises. Hence, although the entrepreneurs in Shkodra were more positive, nevertheless, they feel that:

***"The discussions with local authorities take place on a frequent basis, but they are always of a theoretical nature and are never followed by concrete actions."***

In the discussions, entrepreneurs argued that they would prefer to see more investment going into the regional authorities and their capacity to promote economic and enterprise development enhanced.

**Issues:** The perception is that local and regional authorities have the general competencies but lack the resources, knowledge and sometimes willingness to promote SME development in the areas that they are responsible for.

### Information and Awareness

|  |     |
|--|-----|
| 5. Rating given to the <b>information provided and awareness</b> of the government's institutions, policies, programmes to support new entrepreneurs and develop existing SMEs | 2.0 |
|--|-----|

Turning to the issue of information provision and awareness of institutions, policies and programmes, this also received a "poor" rating. The entrepreneurs participating in the research are not very aware of information focusing on enterprise development. This was particularly noticeable with respect to the entrepreneurs based outside of the capital city. As one of them stated:

***"You can go around knocking on the officials' doors for days and weeks, but you will just waste your time. There is no way to find out who is responsible for dealing with your problem."***

**Issues:** Despite the existence of various institutions, policies and programmes to assist SME development in Albania, entrepreneurs' access to information is surprisingly limited. This raises issues of concern for the relevant official institutions, as well as business representatives, NGOs, etc. operating at national, regional and local level.

### Consultation between Government and the Private Sector

|  |     |
|--|-----|
| 6. Rating given to the <b>quality and regularity of consultation</b> between government and the private sector on SME policy and its performance | 1.6 |
|--|-----|

Despite the existence of consultative bodies such as Business Advisory Council, entrepreneurs maintain that in their view, there is little or no communication between private enterprises and government institutions on SME policy issues and furthermore, that this accentuates with distance from the capital city:

***"Consultation is more a 'show' than about solving the problems businesses face."***

Government-business consultations are felt to be insufficient in quantity and unsatisfactory in quality. Entrepreneurs do not believe that their views are reflected in policy initiatives and decisions when consultation takes place, something which cannot be taken for granted. They think that there is a great need for consultation on the following types of issues: tax policy, rule of law and business regulations applying at national and regional level.

Government has made progress in improving consultation and ensuring representation of SMEs' views, as exemplified by the creation of the Business Advisory Council. However, according to the opinion of the focus group participants, these cannot yet be considered adequate:

***"The representation is heavily weighted in favour of Government. The establishment of the [Business Advisory] Council was done at the initiative of Ministry of Economy and approved by Prime Minister's order, rather than being selected by institutions such as business associations, unions, etc."***

**Issues:** The existence of some initiatives to improve consultation is acknowledged and appreciated, but these are criticised for being unrepresentative. Broadening and strengthening the government-small business sector consultation process between appears to be a priority issue.

### 3.3. Rule of Law and Regulatory Environment

The issues researched under this heading:

7. The formalities for new company registration and comment on the process.
8. The procedures for obtaining licenses, permits and certificates necessary for business operations.
9. The existence of a government approved programme for reducing the legal / administrative barriers for business and rating of the quality and effectiveness of this programme.
10. The efficiency of the programme for reducing the impact of corruption.
11. The quality and regularity of consultation between government and the private sector / SME policy community on draft legislation and regulations that affect business.

#### Company Registration

|  |     |
|--|-----|
| 7. Rating given to the <b>company registration</b> procedure | 1.8 |
|--|-----|

The SMEs participating in the research feel the registration process remains problematic in Albania. The bureaucracy involved is criticised, such as the numerous registration forms, different types of information required, and the time-consuming and thus costly nature of the exercise. They rate the procedure as being between "very poor" and "poor". Entrepreneurs hold the view that:

***"In theory, the procedures are appropriate and imply low registration costs for small business. In practice, the registration process is characterised by high degrees of bureaucracy and unofficial cost."***

Businesses outside the capital were even more critical, since they can only register their businesses in one location, namely at the Tirana District Court. They think that:

***"The registration procedures are totally centralised, leading to corrupt practices. Every business must register at the Tirana court, regardless of the location of its activity."***

**Issues:** The perception is that, in practice, the business entry process is bureaucratic, time-consuming, costly and in need of streamlining. Rather than facilitating matters, the existence of a unique registration court leads to major time and cost implications for entrepreneurs located elsewhere in the country.

### Licenses, Permits and Certificates

|  |     |
|--|-----|
| 8. Rating of procedures for obtaining licenses, permits and certificates | 2.0 |
|--|-----|

The discussions about the legal and regulatory framework concerning the SME sector in Albania indicate that the SME representatives feel strongly that the level of regulation is both excessive and may actually discriminate against the businesses seeking to use the system "honestly", resulting in a "poor" rating:

***"The government does not have the ability or willingness to protect legal businesses. In my opinion, more than 50% of SMEs in Vlora do not have valid licenses, which means that the burden is carried by the legal enterprises."***

In addition to the difficulties of obtaining licenses and permits, the frequency with which they have to be renewed draws criticism. For instance, it is pointed out that construction firms are required to renew their licences annually. According to a Vlora-based entrepreneur:

***"...difficulties in getting an operating licence become particularly evident in such sectors as construction and fuel [petrol stations], which are often closely controlled by officials."***

Part of the discussion focused on SMEs' concerns that in addition to the bureaucratic procedures per se, the associated fees and charges increase without apparent rhyme or reason. These issues tend to increase the non-business related costs and make it harder for businesses to survive and prosper.

Further business regulation issues identified in the BEEPS survey are discussed in box 3-2.

#### Box 3-2. Business Regulations (BEEPS, 2002)

According to the BEEPS, the aspects of the business environment for SMEs pertaining to regulation (labour regulations, customs and trade regulations, title or leasing of land, access to land and business licensing and permits) are considered to be a less severe obstacle than the focus groups analysis. However, variance in the rated severity of various aspects of the regulatory environment is significant, with issues related to customs and trade regulations seen as the most difficult for entrepreneurs, followed by business licensing, issues related to titles or leasing of land and access to land, and labour regulations.

**Issues:** Entrepreneurs are critical of various aspects of the process of obtaining licenses and permits for economic operation, not least the lack of clarity, increasing charges, frequency of renewal, etc. There appears to be much scope for improvement of this aspect of the business environment.

### Simplification Programme

|  |     |
|--|-----|
| 9. Rating given to the efficiency of the programme for reducing administrative barriers for business | 2.0 |
|--|-----|

The regulatory environment confronting small enterprises is generally not considered to be appropriate by the participants. For instance, entrepreneurs argue that:

***"... the current laws are very restrictive and create administrative barriers for start-ups..."***

Numerous examples of administrative barriers were highlighted. For example, in order to participate in a public procurement process, construction companies are required to provide audited and published

accounts dating back three years. This is argued to result in contracts being awarded to larger or more established companies at the expense of start-ups and early growth firms. This illustrates the reason why small entrepreneurs think:

***"... large businesses are 'sheltered' or 'protected' by the State. There is no space left for small and medium size businesses."***

The entrepreneurs participating in the discussions are not aware of any government programme for reducing administrative barriers, resulting in a “poor” rating for this issue, however, they very much welcome such an initiative on the part of Government.

**Issues:** There is a perception that although administrative barriers to doing business abound, there is no official programme for business simplification in Albania.

### Anti-Corruption Programme

|  |     |
|--|-----|
| 10. Rating given to the quality and effectiveness of the <b>Government's programme for reducing the impact of corruption</b> | 1.7 |
|--|-----|

A major concern shared by the businessmen participating in the research relates to the issue of corruption, which is viewed as a pervasive issue affecting the entire business environment. Legally registered businesses are particularly concerned about the apparent ease with which illegal businesses can operate in Albania, resulting in complaints of unfair competitive advantage which adversely affects “honest” businesses. There is a passionately held conviction that left unchecked, the scale of these activities will drive more and more businesses underground or bankrupt them in the long-term.

Almost all SME participants are aware of a government programme aimed at reducing the influence of corruption, however, it is generally thought to be ineffective. Entrepreneurs feel that the Government's anti-corruption impact is effectively “non-existent”:

***"There is no anti-corruption office to deal with the concerns of businesses. Even the High State Control Office does not help. Its officials don't listen to the problems caused by corrupt practices that are jeopardising the very existence of legal businesses."***

The constantly changing regulatory environment dealt with above contributes to this situation by creating ambiguity and uncertainty, thus generating scope for rent seeking activities (see also box 3-3).

#### Box 3-3. Corruption (BEEPS, 2002)

Evidence of corruption affecting the SME sector also emerged from the BEEPS analysis. It found that SMEs pay 3.3% of total annual revenues in unofficial payments/gifts to public officials. This percentage is twice as much as the one recorded by the 1999 BEEPS (1.7%). Yet, a lower percentage of firms is affected by corruption with respect to 1999, according to the same sources. In 1999, 46.7% of those interviewed admitted to having made frequent bribe payments, whereas in 2002, 36.4% of firms did so. Corruption is the fourth most severe obstacle to doing business (out of 21) and is rated as a more than moderate obstacle to doing business.

**Issues:** All entrepreneurs are concerned about the pervasiveness of corruption. They tend to perceive this issue in the same light as the impact of the informal economy and are highly critical of the existing level of unfair competition which, left unchecked, is perceived to lead to certain bankruptcy. They are aware that anti-corruption initiatives exist but rate their quality and effectiveness between “very poor” and “poor”.

### Consultation between Government and the Private Sector

|  |     |
|--|-----|
| 11. Rating given to the <b>quality and regularity of consultation</b> between government and the private sector on draft legislation and regulations that affects business | 1.6 |
|--|-----|

As in the case of the institutional analysis, the entrepreneurs representing the SME sector are vocal in expressing their concern about the lack of consultation with government, which is rated between “very poor” and “poor”. They can see clear potential advantages arising from being consulted on draft regulation and legislation, since they are directly affected by such developments. Entrepreneurs think that the Chamber of Commerce is the only business representative body that is currently regularly consulted by government at present. At the same time, the views of the Chamber of Commerce are not taken seriously by policy-makers, in the entrepreneurs' opinion.

The frequent amendment to business-related legislation is identified by the SMEs participating in the research as being of concern. This problem affects all enterprises, although it is felt particularly acutely by small businesses, especially those located outside the capital city. The latter have no choice but to turn up to the Tirana District Court in order to register and deal with most of the licenses and regulations associated with their businesses, but are not necessarily aware of the latest changes and requirements, resulting in additional delays and costs to them.

The BEEPS survey examined two other aspects of interest. Box 3-4 deals with issues to do with contractual rights and changes to the legal system.

#### Box 3-4. Legal System: Contractual Rights and Impact of Unforeseen Changes (BEEPS, 2002)

Entrepreneurs asked to what degree they agree with the following statement: “I am confident that the legal system will uphold my contract and property rights in business disputes”, mostly tended to disagree as can be seen from the table below.

|                        |     |
|------------------------|-----|
| Strongly disagree      | 11% |
| Disagree in most cases | 20% |
| Tend to disagree       | 19% |
| Tend to agree          | 30% |
| Agree in most cases    | 14% |
| Strongly agree         | 3%  |
| Don't know             | 3%  |

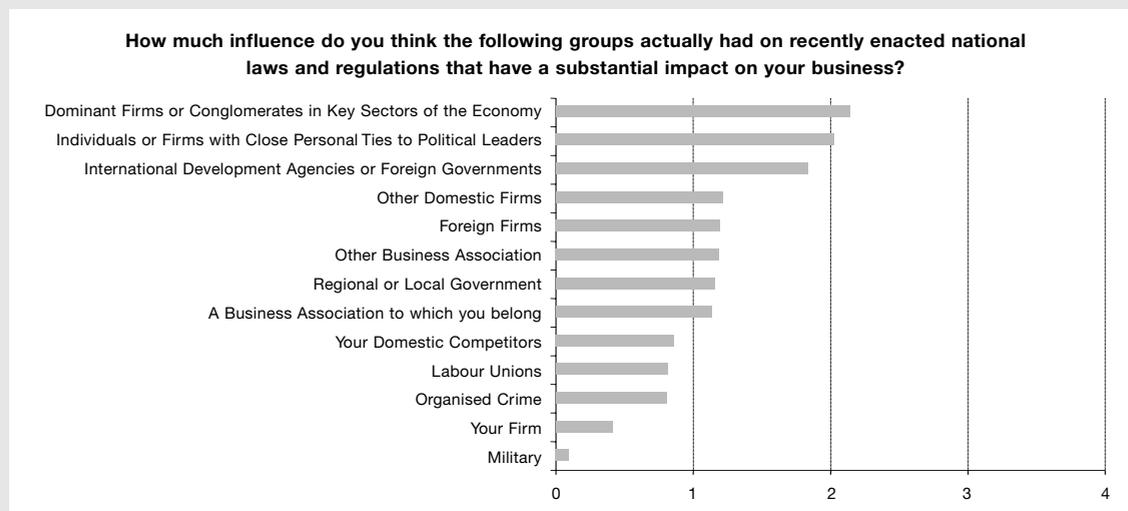
Also relatively more entrepreneurs found that an unforeseen change in laws and regulations would occur in 2003 and would have a significant impact on their business. The following table shows the specific results for the SMEs interviewed.

|                    |     |
|--------------------|-----|
| Extremely unlikely | 1%  |
| Highly unlikely    | 3%  |
| Fairly unlikely    | 13% |
| Fairly likely      | 38% |
| Highly likely      | 22% |
| Extremely likely   | 14% |
| Don't know         | 9%  |

Box 3-5 examines the private sector's perceptions of the lobbying power of various organisations on the making of laws and regulations.

**Box 3-5. Private Sector Perception of Lobbying Power of Various Entities (BEEPS, 2002)**

The entrepreneurs were also asked about the link (in terms of lobbying power) between the legislative powers and regulatory authorities with various organisations and economic agents (the scores can be interpreted as follows: 0 = no impact; 1 = minor influence; 2 = moderate influence; 3 = major influence; and 4 = decisive influence). As can be seen from the chart below, large firms and conglomerates in key sectors of the economy, firms with ties to political leaders and international development agencies or foreign governments, are believed to be able to exercise a moderate lobbying power on the legislative and regulatory authorities. The entrepreneurs interviewed in the BEEPS believe that SMEs have almost no impact on the making of laws and regulations.



**Issues:** The quality and regularity of consultation on issues that affect businesses directly is considered to be inadequate at present.

**3.4. Tax Policy for Small Businesses**

The issues researched under this heading:

12. Whether the present tax policy encourages new enterprise and rating of the tax system in terms of the encouragement, support and ease of use that it provides to new and existing SMEs.
13. The stability and transparency of the tax system for small enterprises.
14. The consultation and communication between government and the private sector on tax rates and incentives for enterprises.
15. Co-ordination of tax policy with other government policies.

**Encouragement of Enterprises**

|  |     |
|--|-----|
| 12. Rating given to tax policy in terms of the <b>encouragement, support and ease of use</b> that it provides to new and existing SMEs | 1.6 |
|--|-----|

Because of the low tax collection rate in Albania, the small business owners and managers participating in the research are critical of the resulting tax rates, which are considered to be both too high and to fall disproportionately on legal businesses. This tax burden directly affects both their profitability and viability:

***"Only legal businesses pay taxes, making the illegal ones more competitive."***

There is also a perception that the tax system is open to high levels of subjectivity, which in turn leads them to think that corrupt practices are pervasive. The resulting frustration results in blanket condemnations:

***"...neither the present tax policy nor the tax administration procedures are of any help to businesses."***

***"Fiscal policies and practices are very restrictive for SMEs, such as the tax pre-payment procedures. The same situation applies with regard to social and other insurance contributions."***

Start-ups are considered to be insufficiently encouraged and to have limited scope of succeeding:

***"Start-ups are doomed to fail. There are no tax incentives or other facilities for new businesses."***

***"It is absurd for businesses to be taxed before generating profits. Every business must pay the profit tax at the beginning of the year, regardless of whether it actually generates profits or not."***

In addition to the problems associated with the national taxes, the issue of local authority charges and fees was also raised by the business representatives from Shkodra, according to whom, the total amount often exceeds the fragile revenues of start-ups.

Taking these issues into account, SMEs conclude that rather than tax policy promoting new enterprise development, it actually works to impede it. The entrepreneurs unanimously think that the tax system needs to be radically reformed in order to facilitate and support the business development process. Priorities include more judicious use of the practice of pre-paid taxes and the introduction of VAT rates that vary according to the nature of the goods and services.

According to the 2002 BEEPS, the two aspects of the business environment for SMEs pertaining to taxation, tax rates and tax administration, are at 3.0 and 2.6 respectively on the BEEPS scale, indicating moderate/minor obstacles to doing business. Tax rates are considered to be the fifth most severe obstacle to doing business.

**Issues:** Issues such as the degree of tax evasion, the disproportionate burden on legal firms, the subjectivity in the tax rules, the lack of incentives for start-ups and the extensive use of pre-paid taxes lead to a perception that the tax system does not stimulate new and existing small enterprises and is in need of reform.

### Stability and Transparency

|   |     |
|---|-----|
| 13. Rating given to the <b>stability and transparency</b> of the tax system for small enterprises | 1.7 |
|---|-----|

The constant changes of government and tax legislation explain in part the reason why SMEs rate the stability and transparency of the tax system between "poor" and "very poor". Unpredictability is one of the key characteristic of tax system, as far as entrepreneurs are concerned:

***"...the tax officials ask for a new [or additional] tax any time the state budget is running short of money and they have to find ways of filling the government's coffers."***

Partly as a result of the instability and the lack of transparency that tend to go hand in hand with frequent changes in the tax system, entrepreneurs consider the behaviour and attitude of tax officials to be authoritarian, rendering it difficult to negotiate and seek redress with inspectors:

***"...the tax administration office has no remit to deal with public relations and complaints from enterprises."***

**Issues:** The frequent and unpredictable changes to the tax system lead to the conclusion that it is unstable and non transparent to enterprises, adding to the compliance burden and investment risk.

**Consultation and Communication on Tax Policy**

|  |     |
|--|-----|
| 14. Rating given to the <b>communication between government and the private sector</b> on tax rates and incentives for enterprises | 1.9 |
|--|-----|

Following on from the previous analysis, the assessment of the quality of business-government communication in the field of tax policy is also perceived to be "poor". This rating is only slightly higher than the previous ratings for consultation in relation to such issues such as institutions and regulations.

**Issues:** Consultation on tax issues is thought by entrepreneurs to be inadequate, given the large degree of change which is regularly experienced in the tax policy and system.

**Co-ordination of Tax Policy**

|  |     |
|--|-----|
| 15. Rating given to the tax policy <b>co-ordination with the overall government policy</b> | 1.7 |
|--|-----|

Although not enough information is available for a well-informed discussion on the extent to which tax policy is co-ordinated with other government policies, the entrepreneurs participating in the focus groups think that there is still a gap between the declared SME policy and what is actually translated into action. Entrepreneurs believe that the government's tax practices could be more in line with the policies and strategies that they expound, resulting in a conclusion that tax policy could be better co-ordinated with overall government policy:

***"...laws affecting business activity are neither well co-ordinated nor easily applicable. There is little or no notice for the introduction of new laws. This unpredictably affects businesses' financial planning."***

**Issues:** Tax policy is not perceived to be entirely aligned with the stated overall government policy, as far as SME development is concerned.

**3.5. Financial Instruments for New and Small Businesses**

The issues researched under this heading:

16. The stability, competitiveness and services of the banking system.
17. The commercial banks' interest in extending credits to the SME sector and lending attitude with respect to the SME sector.
18. The SME access to the following main sources of finance:
  - Own/family capital.
  - Micro finance.
  - Venture capital/Equity.
  - Repatriation capital (from family / friends abroad).
  - Commercial banks.
  - Leasing.
  - Credit reference sources.
  - Bank personnel skills.
  - Others (e.g. credit unions).
19. The availability of finance for SMEs at local and regional level.
20. The availability of funding for all sectors including technology companies.

**Stability, Competitiveness and Services**

|   |     |
|---|-----|
| 16. Rating given to the <b>stability, competitiveness and services</b> provided by the banking system | 2.6 |
|---|-----|

The privatisation of the Savings Bank, the only remained state owned bank, albeit holding about 80% of deposits, without fully ensuring state protection of deposits according to international standards, is thought to have led to a run on deposits in April 2002. Because this was quickly addressed by the government, business confidence in the banking system was maintained. The SME entrepreneurs participating in the focus groups assess the stability, competitiveness and services provided by the banking system as being close to “satisfactory”. For example, the entrepreneurs in Vlora think that:

***“...as the number of banks has increased..., the services offered to businesses have considerably improved.”***

**Issues:** Despite recent banking crises, the participants consider the general stability, competitiveness and services provided in Albania to be close to “satisfactory”.

### **Banks' Interest / Attitude to SMEs**

|   |     |
|---|-----|
| 17. Rating given to the commercial banks <b>interest in developing SMEs</b> and their <b>lending attitude</b> to the SME sector | 2.1 |
|---|-----|

Although the above conclusion applies in general terms to the banking system, entrepreneurs are not as positive when it comes to discussing SME-specific issues. The entrepreneurs participating in the research assess the commercial banks' interest in developing SME sector and their lending attitude to finance SMEs as being “poor”. The key reason for this, and the source of much discussion in the focus groups, was the fact that entrepreneurs consider the interest rates applied by the commercial banks to be so high that they:

***“... keep businesses away from commercial banks.”***

In addition to the perceptions regarding interest rates applied to bank loans, collateral requirements of typically 140% of the loan requested are also a concern, though this is of secondary importance compared to the interest rates charged.

In addition, entrepreneurs located outside Tirana consider that the highly centralised credit decision-making process results in considerable delays in the processing of loan applications. The entrepreneurs from Shkodra argue that commercial banks are reluctant to invest in the District of Shkodra, one of the least economically dynamic regions of Albania. The social unrest during the period 1997-1999 and the associated uncertainty and risk is thought to have discouraged commercial banks from either opening branch offices or offering the normal range of services, to the detriment of the enterprises in the area. Banks are not seen as the only culprits in this respect:

***“Shkodra is politically 'persecuted' in terms of the government's investment priorities. This has very negative impacts on the enterprises located here.”***

**Issues:** Entrepreneurs feel that more could be done to develop SMEs by reducing interest rates and collateral requirements. In their view, the banks' highly centralised credit application process leads to delays. Banks are regarded as being unwilling to open branches and offer a full palette of services in certain areas.

### **Access to Finance**

|   |     |
|---|-----|
| 18. Rating given to the <b>access to key sources of finance</b> and guidance on financial matters to small businesses | 1.9 |
|---|-----|

Despite the close to “satisfactory” rating for the banking system, SMEs feel that access to capital remains “poor” as far as small businesses are concerned.

**Table 3-1. Relative Importance of Main Financial Sources Accessed by SMEs**

| Financial Sources            | Rating | Rank |
|------------------------------|--------|------|
| Family or individual capital | 2.8    | 1    |
| Micro-finance                | 2.3    | 2    |
| Repatriated capital          | 2.2    | 3    |
| Commercial bank loans        | 2.0    | 4    |
| Other (e.g. credit unions)   | 1.9    | 5    |
| Leasing                      | 1.5    | 6    |
| Venture capital              | 1.4    | 7    |
| Credit reference sources     | 2.1    | 8    |
| Bank personnel skills        | 2.6    |      |

Note: The ratings used to represent the views of the entrepreneurs range from 1 to 5 and can be read as follows: 1 = very poor, 2 = poor, 3 = satisfactory, 4 = good and 5 = very good.

Only access to family or individual capital is rated as approaching the “satisfactory” level. This reflects the continuing reliance on informal sources such as friends and family credit rather than the formal banking or micro-credit sector. Micro-finance is also regarded as being easier to access than commercial bank loans, reflecting the fact that most Albanian businesses are micro-enterprises and are attracted by the borrowing procedures from the micro-credit foundations which tend to be cash-flow oriented, rather than basing their lending decisions on established track-records and collateral. Considering the significance of repatriated capital in Albania, accounting for about \$500 million in 2001 (Bank of Albania, 2002a), the relatively young micro-finance industry has done well to reduce its importance to third place as a source of finance for small enterprise activities.

Box 3-6 examines the sources of finance for SMEs' needs.

#### **Box 3-6. Sources of Finance for SMEs' Needs (BEEPS, 2002)**

According to the BEEPS, the two aspects of the business environment for SMEs pertaining to finance (cost of and access to capital) are rated between modest and moderate obstacles to doing business (respectively at 2.7 and 2.1). Differently from other countries of the region, where these types of obstacles are always ranked among the most important, they are ranked only tenth and seventeenth in the set of 21 potential obstacles to doing business. However, an analysis of the sources of finance used by the Albanian entrepreneurs in the past to finance both their working capital needs and new investments shows a very high reliance on internal funds and loans from family and friends (internal sources of finance account for 89.1% of working capital finance used and 87.5% of finance utilised for new investments). In particular local and foreign banks play an irrelevant role in providing finance to SMEs (3.4% for working capital and 4.0% for new investment), with supplier credit being used more widely than foreign banks. On a more positive note, 95% of all firms interviewed managed to obtain finance (either internal or external) to fund new investments (almost all enterprises could find some source of finance to fund their working capital needs). The following table presents the relevance of sources of finance used by interviewed entrepreneurs for working capital needs and to finance new investments in percentage of total.

| Working Capital     |       | New Investment      |       |
|---------------------|-------|---------------------|-------|
| Internal funds      | 83.7% | Internal funds      | 80.6% |
| Family/Friends      | 5.4%  | Family/Friends      | 6.9%  |
| Supplier credit     | 2.8%  | Supplier credit     | 3.0%  |
| Foreign banks       | 2.3%  | Foreign banks       | 2.6%  |
| Government          | 2.0%  | Other               | 2.4%  |
| Money lenders       | 1.3%  | Private local banks | 1.4%  |
| Private local banks | 1.1%  | Government          | 1.4%  |
| Customer credit     | 0.6%  | Money lenders       | 1.1%  |
| Other               | 0.5%  | Equity              | 0.3%  |
| Credit cards        | 0.2%  | Customer credit     | 0.2%  |
| Equity              | 0.1%  | Leasing             | 0.1%  |
| State-owned banks   | 0.0%  | State-owned banks   | 0.0%  |
| Leasing             | 0.0%  | Credit cards        | 0.0%  |

With interest rates for loans ranging between 14%-18% per annum and collateral requirements ranging from 130%-200% of the loan request, commercial banks' requirements are viewed as being "prohibitively" expensive. On the other hand, the skills of the bank personnel on offer are generally considered to be close to the "satisfactory" albeit with large variations in the level of service offered. The FEDAD micro-finance bank is singled out as being one of the better examples in this respect.

Access to other forms of credit is rated as being well below average, with leasing (1.5) and venture capital (1.4) being the least accessible of all. There is a perception that the leasing legislation is not able to stimulate the market and that the current venture capital funds are more risk-averse than elsewhere in the SEE region. While credit unions exist, the low rating obtained reflects the fact that SMEs do not have easy access to them.

Box 3-7 analyses the SMEs' perception of the ease of obtaining bank loans.

**Box 3-7. SMEs' Perception of Ease of Obtaining a Bank Loan  
for Working Capital/Investment Needs (BEEPS, 2002)**

A further question was asked regarding the entrepreneurs' perception of the ease with which they would be able to obtain a loan from a commercial bank for both working capital needs and for financing a new investment. The answers from this hypothetical question point to difficulties in dealing with the banking sector. Only 38% of entrepreneurs think it would be easy to obtain a bank loan for working capital needs and just 23.7% are of the same opinion as regarding obtaining finance for new investments. It is worth noting that SMEs believe that accessing bank loans for the financing of new investments is much more difficult than accessing working capital loans from banks. The entrepreneurs' responses to this question are presented below in percentage of total.

| Accessing Bank Loans for | Working Capital | New Investment |
|--------------------------|-----------------|----------------|
| Impossible               | 2%              | 10.5%          |
| Very Difficult           | 18%             | 25.6%          |
| Fairly Difficult         | 34%             | 31.6%          |
| Fairly Easy              | 35%             | 21.7%          |
| Very Easy                | 3%              | 2.0%           |
| N/A                      | 8%              | 8.6%           |

The BEEPS results on financial obstacles in Albania thus indicate the presence of a serious impediment in doing business, partly relieved by the availability of large amounts of internal finance. Albania is in fact the largest recipient of remittances from abroad among the countries of the Stability Pact area. The fact that the financial constraint are not ranked at the top of the list of obstacles to doing business is not in contradiction with the above but simply means that other aspects of doing business present even more severe obstacles.

**Issues:** Access to all forms of credit is low. Family or individual capital is the main source, although a significant development is that micro-finance appears to have established itself as being of greater significance in Albania than repatriated capital. Other forms of finance are not significant, with leasing being underdeveloped.

#### Access at Local and Regional Levels

19. Rating given to the access to finance at **local and regional levels**

2.7

Based on the preceding discussion, SMEs think that accessing start-up capital and finance for expansion is very difficult in Albania, and that the choice of credit providers beyond Tirana is even more restricted. A range of reasons are advanced as to why access is so poor, such as the relatively limited

network of regional branches, partly related to perceptions of higher political risk and lower profitability especially in the northern parts of the country. There is little financial resource on offer to assist enterprise development at the local and regional levels.

**Issues:** Access to capital at the local and regional level is considered to be limited, partly because the network of bank branches is underdeveloped.

#### Access by Sector

|   |     |
|---|-----|
| 20. Rating given to the access to <b>financial sources for all sectors</b> including technology companies | 2.3 |
|---|-----|

Access to finance is considered to be theoretically available to all sectors of economic activity. In practice, entrepreneurs maintain that the access is quite restricted at the present time.

#### 3.6. Advisory Services for New and Small Businesses

The issues researched under this heading:

21. Satisfaction with the range and quality of advisory services available to new entrepreneurs and SMEs and rating of the present services and comment on the changes needed.
22. Efficiency of advisory services operations.
23. Responsiveness of advisory services provided to demand and the needs of enterprises.
24. The skills, experience and quality of the staff providing business advisory services.
25. The continuity of business advisory services available.

#### Range of Advisory Services

|   |     |
|---|-----|
| 21. Rating given to the satisfaction with the <b>range of advisory services available to</b> new entrepreneurs and SMEs | 2.5 |
|---|-----|

Entrepreneurs rate the range of business advisory services available as approaching the “satisfactory” level, with this section of the focus group research obtaining the highest ratings of the six dimension of good practice in the report. This may reflect two issues: the fact that the business advisory services available are indeed broadly satisfactory and the possibility that the main provider of business advisory services to SMEs in Albania, the Regional Development Association network, facilitated the focus group research, thus possibly introducing an element of bias into the results. Since the ratings for Albania are consistent with the results in the other eight Enterprise Policy Performance Assessments conducted in the Stability Pact countries, a significant degree of bias is not evident.

The level of satisfaction with the range of services on offer is not evenly spread in Albania, since the majority of such services are concentrated in the capital city:

***“...in the District of Shkodra, businesses completely lack specialised business advisory services.”***

***“Business advisory services are not available in this city [Vlora].”***

**Issues:** There is a degree of satisfaction with the range of advisory services available, however, these are concentrated in the capital city, resulting in gaps in provision.

#### Efficiency of Advisory Services

|  |     |
|--|-----|
| 22. Rating given to the <b>efficiency of advisory services</b> available to SMEs | 2.5 |
|--|-----|

The SME owners and managers participating in the focus groups think that the business advisory providers operate in a broadly efficient manner. The entrepreneurs discussed the reasons why the advisory services market may not be functioning in a fully commercial manner. The view is that when donors establish or subcontract organisations to provide training and consultancy for SME development, these initiatives tend to be offered at zero cost or at a highly discounted rate compared to the price for commercial provision. This is argued to result in distorted price signals as far as potential clients are concerned, affecting their willingness to pay for such services and possibly undermining the long-term financial sustainability of existing business advisory centres. In addition, the entrepreneurs from Shkodra argue that provision cannot be considered to be efficient so long the poorer and/or more remote areas of the country lack business advisory service providers.

**Issues:** The efficiency of the advisory services approaches the “satisfactory” level, however, many areas lack such services. Variations in donor and IFI policy regarding charging for business advisory services is thought to affect willingness to pay for the services and hinder efforts to achieve financial sustainability.

### Responsiveness to Demand

|  |     |
|--|-----|
| 23. Rating given to the <b>responsiveness of advisory services</b> to demand and needs | 2.0 |
|--|-----|

By contrast, only a minority of the participants in the focus groups feel that that the services being provided are responsive to the demand and needs of SMEs, resulting in a “poor” rating. Business advisory providers typically offer such services as start-up training, marketing, credit applications and business planning. Based on the discussions, the SME owners and managers hope that as the number of SMEs and advisory services grow, competition will result in a wider range of services being offered to them, with concomitant effects on the quality. Other entrepreneurs consider that given Albania's stage of economic development, the existing enterprise assistance is: “... *more than necessary*.”

An SME expert maintained that entrepreneurs are not always aware of the services that are on offer or what exactly they really require in order to improve their business activities:

***“How can SMEs know what they need if they are not even aware of what services are available to them?”***

**Issues:** The business service providers are not considered to be sufficiently responsive to the small business' actual needs, although this may change in future. By the same token, providers are not convinced that entrepreneurs are fully aware of what is potentially available to them.

### Human Capital

|  |     |
|--|-----|
| 24. Rating given to the <b>skills, experience and quality of the staff</b> providing advisory services | 2.7 |
|--|-----|

The existing networks of providers, including profit-oriented companies, are considered to have broadly the right range of skills, experience and quality. Although they obtained a rating close to “satisfactory”, at the same time entrepreneurs perceive a need for further improvements in the human capital of these organisations.

**Issues:** The quality of the staff available is thought close to “satisfactory”, however, it could be enhanced so as to deliver a wider range of business expertise, as increasingly demanded by small enterprises.

### Continuity of Provision

|  |     |
|--|-----|
| 25. Rating given to the <b>continuity of advisory services</b> available | 2.6 |
|--|-----|

The rating given by entrepreneurs for the continuity of business advisory services approaches the “satisfactory” mark. The respondents in the Tirana region rated continuity of business advisory service

provision highest of all (3.2), whilst those outside the capital in Shkodra and Vlora rated it less well (2.4 and 2.1 respectively). This reflects the concentration of provision in and around the capital city, which also means that there is a greater degree of continuity of provision in that area.

It was argued that most SMEs have difficulties paying commercial fees for business advisory services delivered by consultancy companies. As a result, they tend to use business advisory services provided through donor-funded networks, which as discussed earlier, are either free or subsidised. This raises the risk that once donor programmes come to an end, continuing access may be jeopardised if the business advisory centres fail to become financially sustainable.

**Issues:** Continuity of provision of advisory services is assured in the capital city by virtue of the concentration of such providers. This is not necessarily the case elsewhere, especially once donor funding is withdrawn. Financial sustainability has yet to be secured for the business advisory centres that have been established.

### 3.7. Business Incubators

The issues examined under this heading were:

26. Experience with business incubators and importance to new entrepreneurs and existing SMEs.
27. The efficiency of the government policy and programme encouraging business incubators.
28. The state of the business incubators' governance structures.
29. The locations, the infrastructure and facilities of business incubators.
30. The extent to which the business incubators' activities are focussed on the needs of the local entrepreneurs.
31. The extent to which the operating conditions, services and charges are transparent and clear.

#### Experience of Business Incubators

|   |     |
|---|-----|
| 26. Rating given to the business incubators' <b>importance</b> to new entrepreneurs and existing SMEs | 1.5 |
|---|-----|

The great majority of entrepreneurs in the focus groups did not have a clear idea about the nature, aims and functions of business incubators. Although two business incubators have been established since 1998 in Albania, the overall rating given to the importance of business incubators lies between "poor" and "very poor". As one entrepreneur from Vlora put it:

***"...businesses do not know anything about business incubators and what their role is."***

The very poor levels of knowledge mean that the rating obtained must be treated with caution. The participants assess the importance of business incubators to start-ups and existing SMEs as lying between "very poor" and "poor" (1.5) and the government policy in encouraging business incubators is rated in a similar light. The fact that not many respondents had heard of the two existing business incubators leads the participants in the focus groups to assign a "poor" rating (1.7) to the extent to which they satisfy entrepreneurs' needs. Issues such as governance structures, facilities and operating conditions could not be fruitfully discussed and, therefore, ratings were not obtained.

**Issues:** For a country that has had two business incubators since 1998, there is remarkably little knowledge of their nature, operation and effectiveness.



## Chapter 4.

### ANALYSIS AND ASSESSMENT

This chapter presents the OECD-EBRD analysis and assessment of the six dimensions of good practice for the business environment to complement the analysis of the discussions with the owners and managers of SMEs presented in the preceding Chapter of this report. It reviews the current situation in each of these areas, takes into account other OECD and EBRD studies and analyses of good practice, and the private sector views, based on the preceding qualitative research with the owners and managers of SMEs. The assessment of the current situation leads to a series of recommendations by the OECD and EBRD, presented in Chapter 1.

#### 4.1. Implementation of the Institutional Framework for SME Policy

##### *The Situation on the Institutional Framework*

SME activity in Albania is closely linked with a *variety of public institutions* such as ministries, agencies, regulatory bodies, as well as the Courts, Institute of Statistics and local government. This is a complex range of organisations that do not always co-ordinate and co-operate in forging ahead with the agenda for improving the business environment. The principal responsibility for SME policy development falls to three main bodies: the Business Promotion Department of the Ministry of Economy, the Small Business Development Agency (the SBDA is expected to start operating at national and regional level in the near future); and the Economic Policy Committee, reporting to the Council of Ministers and operating at the inter-ministerial level.

The Ministry of Economy has the responsibility for SME policy development. The Ministry of Economy's *Business Promotion Department* is responsible for designing, reviewing and implementing the SME policies and programmes. A key responsibility is the preparation and approval of the *National SME Strategy*, whose implementation the SBDA will oversee once it is created. The first draft SME strategy was created in 1996 but due to a number of circumstances, such as the economic and financial turmoil of 1997, the Kosovo crisis of 1999, etc. this was only approved by the Albanian government in February 2001.

The SME strategy plays a key role in the government's strategic goals for the social-economic development of Albania. In approving it, Albania recognised that implementing a strategy for rapid and sustainable SME development would require considerable resources and support. The effective implementation of the SME strategy is thus premised on a strong public-private partnership, as well as on close co-operation of all local stakeholders and the international donor community. The strategy envisaged a "bottom-up" approach to identify the needs of SMEs and thus create a positive business development climate to allow for sustainable SME growth, however, the process of consultation does not appear to have been as extensive as originally envisaged.

The SME strategy seeks to achieve the following:

- Institutional strengthening and development through SME policy and programme development and delivery of SME support services via intermediary institutions (such as the Chambers of Commerce, Regional Development Agencies, business associations, consultancy companies, etc.).

- Working towards a transparent legal and fiscal framework which is conducive to SME development (e.g. a database of laws and measures affecting SMEs, reviewing and reforming legislation, etc.).
- Improving the management of SMEs, via training programmes delivered by intermediaries.
- Improving access to finance by expanding micro-finance and initiating new tools such as credit guarantee schemes, seed capital, leasing, etc.
- Achieving balanced regional and sectoral development through incentives to stimulate SME development in deprived areas and regions.

The SME Law (2002) provides for the establishment of an SME Agency in Albania, to be called the Small Business Development Agency (SBDA). In response to this law, the Council of Ministers has issued two decisions for the approval of the budget of SBDA (Decision No.56, dated 23.01.2003) and approval of its statute (Decision No. 74, dated 06.02.2003). The SBDA will be a not-for-profit public entity operating both in Albania and internationally, and may establish local offices to assist the implementation of its activities. Its key functions are defined as follows:

- Implement policies, strategies and programmes in support of SME development.
- Propose amendments to laws and bylaws, as well as the regulatory framework, economic, fiscal and financial policies influencing SMEs.
- Develop a close relationship with the Council of Ministers through its Supervisory Board.
- Co-ordinate SME development activities and programmes by communicating with all ministries, institutions, chambers of commerce, regional business agencies, business associations and other SME stakeholders, including the business community in general.
- Undertake research activities such as feasibility studies, market research, surveys and training.
- Collect and disseminate SME information to all interested parties.
- Evaluate incentives for SMEs and formulate proposals to improve finance for SMEs, etc.

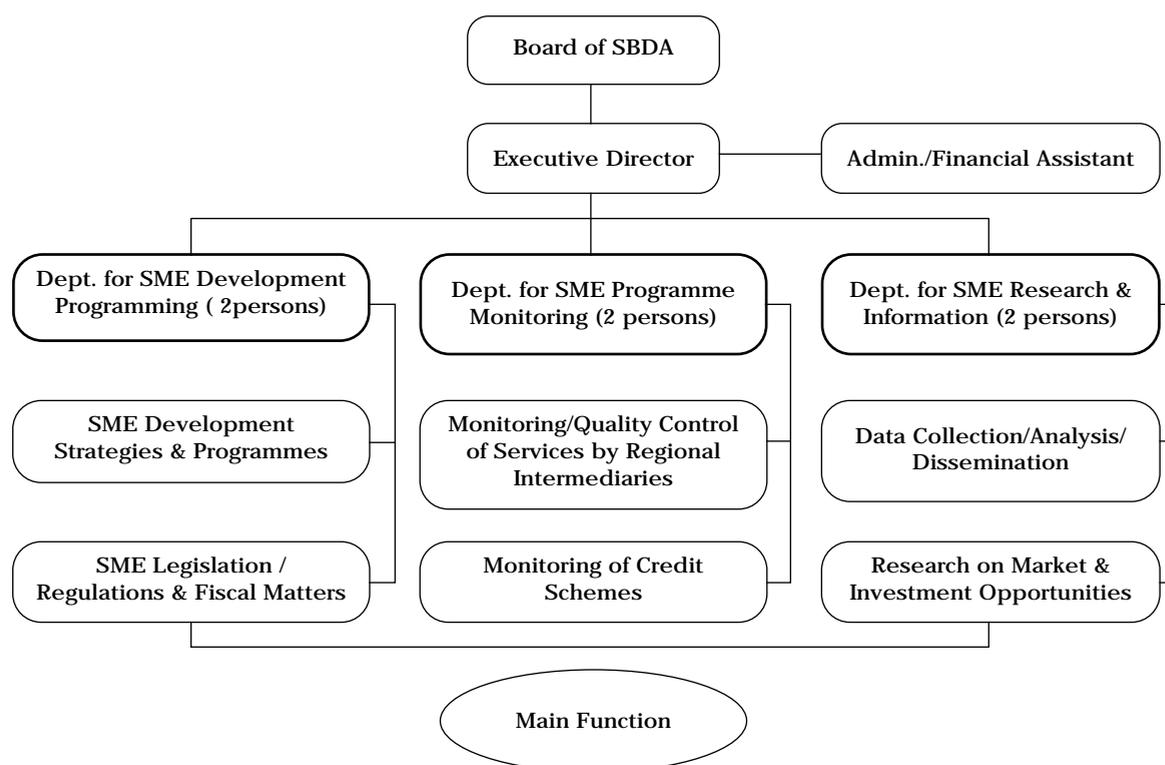
The main source of finance for the SBDA will be the state budget, however, the financial situation is far from clear. Decision No. 56 provides for very limited funding (ca. €20,000) for 2003 when it is expected to become operational. However, the SBDA is able to obtain additional funding from local and international donors, subject to approval by its Supervisory Board. Donors that contribute more than 50% of the budget have the right to appoint an advisor to the Executive Director of the SBDA. The Executive Director has a duty to consult with such advisors on the use of the donated funds in order to ensure accountability and transparency in their use. No information exists at the time of writing about the nature and role of the Supervisory Board, or indeed about a variety of other issues, such as when it will become operational, its staff complement (figure 4-1. implies a lean organisation of eight staff), likely premises, number of regional offices, how it will report to the Ministry of Economy, whether it will have an SME advisory board for consultation purposes, etc.

The co-ordination and development of the programmes will be carried out SBDA but the actual implementation of these programmes, such as the delivery of services to support SMEs, is expected to be carried out via intermediate regional institutions such as Regional Development Agencies, Chambers of Commerce, Business Centres, Business Associations and Advisory Firms (Ministry of Finance, 2002). It is worth noting that the intention of the Ministry of Economy is to carry out the above programmes in close collaboration with local and regional government, and other relevant international donors (not least USAID, EU, WB, GTZ, UN, etc.).

The official policy position is to allow all relevant Ministries input into SME policy, strategy and development. This is done through meetings of the *Economic Policy Committee*, established by Prime Minister and composed by senior officials and ministers. These include Ministry of Finance, Labour and Social Affairs, Industry and Energy, Public Works and Tourism, Agriculture and Food, Transport and Telecommunication and Environment. These ministries are also responsible for stimulating SME development through programmes that:

- Create new employment and promote investment.

Figure 4-1. Proposed Organisational Structure for the SBDA



Source: Council of Ministers Decision No. 56, 23.01.2003

- Increase export activities and improve SMEs competitiveness.
- Improve information on advisory services.
- Increase and strengthen professional qualifications and entrepreneurship.
- Support the enlargement of SMEs using advanced technology.

Several attempts have been made by the government to increase the participation of the SME stakeholders in a Government-Business consultative process. For example a *Business Advisory Council (BAC)* was established in February 2000 to provide a regular mechanism of dialogue on business-related legislation and procedures. The Council was proposed and is Chaired by the Minister of Economy. Although several meetings have been held, they are irregular in nature and tend to focus on the fiscal package associated with the annual state budget and the related tax changes.

### Assessment

The government has undertaken several important initiatives to address the issue of SME development in Albania, not least the creation of the Business Promotion Department at the Ministry of Economy, the approval of a national SME strategy, the adoption of an SME Law and the intention to establish an agency to implement SME policy and strategy. All these efforts are important, but they remain at an early stage of implementation and their effectiveness remains to be seen. The government has emphasised the need for effective implementation of the strategy and the necessity to make the SBDA operational and effective as soon as possible. The fact remains, however, that progress has been slow and, based on the views of the SME owners and managers participating in this research, entrepreneurs are highly critical of the existing situation.

The variety of uncoordinated institutions involved in SME development, combined with the fact that the SBDA has not yet been implemented, mean that it appears to entrepreneurs as if clear responsibility for SME development has not been allocated by central government and their effectiveness in encouraging start-ups and development of existing small enterprises is poor. There is a need to enhance the institutional support to SMEs. For example, it is still unclear when the SBDA will be up and running, whether it will have adequate staff and financial resources (state support amounting €20,000 for 2003 does not inspire confidence in its future sustainability), whether it will have a regional structure, etc. Regarding the latter issues, it is important that any regional structure that may be developed does not replicate or compete with what already exists on the ground. In particular, attention needs to be given to the areas of the country that have limited or no SME support infrastructure (see also section 4.5 below).

Following six years of preparation leading to a government-approved national SMEs strategy, entrepreneurs expect its implementation to be more effective than its preparation. It is the duty of government to ensure that the strategy is adequately resourced and effectively implemented, whilst securing equality of access and geographic fairness in the distribution of support. This can be achieved by improving the quality of SME-related policies, enhancing institutional capacities, providing clear mandates and resources at local level, etc. However, in the continuing absence of the SBDA there remains an important lacuna in government policy-making and implementation, since the Ministry of Economy's Business Promotion Department has neither the remit nor the capacity to do this.

Although there is a reasonable degree of satisfaction with the SME strategy, the feedback received is that there has been little progress on the implementation side. The research with SME owners and managers indicates a dearth of information and awareness about the institutions, policies, programmes, etc. on SME development, an issue that is even more acute in the case of firms located in remote areas. The SME strategy itself is considered to be theoretical in nature, rather than something that offers practical benefit to small enterprises. At the local level, local authorities have an enterprise development remit but virtually no resources to develop an effective enterprise support capacity, leading to a perception that local authorities largely ignore the small enterprise sector.

Businesses are extremely wary of government. The existing advisory bodies for government-business consultation, such as the Business Advisory Council (BAC) and the Chamber of Commerce to a lesser extent, are neither viewed as being representative of Albanian small enterprises nor as providing adequate consultation and dialogue on policies affecting small businesses. The BAC is a positive development but does not appear to be operating to full effect at present. The selection of the business community needs to be done on a representative basis. Consideration needs to be given to ensuring that this becomes a representative, regular, effective mechanism for government-business dialogue and representation, as anticipated by the national SME strategy. It is the business of government to provide effective mechanisms for consultation between public institutions and private sector representatives.

#### **4.2. Implementation of the Rule of Law and the Regulatory Environment**

##### ***The Situation on the Rule of Law and the Regulatory Environment***

According to the Commercial Companies Law and the Civil Code, an enterprise can either be a legal or physical person (i.e. an individual). A legal person or enterprise can take one of the following forms: partnership, limited partnership, limited liability or joint stock company.

On average it takes seven steps to register a company (from getting a bank account and registering at the court, to licensing at the tax office) and payment of seven sets of fees for various licences and permits (e.g. health and safety). A key stage for the registration of a company is the presentation of proof of all these steps and payments to the *District Court in Tirana*, followed by its approval with a court decision, which takes 23 days on average. While registration is open to anyone wanting to establish a company, such registration can take place only at the Tirana District Court. This requires businesses from other areas to

travel to Tirana to register their businesses. Further information on the registration and the licensing procedures is set out in box 4-1.

#### Box 4-1. Registration and Licensing

Legal persons are required to submit the following to the district court: foundation act, statute, certificate of payment of start-up capital, ownership/leasing contract for the premises to be used. The court should make a decision within a month. A copy of the decision goes to the Chamber of Commerce and Industry. The Trade Register documents include a copy of the court decision, company contract / statutes, ownership / leasing contract and certificate of the registration tax.

The documents needed in order to obtain a license include: statute of the company, act of foundation of the company, the decision of the Tirana Court, attestation of the Social Support Office, contract with the Labour Office, attestation of Social Security Office, registration in Chamber of Commerce and Industry, tax for advertising, tax for exercising the activity, cashier register, tax for the building, tax for renting the land, tax for cleaning, opening of bank account and the attestation of the bank and hygiene/sanitary permission from the Inspection Services.

Most businesses do not need to re-register annually, depending on the economic activity, but some do, such as construction companies. The documents submitted by the legal entities in order to re-register the business include: the old license with two photographs of the company's administrators, the address of the firm, the contract with the social security office, the contract with the labour office, all the tax bills paid in the preceding year, the bill for the rent payment in the preceding year, all the permissions renewed and submitted, the changes in the statute and in other acts of foundation presented, after being incorporated in the trade register.

Following registration in the Trade Register the legal persons must present a request for registration in the local tax office. They also present the court decision on the company, the trade register certificate and the bank account details. After verification of the above documents, an annual license and certificate form containing the VAT identification number is provided by the tax office.

Apart from the costs of due diligence and those of lawyers in drafting the articles, other costs include the fees paid to the different offices involved in the registration of a company. These include the registration fees paid in the Office for the Registration of Companies in the District Court of Tirana, the fees for the registration in the Chamber of Commerce and Industry (annual fee), fees paid for the registration in the tax office, including the local tax. Other costs are related to the notaries and translation if the documents are not in Albanian, and opening a bank account. The estimated cost of registration can be up to €650.

Source: PPF1

The basic notary services for registering an enterprise are officially said to be €192 but the estimated costs range between €350–€650 (Guide for Investment in Albania, 2002). Just the notary costs amounts to about 24,000 Lek (about €170) and there is also a minimum deposit requirement in order to open a bank account, which varies from bank to bank.

The *court system* in Albania consists of District Courts, Appeal Courts, Supreme Court and the Constitutional Court. There are no national Commercial Courts, however, at the district level, courts have a special division dealing with commercial disputes. There is currently no arbitration system in Albania, a gap that is acknowledged by the Ministry of Justice, and work on changing this is at an early stage. As a result, the duration and procedures for settling commercial disputes are known to be long and often complex.

According the law on Public Procurement, the *National Procurement Agency* is the main institution responsible for developing and monitoring the public procurement process in Albania. This institution is

under the Prime Minister's Office and performs its activities through local units in different public institutions, including municipalities. There is some evidence that the National Procurement Agency may have applied inappropriate public procurement procedures. It is subject to anticorruption measures included in the National Anticorruption Plan (Council of Europe and US, 2002).

The Bankruptcy Law (No. 8017 / 1995) determines what happens when a commercial company becomes insolvent. Once a bankruptcy decision is filed, the court:

- Appoints a receiver in order to manage the properties of the debtor.
- Sets a deadline by which all claims against the debtor should be filed.
- Sets the dates for the creditors' meeting (if any), examination of credits and the deadline for the submission of the debt repayment claims.

With regard to the priorities and claims, according to article 21 of the Bankruptcy Law, the Court prepares a list of the claims submitted by the creditors in the following order:

- Tax and other obligations towards the State which have not been fulfilled by the debtor (the law also refers to claims filed by international organisations).
- Claims for the reimbursement of credits extended by banks for the acquisition of commodities.
- Claims filed by the social and health insurance bodies.
- Labour claims.
- Other claims.

The *informal economy* is believed to have an extensive influence on economic development generally, and SME development specifically in Albania. Despite the significance of this issue, comprehensive studies do not appear to have been undertaken to quantify its extent. The main source of reference remains an empirical study undertaken by the Albanian Centre for Economic Research (ACER, 1999) which estimated the informal economy constituted 30% of Gross Domestic Product (GDP) in 1998. This estimate excludes the remittances from overseas which alone account for about 14% of GDP or about €600 million (Bank of Albania, 2002a). The informal credit market is also thought to be extensive, leading to the working hypothesis that the actual size of the informal economy is substantially higher than estimated in 1998.

Corruption represents one of most serious constraints to more rapid economic development in Albania. It affects entrepreneurs' willingness to register their businesses and raises the cost of doing business. In addition, nepotism, political patronage and bribery are believed to be commonplace. A "culture of non-compliance" is prevalent in both business and government circles. The Transparency International Index (2002) ranks Albania 81 out of 102 countries, with an average of 2.5 out of 10 (the lower the score, the higher the degree of corruption). The *Albanian Commission Against Corruption* was created (Gov. Decree No. 72 / 1998) in order to address these issues by developing an anti-corruption strategy, co-ordinating anti-corruption activities (by public institutions and private sector) and co-operating with the International Financial Institutions (IFIs) to further anti-corruption initiatives.

The government has sought to increase the accountability and transparency of civil servants' activities. The Law on the Status of Civil Servants aims to depoliticise public institutions by providing equal access to public institutions, thereby avoiding nepotism. This law is said to be comprehensive, however, it is unclear how much implementation progress has been made.

In the time since the research was undertaken, a comprehensive report has been published (FIAS, 2003) on Removing Administrative Barriers to Investment, which sets out a detailed analysis of the problems sketched above and recommends a series of actions to counteract the problems in Albania.

## **Assessment**

Based on the research, there is a strong and pervasive impression that public officials often apply laws and regulations in an arbitrary and subjective manner. The lack of clarity and transparency in the enforcement of laws/regulations creates a business environment characterised by suspicion and lack of trust in Albania. This, combined with a general lack of systematic publication and dissemination of legal norms, court decisions and other information relevant to businesses, increases the scope for rent seeking activity. The problem is compounded by the fact that, as far as SME managers and owners participating in the research are concerned, laws and regulations seem to be in a constant state of flux, hindering decision-making, compliance and enforcement.

The business registration process is highly bureaucratic and time consuming in nature. Numerous forms and documents are required for the various pre-determined steps towards registration. International best practice suggests that much of the registration process could be accelerated and streamlined. The necessity for court approval of business registration has been dispensed with elsewhere, reducing the time and cost involved. The Tirana District Court is the source of much criticism by entrepreneurs, especially those located outside the capital city. This degree of centralisation neither results in efficient practices nor does away with scope for corruption. However, the fact that all businesses located outside of the capital must register in the Tirana District Court, leads to significant delays and costs which are borne by those companies. Consideration needs to be given to introducing a “one-stop-shop” system for company registration, including the main licenses required for operation. If the Tirana District Court is to be retained, scope for on-line registration should be urgently prioritised.

The licensing regime is also in need of reform. Unclear and unpredictable application of regulations (inspections, permits, licenses, particularly in tax and customs) impedes business start-ups, renewals and general operation. This is argued by the participants in the research to incentivise activity in the informal economy and promote a sense of discrimination and unfairness vis-à-vis SMEs operating “honestly”. The scope for introducing the principle of “silent consent” should be considered, although it will not tackle all the problems. Under this arrangement, if an official response is not made within a predetermined period by the public body concerned, permission is deemed to have been granted to the enterprise in question.

Administrative barriers pose a great obstacle to business development, yet there is no awareness on the part of SMEs of any effort by government to reform the regulatory environment as it affects small enterprises. With the publication of the FIAS analysis of the administrative barriers to investment (2003), the establishment of a Working Group on Reducing Administrative Barriers to business, as is the case in many countries of SEE such as Romania, would be welcomed by the business community. Any such initiative would need to be well resourced, staffed and operate within the framework of a government-approved action plan for reform. It would need to consult with the business community and have the capacity to convert proposed reforms into improvements whose benefits can be felt rapidly “on-the-ground” by entrepreneurs. For now, SMEs remain to be convinced of the Government's seriousness in addressing the challenge of regulatory reform.

While the legislative framework is becoming generally more complete and comprehensive, the same cannot always be said of the implementation and enforcement side of the activities. Both the experts and the SME representatives participating in the research agree that corruption and the informal economy are widespread in Albania, and that these phenomena have a pervasive effect in impeding business development generally, with multiple negative impacts on the SME sector. They result in reduced tax revenues and, therefore, a higher tax burden and unfair competition on compliant businesses. The process instituted by government to reduce incentives to operate in the informal economy needs to be expedited and implemented in a systematic and determined manner in all sectors of the economy.

The level of corruption is a widespread phenomenon in Albanian society and is of vital concern to SMEs. The efforts to tackle corruption, such as the Albanian Commission against Corruption, are welcome

developments. SMEs acknowledge the government focus on this issue but are sceptical about its likely impact, since the results achieved so far are perceived to be very modest. Unlike the situation in other countries, the government programme has been in place since 1998, a sufficient period of time for positive effects to be detected. SMEs must perceive these beneficial effects, if they are to be persuaded of the government's seriousness in addressing this issue.

The current mechanisms for consultation on draft legislation and reforms to the regulatory environment are in need of attention. Consultation on new laws that have direct impact on the activities of SMEs is rare and principally achieved through the Chambers of Commerce. On the occasions when consultation does occur, there is little confidence that entrepreneurs' views will be taken on board. SMEs would welcome a higher degree of regular consultation, involving a wider range of business representative bodies and SME stakeholders than is presently the case.

### 4.3. Implementation of Tax Policy for Small Businesses

#### *The Situation on Taxation Policy for Smaller Businesses*

The Albanian government has introduced a number of reforms to the tax legislation, policies and, more recently, the administration itself. The *tax system* operates according to the calendar year and the total tax revenue amounted to €650 million or 15.5% of GDP (Bank of Albania, 2002a) in 2001.

Six main taxes apply to enterprises. Table 4-1 summarises the main taxes and rates. In addition, a further 24 national taxes and 13 local taxes are applicable to various transactions and activities.

Table 4-1. Taxes on SMEs in Albania (2002)

| Tax                  | SMEs                                   | Rate   | Frequency |
|----------------------|--|--|-----------|
| Corporate Income Tax | Exempt                                 | 25%  | Quarterly |
| VAT                  | Exempt if turnover under Lek 2,000,000 | 20% (plus refunds only for amounts over Lek 400,000 and if a credit has been carried forward for 6 consecutive months) | Monthly   |
| Small Business Tax   | Applicable                             | Fixed rate (Lek 15,000 to Lek 100,000) plus 4% of turnover (over Lek 2,000,000)  | Bi-annual |
| Property Tax         | Applicable                             | Lek 50-100 per m <sup>2</sup>  | Annual    |
| Excise Tax           | Applicable                             | 5-110%   | Monthly   |
| Social security      | Applicable                             | Employers (34.2%); Employees (11.7%)   | Monthly   |

Source: PPF1

The *Corporate Income Tax (CIT)* applies to all legal entities undertaking commercial activities in Albania, whether domestic or foreign. A unique profit tax of 25% is applied to all types of activity. Tax credits of up to 60% may be available where a company reinvests its profit in the productive sector. In addition, if a company does business in the productive sector (e.g. oil and gas, energy, minerals, chemical, wood and paper products, construction, machinery and equipment, etc.) for at least ten years, profits earned during the first four years of activity are exempt from CIT. Enterprises active in the tourism sector are eligible for a two-year tax holiday on profits.

Companies are expected to make an estimated CIT payment every three months, in advance of the quarter in which the profit will be earned. Companies are also expected to provide an annual financial statement to the tax authorities. A recalculation of the CIT takes place within 15 days of the presentation of the financial statements but due to the inadequate administration, it can take several months for reimbursements to be made.

Albania implemented a *value-added tax (VAT)* in 1996. A VAT rate of 12.5% was applied, subsequently increased to 20% in 1997. There are very few exemptions (e.g. financial services), but exports are zero-rated. Businesses are required to register for this tax if their annual turnover exceeds Lek 2 million (about €14,000). For imports, this taxable value is based upon the customs valuation determined in accordance with Law 7609 on Customs Tariffs.

VAT taxpayers are required to issue receipts that reflect their VAT identification numbers and the VAT payable, as well as documentation of the VAT paid on purchases and sales. VAT taxpayers submit a monthly VAT declaration, together with the payment. VAT taxpayers may request a refund of VAT if two conditions are satisfied: first, the taxpayer must have carried forward a VAT tax credit for six consecutive months and second, the total refund claimed must exceed 400,000 Lek (about €3,000). Despite these stringent conditions, it is not unusual for eligible firms to wait up to six months for reimbursement.

The *small business tax (SBT)* applies to economically active small business / individuals not subject to the VAT and corporate income tax. There are two elements to the SBT: a fixed and a variable tax. The fixed amount (€110 to €740) is imposed on those with annual gross revenues of up to €15,000. The actual amount paid varies depending on the size of the district where the activity takes place and on the nature of the business activity. In addition, a fixed rate of 4% is paid on the annual gross revenues between €15,000 and €60,000. This tax is prepaid twice a year (June and December) and does not apply to agricultural activities.

All persons classified as resident are subject to *personal income tax* on their worldwide income. Exceptions exist for persons who are employed by international organisations that have signed bilateral agreements with the Albanian government. Non-residents are taxed only on Albania income. The tax itself is progressive, with a top marginal rate of 20%. Employers and contractors have the responsibility for withholding tax from wages and transferring it to the state when the wages are paid.

Employers and employees are required to make contributions to the *state social and health care insurance* system. Each month, the employer pays the total social and health insurance tax, which amounts to 45.9% (34.2% employer contribution and 11.7% employee contribution) of the wage, based upon the official wages of the State employees in a range between a minimum of 6,400 Lek (approximately €40) and a maximum of 18,120 lek (approximately €110).

The *property tax* applies to agricultural land and buildings. The Ministry of Finance is in charge of administering the property tax, but communes, municipalities and offices of the state owned electrical company participate in certain aspects of its administration. The revenues from the property tax support the central and local budgets. Various rates apply and are adjusted annually.

*Excise tax* applies to items such as tobacco, alcohol, petroleum products, leather, soft drinks, and water. This excise tax is levied on all individuals and legal entities and rates vary from 5% to 110%. Excise tax on imported products is collected at the same time as the customs duties and is calculated on the basis of the customs value. Excise taxes on domestically produced goods are calculated on the basis of the value of the goods sold and the seller collects these taxes along with the original invoice. The excise duty is paid once by importers or producers of goods and not on subsequent transfers.

*Corruption and smuggling* remain very serious problems confronting the tax system in Albania. Survey results indicate that *bribing* of public officials is relatively widespread and confidence in tax authorities is weak (Chesapeake Associates, 2001). In response, several laws have entered into force such as: the Customs Code, the Law On Tax Procedures, the State Police Law and a revised Civil Service Law, in order to create a more professional and de-politicised civil service. Other measures are being undertaken with a view to strengthening controls on tax officials and increasing penalties on individuals involved in corrupt transactions. Furthermore, an *Independent Audit Authority* has been established to monitor customs personnel and the Customs Service has recently adopted an *Anti-corruption and Anti-smuggling Action Plan*. Despite the many initiatives, however, implementation and enforcement remain problematic.

The taxation legislation sets out specific tax procedures, according to the type of tax and businesses in question. Almost all taxes are *prepaid*, meaning that the private sector is effectively crediting the State at the expense of its own flexibility, with significant potential cash flow implications. For example, the profit tax is required to be paid before profits are realised. Although refunds are foreseen once the balance is done, the process is long and procedures unclear with regard to such issues as deadlines for reimbursement. This makes the process of tax collection and administration burdensome to the enterprise sector and encourages even formal SMEs to evaluate the advantages of transferring to the informal sector (Reci, 2000). Generally, transparency concerns still need to be fully addressed in most laws and the procedures with respect to communication for tax collection, reimbursement of prepaid taxes and dispute resolution. These issues present significant administrative barriers to businesses, especially the small enterprises.

A particularly significant issue for enterprises is the fact that since 1992, the tax authorities have had the right to demand payment of liabilities due directly from the *taxpayers' bank account*. Banks are not only subject to fines for non-compliance, they are also required to submit taxpayers' bank account details every three months. This issue is recognised by the Albanian authorities as being a major concern to all enterprises. Both national and foreign businesses consider it one of the biggest impediments to doing business in Albania, and the issue has been a focus of attention for international donors and IFIs active in trying to improve the business climate, such as the World Bank, EBRD, IFC, etc. Despite the extensive and continuing attention given to this questionable practice, no action is planned to address the issue.

#### **Assessment**

According to the participants in the research, the Albania tax system is characterised by:

- Unpredictability in that taxes and tax rates are change frequently, usually with little or no warning.
- Prepayment of taxes, rather than collection after the activity has taken place or the profit realised.
- Lack of transparency and poor availability of tax information.
- Lack of independent dispute settlement in case of complains.
- Lack of effective consultation on proposed changes.

Albania started its economic and democratic transition inheriting neither an adequate taxation system nor administration. The last decade has witnessed major progress in the taxation system in terms of policies, legal framework and administration. However, the fiscal framework continues to suffer from substantial amendments to the tax laws and rates, most of which reflect the priorities of the state budget, rather than the need to establish a stable, business-friendly environment. As a consequence, the tax system was allocated the second worst rating in the research. Small enterprises are highly critical of the practice of tax changes being introduced frequently, without either adequate warning or advance information being provided to the business community. The total number of taxes is viewed as being excessive. This, together with the frequent changes, places a significant burden on small enterprises, especially those that cannot afford tax experts to ensure they do not fall foul of the law.

The fact that almost all taxes must be prepaid means that small firms with little recourse to formal sources of funds feel that they are subsidising the state. They are critical of the effects of tax prepayment on their cash flow; and are equally concerned about the delays and unpredictability associated with whatever refunds they may be legally eligible for. The necessity to pay taxes before profits are generated is considered to be counterproductive as they do little to incentivise new company registration and may actually achieve the positive effect.

More generally the tax refund procedures, timetables and deadlines are in need of greater transparency, so that they can also be applied consistently. For example, the VAT refund period typically takes up to six months to materialise and can seriously impact the survivability of small enterprises. It should be designed to facilitate cash flow for enterprises, using the international standard of one month. Likewise, the associated conditions do not conform to international best practice.

The fact that the tax authorities can demand both information and payment of tax liabilities directly from the enterprises' bank accounts without prior agreement, remains a major concern for entrepreneurs and a significant barrier to further domestic and foreign direct investment in Albania. This measure is in urgent need of abolition.

Despite recent reductions in the tax burden and a recognition that the tax system is improving, SMEs are highly critical of the tax administration system, not least the abject failure to track-down and identify undeclared income. Economic activity in the informal economy is thought to be extremely widespread, resulting in unfair competition. By default, this imposes a higher burden on legally registered and compliant taxpayers. During the focus group discussions, the entrepreneurs discussed at length the effects on "honest" businesses. In order to avoid further discouraging entrepreneurship and SME business development and to generate a reduction in the size of the informal economy, the government needs to continue widening the tax base by relentlessly tracking down undeclared income. The increased yield could be used to further reduce taxes on business and the social contributions.

There is almost no consultation between enterprises and the Government on tax policy and its administration. The absence of mechanisms for consultation means that unexpected or aggravated tax liabilities can jeopardise start-ups or investment plans. Experience from elsewhere in the SEE region suggests that both the government and the business sector would benefit from a mechanism allowing for more effective, regular and timely consultation on proposed changes. Allied to this, entrepreneurs highlight the authoritarian and non-transparent nature of their interaction and dialogue with tax inspectors. Dispute resolution in cases of complaint does not exist or is underdeveloped.

#### 4.4. Implementation of Financial Instruments for Fostering Small Businesses

##### *The Situation on Financial Instruments*

Despite recent improvements, Albania has a relatively underdeveloped financial sector as indicated by the EBRD financial sector reform score as of end-2002 of 2.3 for the banking sector and 1.7 for the non-bank financial sector (scores range from 1= little or no progress from the command economy to 4.5= equivalent standards and institutions to those of a well functioning market economy). While privatisation of the commercial banking sector is almost complete, the Savings Bank, the only remaining state-owned bank, is still to be privatised. Although other banks have gradually increased their market share in terms of assets (40.8% in 2001 to 46% in 2002), the Savings Bank, which was prevented by the government from issuing new loans to the private sector in 1998, still retains a dominant position in the sector with 54% of the assets as of end-2002. The Savings Bank also still holds 60% of total bank deposits and enjoys the largest branch network (50% of total number of bank branches in Albania).

The development of the non-bank financial sector has lagged behind that of the banking sector. Tirana Stock exchange traded only in treasury bills during the period 1996-1999 and then stopped even doing that because of a lack of demand for its services. Between 2000 and 2001 there were no security or stock trades and the Stock Exchange closed down in August 2001. Although the legal and regulatory basis for an independent Stock Exchange was approved in 2002, its re-establishment has been delayed due to deficiencies in accounting and auditing practices.

Table 4-2. EBRD Financial Sector Reform Index

|                        |  | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|------------------------|--|------|------|------|------|------|------|------|
| Financial Institutions | Banking reform & interest rate liberalisation        | 2.0  | 2.0  | 2.0  | 2.0  | 2.3  | 2.3  | 2.3  |
|                        | Securities markets & non-bank financial institutions | 1.7  | 1.7  | 1.7  | 1.7  | 1.7  | 2.0  | 1.7  |

Source: EBRD

Following the pyramid scheme crisis in 1997, the confidence in the banking sector has been gradually recovering, as shown by the increase in foreign and local currency deposits. Supporting the renewed confidence in the sector, a deposit insurance scheme became operational in October 2002. The Bank of Albania started a campaign to reduce the volume of cash transactions in the economy by urging banks and public utility companies to make it easier for citizens to pay bills directly from bank accounts. The implementation of the new Bankruptcy Law, adopted in October 2002, is expected to have a positive impact on bank lending to the private sector as it provides increased protection of creditors' rights. Banking supervision has been considerably improved but further strengthening of the banking sector is still needed: the sector's capitalisation as of end-2002 was still very low at 6.3% of total assets.

At present there are only three types of institutions providing commercial finance to SMEs in Albania: commercial banks, micro-credit institutions and venture capital funds.

At the end of 2002 the banking sector in Albania consisted of 13 commercial banks, all majority foreign-owned, with the exception of the Savings Bank. When the pre-privatisation restructuring started in 1998, the government banned the bank from lending to the private sector to prevent it from accumulating new bad loans, on top of those it already had.

The level of banking sector intermediation in Albania is low compared to that of other transition countries, especially countries that are candidates for EU accession. As of end of 2002 domestic credit accounted for 44.9% of GDP. Worse than that, domestic credit to the private sector was only 6.8% of GDP (of which lending from commercial banks was 4.7%), reflecting a combination of factors. The public sector's crowding out of the private sector, the banks' lack of skills in lending to the private sector, a series of administrative and regulatory obstacles to traditional bank lending to enterprises and the relatively low demand for bank credit contribute to the very low degree of intermediation of savings to the private sector. Although it has been increasing, the level of bank lending to the private sector compares poorly with an average of 27% in the EU accession countries and 10% in the rest of SEE.

**Table 4-3. Domestic Credit (in % of GDP)**

|  | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|--|------|------|------|------|------|------|------|------|
| Domestic Credit                          | 37.0 | 44.6 | 52.1 | 50.4 | 48.2 | 46.3 | 44.9 | 44.9 |
| Domestic Credit to Private Sector        | 3.6  | 3.9  | 3.8  | 3.5  | 3.7  | 4.4  | 5.7  | 6.8  |
| Of which: Bank Lending to Private Sector | 3.6  | 3.9  | 3.8  | 0.6  | 2.1  | 2.9  | 3.8  | 4.7  |

Source: EBRD and IMF

Commercial bank lending to SMEs accounts for an even smaller proportion than bank lending to the private sector. Donor credit lines (donors include Italian and Greek governments, and GTZ) aimed at SMEs have failed to provide finance to the target group in a significant way. However, promisingly, falling margins in the banking sector are pushing some banks toward smaller clients to secure new business. Bank lending to SMEs is mainly concentrated on working capital loans with short maturities (mostly up to 3 months). The average loan size in Albania was US\$ 8,948 as at 1 January 2000. The average maturity of SME loans is under 24 months. Loans larger than US\$ 100,000 tend to have longer maturities. Interest rates in 2002 varied from 6% for loans denominated in US\$ from the commercial banking sector to 19% for micro-loans in Lek extended by FEFAD (NGOs charge even higher rates). According to Bank of Albania regulations, loans issued by commercial banks should not exceed 70% of the market price of the collateralised real estate and the real estate should be registered.

FEFAD is the only commercial bank effectively addressing the needs of the micro and small enterprises in Albania. It was set up by a group of IFIs and donors (current shareholding comprises IFC,

Table 4-4. Cost of Credit Available from Official Sources

|             | Foreign Currency Denominated Loans |                 |                    | Local Currency Denominated Loans |                 |                  |
|-------------|------------------------------------|-----------------|--------------------|----------------------------------|-----------------|------------------|
|             | FEFAD                              | Other providers |                    | FEFAD                            | Other providers |                  |
|             | Interest Rate                      | Banks           | NGOs/ Programmes * | Interest Rate                    | Banks           | NGOs/ Programmes |
| Micro loans | 13-16.5%                           | n/a             | 18-20%             | 16-19%                           | n/a             | 14-20%           |
| Small loans | 8-12%                              | 6-10%           | n/a                | 14-16%                           | 14-18%          | n/a              |

Source: Group for Small Business, EBRD, 2003.

EBRD, KfW, Commerzbank AG and IMI) in order to provide finance to the smallest enterprises on a commercial basis. At the end of 2002, FEFAD had extended 12,430 loans to micro and small businesses for a total of US\$ 80.7 million. Its loans in arrears over 30 days were under 2% of total loans at end of 2002.

Other IFI and donor-sponsored initiatives targeted to provision of finance to SMEs include:

- *The World Bank's Micro-credit Project for Albania* aims to address private sector development and poverty alleviation by increasing the availability of financial services to rural farmers and entrepreneurs and urban micro-entrepreneurs and the self-employed. The project has four components: the first helps establish and extend a private, sustainable savings and credit association (SCA) network in rural areas-using as a basis the current system of village credit funds and the progressive development of an SCA Union; the second expands urban micro-credit and the development of a private, sustainable micro-credit institution, established from the existing Urban Credit Department of the Albanian Development Fund (ADF); the third provides technical assistance and training to develop an appropriate legal, regulatory, and supervision framework for rural SCAs and their Union, and micro-credit NGOs; and the fourth component finances project management.
- In the framework of Stability Pact, IFC established the *South Eastern European Development (SEED)* aiming to provide support to SMEs in the Balkan region. In September 2001 SEED/IFC opened an office in Albania providing support to SMEs through three main channels: investment services; capacity building; and improvements of business climate. SEED does not provide finance directly to SMEs but helps them to assess their financing requirements and formulate their loan requests to local credit providers. Until now SEED has helped 11 SMEs in their efforts to obtain finance from local commercial banks, including FEFAD. The activities of SEED are complemented by the Trans-Balkan Fund, established by the IFC and other development finance institutions, to make equity and quasi-equity investments in private SMEs in the region.
- USAID has addressed the issue of SMEs through the *Albanian Small Business Credit Assistance Project*. This is a three-year project focussing on offering credit and technical assistance to SMEs in the productive sector, mainly focusing on agricultural businesses.
- The *Albanian Reconstruction Equity Fund (AREF)* was set up by the EBRD and the Italian Government, with a total capital of US\$ 14 million to support the restructuring and expansion of private enterprises. Its investments are limited to a maximum amount of 10% of the Fund's resources (€13 million). The Fund has signed twelve projects so far for a total commitment of €4.4 million in areas ranging from teas, spices and dairy products to furniture products and construction.
- *Albanian American Enterprise Fund (AAEF)*, funded by the US government through a USAID grant, provides finance to medium and large-scale firms (US\$ 30 million). Although incorporated as a not-for-profit organisation, the AAEF is managed as a private investment fund to maximize risk-adjusted returns. The forms of investment include medium term loans, leases, equity, and guarantees. Typical financing is in the \$300,000 to \$1,000,000 range. All profits generated from AAEF investments are reinvested in new projects in Albania.

The NGO finance programmes active in Albania provide loans to small businesses, charging them heavily discounted interest rates. This use of subsidy creates a distortion to competition in the financial sector.

#### ***Assessment***

Despite the recent gradual increase in bank intermediation to private sector and a significant reduction of spreads between lending and deposit interest rates (from 17% in 1999 to 6% in 2002), the role of banks in financing the enterprise sector is largely irrelevant. Only 4.4% of SMEs' working capital requirements and 4% of SMEs' investment requirements are supported by banks.

Yet Albanian enterprises and SMEs only rate lack of external finance as a moderate to modest obstacle to their growth and development. The reason for this conundrum is that Albanian entrepreneurs have access to far larger internal funds than entrepreneurs in other countries of the region do. Albania is by far the largest recipient of emigrants' remittances both in absolute terms and in relation to the size of the economy in the SEE region. The largest share of remittances is, however, not intermediated by the banking sector, but transferred in cash or consumption goods to the final recipients. This means that savings are inefficiently intermediated and this reduces the level and quality of investment in the economy. A reduction in administrative costs to transfer emigrants' remittances from abroad through the banking system would de facto increase the amount of savings available for intermediation.

Bank lending could be stimulated by improvements in land and real estate registration (to facilitate provision of required collateral) and accounting standards (to facilitate the banks' evaluation of SMEs' credit applications).

#### **4.5. Implementation of Advisory Services to New and Small Businesses**

##### ***The Situation on Advisory Services***

A number of institutions interface directly and almost exclusively with enterprises and entrepreneurs. These organisations are particularly important since they are the only ones that actually assist small businesses with their everyday problems, delivering services such as training, advice, information, planning and consultancy.

There are around 50 business support centres in Albania. The key ones are discussed below and typically provide services such as:

- Counselling and advisory services to enterprises.
- Assistance to enterprises in preparing business plans, including applications for credit.
- Information provision, training and seminars.
- Trade and investment services.
- Income generating services, such as consultancy.

There are 10 *Regional Development Agency (RDA)* offices (seven funded by EU Phare, two by UNDP and one by GTZ) constituted as independent foundations (NGOs) able to charge for the services they provide as the means of covering their cost. Their remit is to promote SME and economic development in their respective regions by working with both the public and private sectors, especially start-ups and established small enterprises. They rely on applying for funds from international donors to deliver services (two thirds of their income) and fees charged to local businesses (balance of their income). The RDAs have been supported by international donors as a means of trying to improve the quality of business advice and achieve financial sustainability. GTZ has funded part of the RDA network since 1997 and USAID has also assisted in strengthening the RDA Network. The RDAs have had limited success charging commercial fees for their services as small enterprises are typically reticent to pay anything, especially if they are aware that international donors are backing the projects. The long-term financial

sustainability of the RDAs depends on the generation of income from SME-related projects, as well as income generation for commercial services delivered to the private sector. The RDAs have created a network to ensure co-ordination of their activities.

UNOPS has set-up a *Local Economic Development Agency* in Shkodra and intends to set up others in Vloora and Durres. The remit of these centres is to promote local economic development through co-operation with the public and private sectors, and will have access to a credit line operated via local banks. The services on offer include: training, fund raising, general business advice, market and economic research and civil society promotion. UNOPS intends to co-ordinate with the RDA network to ensure co-operation between the two sets of organisations, although the details have yet to be finalised.

The *Agro-Business Management Centre* is located in Tirana and focuses on agricultural associations. It offers services such as technical assistance and business support services to agricultural associations and their members. These services are provided as part of the associations' annual fee and technical assistance is targeted at agribusinesses on a commercial basis.

Over and above the business support centres discussed above, there are also several initiatives providing technical advice and/or funds to *specific sectors or clusters* that are funded by international donors. However, based on the research, there is currently little awareness of the business advisory services available to start-ups and established SMEs. The main reason for this appears to be because the services that exist tend to be supply-driven and entrepreneurs may not be making full use of what is on offer.

The *Chamber of Commerce (CoC)* is a business association based on a mandatory membership fee of €250 per annum. All businesses must pay this fee before that can obtain the annual license from the tax office. The senior management is appointed by Government and the CoC is a member of the business-related discussion forums. The CoC consists of the national Union of CoC and the 35 CoCs in various districts of the country. Its services and activities are principally focused on trade promotion, providing information and providing business linkages (World Bank, 2002) and it is ultimately answerable to the Ministry of Economy.

In addition, there are quite a number of other *business associations* operating on a not-for-profit basis. They tend to focus on a particular sector and are often supported financially by international donor projects. Examples of these include the National Farmers' Union, Association of Beekeepers, Association of Builders, etc. There are no official data on the number of associations, but they are known to be numerous (American Chamber of Commerce, 2001).

### **Assessment**

Advisory services in Albania received the best rating from the SME entrepreneurs participating in the EPPA research, an overall rating that came close to the "satisfactory" mark. This primarily reflects the fact that the international donor community has been very active in funding a range of business advisory services targeted at assisting start-ups and established small enterprises. It is estimated that about 50 such organisations exist, focusing on various aspects of the market such as start-ups, rural businesses, etc. However, these service providers are concentrated in and around Tirana, and SME participants in the research were critical of the uneven provision, which means that rural and remote areas benefit from little or no provision. Whatever local business support offices may be created by the new SBDA (if any, since its official annual budget is currently extremely limited), should ensure that the focus is on filling the geographical gaps in provision, rather than overlapping with existing providers.

Some business advisory centres are more advanced than others, however, all will continue to require some degree of technical assistance in order to be able to deliver good quality training and consultancy advice. The RDAs have organised themselves into a network for various reasons to do with co-operation, co-ordination and synergy. This is a welcome development which may assist in the process of achieving financial sustainability. For the moment, the business advisory services remain heavily dependent on

SME-related projects, mainly from IFIs and international donors. The income generation part of their activities remains modest, covering about a third of their budgets, something which is not likely to change unless they become more focused on achieving a fuller commercial orientation to their activities. This will need to be combined with a greater understanding by Albanian entrepreneurs of the value of business information, training and consultancy, as well as a greater willingness on their part to pay for such services.

There is little evidence of a greater willingness to pay at present. For this to come about requires further improvement in the range of services on offer, greater responsiveness to the actual needs of small enterprises and a greater focus on quality and delivering value added. There is a strong perception among the entrepreneurs that the services on offer do not always meet their needs. Equally, the business advisors and experts are of the opinion that entrepreneurs are often neither aware of what is on offer nor particularly clear about their needs. Introduction of internationally-recognised quality standards and certification for providers of business advisory services (such as internationally-recognised qualifications, membership of relevant bodies, confidentiality principles, charging policies and other general quality standards) would go some way towards generating both greater confidence and willingness to use and pay for advisory services.

SMEs tend to be dissatisfied with the compulsory services provided by the Chambers of Commerce, mainly because of difficulty in obtaining services that are actually customised to their needs and the poor value for money they are considered to provide. International good practice suggests that membership of such bodies could be on a voluntary basis, such as in the case of Romania. Many would like to see a reform of the existing system or establishment of additional associations focusing on small enterprises in order to better represent and meet their specific needs.

#### **4.6. Implementation of Business Incubators**

Business incubators are generally defined as special areas for new and young developing businesses that provide such businesses with premises, infrastructure, a comprehensive range of services and support that can improve their ability to initiate and run their operations during the early developmental period. The combination of features such as physical facilities, focus on start-ups and SMEs, and provision of “soft” advisory and support services are what distinguish business incubators from other industrial centres or industrial estates (OECD-UNIDO, 1999, pp.51-53).

##### ***The Current Situation on Business Incubators***

There are currently two business incubators in Albania. The Tirana business incubator was established in 1998 and the one in Shkodra was created in 1999. They were set-up by the World Bank's Training Enterprise and Employment Fund, which began operating in 1993. Business incubators are the responsibility of the Ministry of Labour, rather than the ministry that has the responsibility for enterprise development, namely the Ministry of Economy. The business incubators were financed for the first three years of operation in order to assist them to take-off. Since then, they have been operating on a self-financing basis, but will continue to have rent-free premises until 2005.

To become members of the business incubators, all potential tenants must be start-ups. They can benefit from the subsidised rents for a maximum of three years, after which they must pay the full rent. The services offered on subsidised basis include: telephone, fax, reception, etc., training such as business planning and legal advice.

##### ***Assessment***

Based on IFI support, two business incubators have been created since 1998. Both are striving to achieve financial sustainability, something which will become more difficult once the rent-free period terminates in 2005. It is not clear whether there is currently an official policy, programme or funding for the

establishment of further business incubators in Albania. Very little is known about the extent to which they have been successful, their governance structures and/or their financial state. This is symptomatic of a wider lack of knowledge about incubators, even though they have been operating in Albania for five years. The SME entrepreneurs participating in the research know very little about the nature of business incubators and considered whatever policy may exist for encouraging them to be "ineffective".

The above situation may be a result of the way in which the institutional responsibility for business incubators is currently defined. This remit resides with the Ministry of Labour, which has a focus on reducing the levels of unemployment. Given the nature of this enterprise development tool, it may be more effective for business incubators to be part of the Ministry of Economy's portfolio of responsibilities, not least because this is where the SME strategy and its implementation is determined.



## Chapter 5.

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**WEB SITES**

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Albanian Parliament: <http://www.parliament.gov.al>

Bank of Albania: <http://www.bankofalbania.org>

Council of Ministers - Albania: <http://mininf.gov.al>

European Commission/The World Bank Economic Reconstruction and Development in South East Europe  
<http://www.seerecon.org>

Institute of Statistics: <http://www.instat.co.al>

International Monetary Fund: <http://www.imf.org>

Ministry of Foreign Affairs: <http://www.mfa.gov.al>

Ministry of Economic Cooperation and Trade: <http://www.mininf.gov.al>

Ministry of Economy: <http://www.mbet.gov.al>

Ministry of Public Economy and Privatization: <http://www.mepp.gov.al>

Ministry of Finance: <http://www.minfin.gov.al>

Office of the President: <http://www.president.gov.al>

Special Co-ordinator of the Stability Pact for South Eastern Europe <http://www.stabilitypact.org>

World Bank: <http://www.worldbank.org>



*Appendix 1.*

**OBSTACLES TO DOING BUSINESS**

The main results of the Albanian Business Environment and Enterprise Performance Survey (BEEPS) 2002 are summarised in the following table. It contains the average score assigned by respondents to each aspect of the business environment, where the scores can be interpreted as follows: 1 = no obstacle; 2 = minor obstacle; 3 = moderate obstacle; 4 = major obstacle.

**Rating of Severity of Obstacles to Doing Business (BEEPS, 2002)**

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|  |     |
|--|-----|
| Macroeconomic instability                      | 3.4 |
| Electricity                                    | 3.2 |
| Economic policy uncertainty                    | 3.2 |
| Corruption                                     | 3.2 |
| Tax rates                                      | 3.0 |
| Anti-competitive practices of other producers  | 3.0 |
| Functioning of the judiciary                   | 2.9 |
| Customs and trade regulations                  | 2.7 |
| Contract violations by customers and suppliers | 2.7 |
| Cost of financing                              | 2.7 |
| Tax administration                             | 2.6 |
| Street crime                                   | 2.3 |
| Organised crime                                | 2.3 |
| Business licensing and permits                 | 2.3 |
| Title or leasing of land                       | 2.2 |
| Transportation                                 | 2.2 |
| Access to financing                            | 2.1 |
| Telecommunications                             | 2.0 |
| Skills and education of workers                | 2.0 |
| Access to land                                 | 1.8 |
| Labour regulations                             | 1.8 |

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Source: EBRD



*Appendix 2.*

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The Organisation for Economic Co-operation and Development (OECD) groups 30 member countries sharing a commitment to democratic government and the market economy. With active relationships with other countries, Non-Governmental Organisations and civil society, it has a global reach. Best known for its publications and statistics, its work covers economic and social issues from macroeconomics, to trade, education, development and science and innovation. Over time the OECD's focus has broadened to include extensive contacts with non-member economies and it now maintains co-operative relations with some 70 of them. These contacts aim to further economic integration by making the OECD's experience available to other countries and enabling the OECD to profit from the insights and perspectives of non-members. (see [www.oecd.org](http://www.oecd.org))

The European Bank of Reconstruction and Development (EBRD) was set up in 1991 to support the development of market economies in central and eastern Europe and the Commonwealth of Independent States following the collapse of communism. The EBRD supports the economies of its 27 countries of operations by promoting competition, privatisation and entrepreneurship. Taking into account the particular needs of countries at different stages of transition, the Bank focuses on strengthening the financial sector, developing infrastructure and supporting industry and commerce. The EBRD is the largest investor in South Eastern Europe and is also an active contributor to the Stability Pact. (see [www.ebrd.com](http://www.ebrd.com))

