Lack of Credit in Albania; Who is to "Blame" Analyzing the Demand

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Abstract:

The last global crisis had it influence on Albanian economy as well. As the economy is still struggling to recover from the slowdown, a special attention is dedicated to lending which will in turn help investments pick up. Banks in Albania are currently flooding in excess deposits, but meanwhile the lending has hit its lowest score. What is refraining banks from lending? Is it really them to blame or maybe the demand is also part of the problem? Are businesses suffering from lack of funds to finance their activity or are they hesitating to invest and are waiting for better times to come along? The purpose of this study is to look into these questions and find the reasons behind them. This paper is focused on the demand side, analyzing some of the most important indicators influencing the demand for credit like enterprises growth, profits, planned investments, working capital needs, liquidity, etc. In order to get better understanding on the behavior of these variables the enterprises are divided in four groups by size criteria. The analysis is covering data for five-year timeframe, which is corresponding with the start of the economic slowdown. To help getting a prospect of the present and the future perceptions of the economic situation, a survey was conducted on a small sample of enterprises. This study comes to the conclusion that the demand for credit is growing, but what's keeping businesses from applying for it, is mainly because of high interest rates and cost of credit, the study ends with some recommendations toward the solution.

Key Words : *Albania, demand for credit, credit gap, banking system, economic slowdown*

1. Introduction

Albania is part of the global economy and it can't be immune from what is happening around the world. Even though in the country there is the presence of some international banks, during the first wave of the subprime crisis it didn't look like any of them were affected and the economic and financial situation in the country looked pretty solid. During the first couple of years after the crisis, Albania was still enjoying a good economic growth and everybody was thinking that after all the country is not that much integrated into the global market and at least for this kind of scenario was a good thing. But it wasn't so. Right after the start of the Greek debt crises and Italy's recession, the effects didn't take long to reflect on Albanian economy. There is no surprise in this, considering that Italy and Greece are Albania's main trade partners and also host almost 1 million Albanians who live and work in these two countries.

An economic slowdown followed. Diminished remittances coming from abroad, the fall in consumption, because of the "upcoming crisis" perception, all this and else, contributed in a rise of the number of bad and non-performing loans up to 24% of the credit outstanding[1], which put banks in a not very comfortable position. So, logically the bank lending got more rigid and the economy started to reflect loss of liquidity, lower consumption rates and economic slowdown.

Even though the Bank of Albania took some actions trying to stimulate the lending by lowering the base interest rate from 5. 25% at the end of 2009 to 2. 00% on July 1, 2015[2] and also by making commercial banks to write off some of the bad loans etc. , all this had no success in reviving the lending.

[1] Bank of Albania

[2] Bank of Albania

At this point in time this study is looking into the main indicators influencing financing to find the answer to where the problem may lay. Specifically in this paper we are focusing our attention on the demand side. We analyzed the behavior of indicators like investments, growth, and profit of the enterprises to determine what is influencing the demand also we conducted a survey to catch the perception of the business in their need for credit and the access they have to finance.

2. Research questions, hypothesis and objectives

As stated before with this study we want to find out why there is a lack of credit in the economy and who is to "blame". In this paper we are particularly focusing on the demand side of the problem and our research question to be answered is: Is it the demand for bank credit from businesses low because of the unsecure economic situation or is their access to financing limited?

To answer to these questions we are hypothesizing that:

H1. The businesses are not asking for credit because they feel is not the appropriate time to invest

H2. The businesses are not asking for credit because the cost of financing at the moment is high and/or there is no access to financing

The main objectives we will aim to achieve in the quest of proving our hypothesis will be finding out if businesses are suffering from lack of credit. Is there a good business climate to stimulate their growth? Do they have enough information about different financing options and which are the most used/preferred financing methods?

3. Methodology

The approach of this study will be the descriptive analysis of the behavior of different economic and structural indicators and the interaction between them. We will make use several data sets from secondary sources like The Albanian Institute of Statistics (further on we will recall it only as INSTAT), Doing Business Albania, World Bank, Bank of Albania, etc. and will compare them against our primary source data gathered through a survey[1] in the form of a structured questionnaire which we did among a random sample of the local businesses. Objective indicators of access used include whether the firm has any credit products (e. g. overdrafts, loans or line of credit), loan applications and rejections, percent of finance for working capital and investment, and interest rate. Subjective indicators of access include whether the firm claims access is one of the top three obstacles and whether the firm states "no need for a loan" as a reason for not applying for a loan.

4. Literature Review

In this study we are looking at a possible financing gap to be the reason explaining why there is a lack of credit in the economy. Even though there is no agreed definition of the term "financial gap", according to OECD, it is "used to mean that a sizeable share of economically significant SMEs cannot obtain financing from the banks, capital markets or other suppliers of finance" (2006: 16). The literature suggests that the extent of financing gap can only be determined by comparing the supply of financing to what is demanded (National Credit Regulator, 2011). Focusing on the demand side for instance, we find different authors to argue that the availability to finance can be influenced by both internal and external factors Beck (2006). When looking at the demand side of credit we will notice that SME are more vulnerable to accessing credit during or after crisis because as Falkena et al. are pointing out in their study "SMEs tend to seek finance for relatively small amounts. The cost involved in the credit assessment and monitoring of a loan or investment make it disproportionately more expensive to provide funds to an SME" (2004). Common knowledge is that know during economic crisis the agency problems, adverse selection and asymmetric information grow to be more significant which makes the suppliers of finance to choose to offer credit at higher interest rates and that can leave many potential borrowers without access to credit. Even though this problems are not specifically connected to SMEs a study of OECD, concludes that "their impact is bigger for

[1] The survey was prepared based on the model of the Survey on the Access to Finance of Small and Medium-sized Enterprises (SAFE) established in 2008 from the European Commission and the European Central Bank

SMEs than for larger companies " (2006). Other studies suggest that credit sources tend to dry up more rapidly for small firms than for large companies during economic downturns (ECB, 2013a).

The literature suggests that the nature of funding required by an SME depends on its development phase. Businesses in the start-up phase generally rely on personal savings, friends and families, while those businesses which are stable rely on bank loans for financing (Felkana et. Al, 2001). The most influencing factors on a company financial behavior are firm size and age, ownership type and legal form, geographical location, industry sector and asset structure or the ability to provide collateral (Abdulsaleh, 2013). Ou & Haynes, argue that equity financing is preferred mode over debt for financing new SMEs (2006), but according to Berger and Udell (1998) "issuing additional equity to satisfy the firm's financial needs would lead to a dilution in ownership and control" so they suggest that the owner-managers may prefer debt rather than equity financing. Further on we find that one of the most popular sources of external financing for SMEs is trade credit. According to Berger & Udell trade credit was estimated for almost one-third of the total debt of SMEs in US in 1998 (2006). Garcia-Teruel & Martinez-Solano (2010) define trade credit as "a delay in the payment for goods or services after they have been delivered or provided as a result of an agreement between the supplier and the firm". Emphasizing the role of trade credit in developing countries, Abdulsaleh (2013) states that "the role of trade credit as a source of raising financing for SMEs is even more important in countries with less developed banking and financial systems where asymmetric information problems are more pronounced". Still to many empirical and theoretical studies are pointing that usually in developing economies bank credit is the most important source of external financing. Just to mention a few studies that comes to this conclusion for example: according to OECD "the commercial banking sector is the main source of external finance for SMEs" (2006), also to the conclusion that banks are the main external capital provider for SMEs sector in both developed and developing countries, come Ono & Uesugi, (2009) etc. A very interesting conclusion we find from Keasey and McGuinness (1990) who argued that in spite of the fact that bank financing is more expensive in comparison to other sources of finance, it generates a higher rate of return for SMEs. They further conclude that bank finance can help SMEs accomplish better performance levels than other financing sources can do, because SMEs employ the funds more efficiently when they are monitored by, and answerable to banks.

5. Analysis

We begin by looking at the structure of the market and identify the main groups of actors in the economy to determine their importance and influence. As the literature suggested we find that in practice it is true that there is no unified unit for classifying enterprises. Chart 1, shows them grouped by employee number which is a pretty common division only that there is no universal standard for what the intervals should be, so the interval number is not always the same. Using the classification used by INSTAT, we are getting 4 groups defined by the intervals: 1-4 employed, 5-9 employed, 10-49 employed, 50+ employed, but on other statistical data we used from the same source, intervals were slightly different. We are further on calling these groups respectively Micro, Small, Medium and Big and we will sometimes summarize the first 3 groups like SMEs.

By this classification we can notice that the number of micro enterprises in Albania is the dominant one with a 90% share. If we want to add up the small and medium-enterprises categories we will end up with almost 99% of the market been made up from SME. This results suggest that Albanian enterprises structure is no different than the EU structure pattern where Small and Medium-sized Enterprises (SMEs) accounting for more than 99% of all business and two-third of employment (EC - 2013 SMEs Access to Finance Survey).

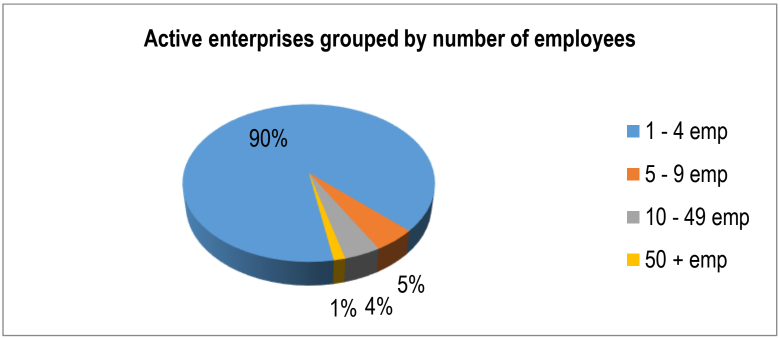
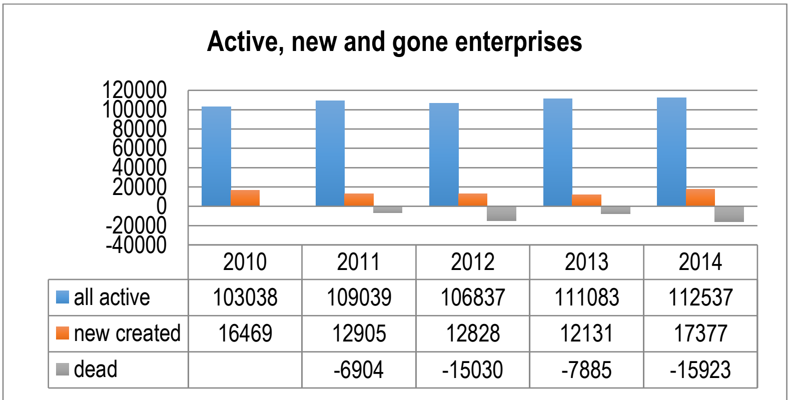


Chart 1. Source: INSTAT - Business Register 2014, chart build by authors

But as the literature suggests, groups divided only by the number of employed people by itself doesn't tell much, so for getting a better understanding of the weight which each category has on the economy, we looked for more indicators associating this groups. Table 2[1] shows us that micro-enterprises and the big-enterprises employ almost the same number of workers respectively 35% and 31 %. But again if we have to account for SMEs total weight, they employ almost 70% of the working force. If we take a look at the turnover by groups we will see that bigger here is better. And is getting more obvious when it comes to investments where the group of the big-enterprises (accounting for just about 1 % of the total number of enterprises), is doing 54% of the total investments for 2013 and the rest of it is almost equally distributed to the rest of the groups.

Another indicator at which we looked at was the trend of growth of active enterprises during the last five-years.



	2010	2011	2012	2013	2014
all active	103038	109039	106837	111083	112537
new created	16469	12905	12828	12131	17377
dead		-6904	-15030	-7885	-15923

Chart 2. Source: INSTAT - Business Register 2014, chart build by authors

As we can see from the Chart 2, the overall number of active enterprises during the last years is having some fluctuations but still holding a growth trend. The number of the new enterprises apparently is showing a crisis perception behavior with a fall of the number of new enterprises during 2011, 2012, 2013 to start rising on 2014. On the other hand the number of enterprises going out of business was high during this period, making the real growth very small and even negative in 2012[2].

[1]Table 2, in the appendix
[2] Chart 4, in the appendix

Even though the growth in the number of enterprises during these years is slow, the investments didn't look to surfer too much and are not reflecting the overall economic slowdown. As we can see on the chart below the growth after 2011 is looking stable.

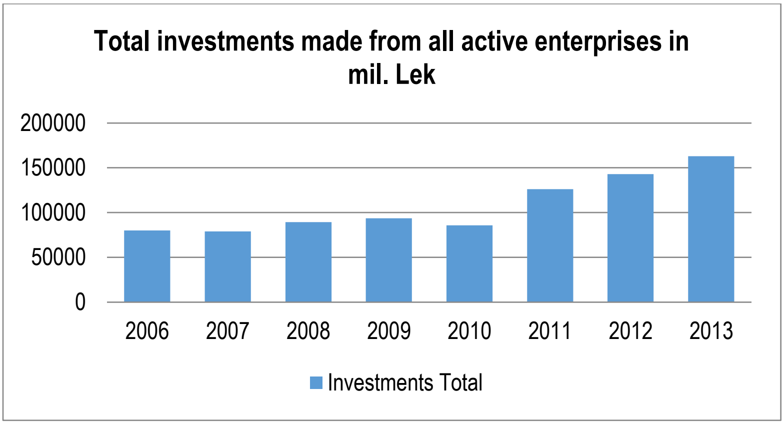


Chart 3. Source: INSTAT - Business Register 2014, chart build by authors

Considering the fact that the bank lending has shrunk, we have to look at other indicators to find out what are the sources used for financing these investments. To do so we analyzed the net profit/loss indicator trend for all enterprises during the same period. Chart 5 shows that the profits got smaller after 2010. This trend complies with the economic slowdown pattern. What is noticed next in Chart 6[1] where we compare side by side the two indicators, is that after 2011 the investments got bigger than the net profit, by it we can conclude that the growth in the investments cannot be explained by internal financing.

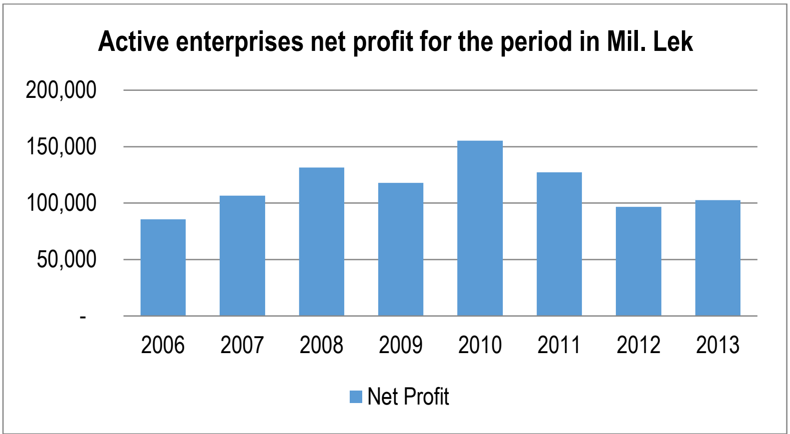


Chart 5. Source: INSTAT – Statistical databases, chart build by authors

If we focus our analysis on every group separately the patterns we find are telling different stories for each group[2]. Starting with the first group of the micro-enterprises we notice that the investments with this group are generally low and they are always lower than the generated net profit, suggesting that on this category investments are financed internally by retained profits. Moving to the next group, the small-enterprises mostly tend to invest all generated profits and after 2012 they are investing more than they are earning suggesting that they are using external financing. Further on the medium-sized

[1] See Chart 6 in the appendix
[2] See Chart 9 in the appendix

enterprises investments pattern is more like the micro-sized on, it looks like they invest more moderately relaying on internal financing. One exception is noticed during 2012 where the investments are more than double the net profits of that same year, but by this we cannot conclude with certainty that their financing behavior changed because most of the investments are planed ahead and the ratio of profit vs investments of the previous couple of years gives them enough funds from retained profits to finance their investments internally. The last group, the big-enterprises after 2011 shows a changing pattern where investments are growing significantly, but profits are the lowest of the analyzed period. This may suggest that they are investing in long term projects on which the return on investment is delayed, but for sure we can say that they are using external financing.

Survey results analysis[1]

In explain the sources of external financing used for supporting investments, working capital and liquidity we went looking into the data's gathered from our survey. The results will be interpreted for every group as follows:

The first group, micro-enterprises, when asked about the importance of financing for their businesses in a scale 1 to 10 where 1 is low importance and 10 is high importance, they responded to an average of 5. 8. 69% responded that profit is lower and 29 % said that it hasn't change, meanwhile 31% stated that their investments had grown, 30% had fallen, 39% answered that investments hasn't change. When asked about what kind of financing is used, some 50 % of them responded internal financing mainly from retained profits. None of them has been using bank overdraft or line of credit during the last year. Some 12 % are using bank credit, 19% has used bank credit before but not during the last year and 69% of them have never used a bank loan as a form of credit for their business needs. More than 50% are using trade credit and more than 10% have used it before. Also popular with this category is crediting though loans from family and friends with about 40%, leasing accounts for 20% for this year and around 20 % used in the past. There is also a growth by almost 31% for external crediting for supporting planned investments and 38% for working capital needs. Bank credit is the most preferred form of credit among this group with 80 %, but only 12% applied for a loan this year, 50% didn't apply because they didn't need one and 38% didn't apply because of other reasons, where the most important one for 75% of the cases is high interest rates and cost of the loan and only 12 % think they don't meet the collateral or other forms of guaranties.

The second group, small-enterprises are valuing the importance of financing for their business with only a score of 3 out of 10. While 80% of them is getting lower profits, 20% are claiming higher profits, this may be due to many factors (the most probable one may be the industry related) but considering our low population sample we are not going to dive into this as it is out of the focus of this paper. 60% of this group is using internal financing to support their activity and also bank overdraft or line of credit is used by 40% of them. Bank credit even though has been used in the past, currently is not used. Even though this group prefers bank credit 40% better than other means of financing, the main reason for not applying for 60% of them is high interest rates and cost of the loan. Future needs for crediting for this group are growing as data shows that 40% of them will need credit to finance their investments projects, 20% for financing working capital and 40% for cash flows availability.

The third group, medium-sized enterprises is giving an average score of 5 out of 10 to the importance of financing their activity. Approximately 90% of them are having a drop on profits and 100% of them have drop on investments. They financed their businesses primary through bank overdrafts or line of credit as well by bank loans, trade credit and 40% of them also by leasing. All this gives imprison that they are going through hard times. This is more obvious when we look into their future growing needs for working capital financing for 50% of them and for cash flow financing for also 50% of them. It results that they applied for bank overdraft or line of credit, bank credit, trade credit but at some cases they got rejected or got amounts lower than 75% of what they asked. For almost all of them bank credit is the most preferred financing mean, but 50% of them think that interest rates and costs of loan are too high.

The last group, Big-enterprises gives an importance of 4. 5 out of 10 to financing. They are claiming that their profits didn't change. Investments didn't change for 50 % of them and went down for the other 50%. In this group, 50% are using internal financing, currently are not using bank overdraft, line of credit or bank loans, but they have in the past. 50% of them predict

[1] Considering the small sample used on this survey, the results we are presenting are being considered more like a perception of the overall behavior of the enterprises rather than statistically significant argument

growth on their need for external financing for investments projects and also for cash flow needs. They didn't apply for a loan during the last year because they consider that interest rates and costs of loan are high.

6. Conclusions and recommendations

At the end of our analysis of some of the most important indicators influencing the demand for credit in Albania, it results that beside a drop in profits lately there is a growing trend for investments especially for the group of small and Big-enterprises. This was consistent within the data provided though secondary and primary sources, leading us to reject our Hypothesis 1 which stated that there is no demand for credit because of low investments rate. Additionally, we noticed also a growing demand for credit for financing working capitals and liquidity needs. Even though between groups of enterprises the purposes, amounts and type of crediting was different, they all had the same most common reasons for not applying for a bank loan and that was high interest rates and costs of loan. This is proving that our Hypothesis 2 is true, that the demand for credit is low because of high cost of credit and high interest rates.

Also, our study found out that there is not enough information, especially for the micro-enterprises about different kind of crediting available, more specifically about the bank overdraft, line of credit, factoring etc. Bank credit is by far the most preferred way of external financing among all groups, but especially for SMEs. The one group who suffered the most the lack of credit is the small-enterprises. This group is showing struggle to grow and in this they have bigger needs for financing, which as it shows are not served and by these they are the most endangered category risking failure the most. Looking at the absence of equity financing option we conclude that even the big enterprise in Albania are left with only one option to finance their needs and that’s through bank credit.

The government has to recognize that the SMEs sector faces constrained access to external financing which may negatively affect its crucial role in achieving national development goals. So we suggest that governmental programs and initiatives like credit guarantee loans, subsidized fees will be typical examples to ensure that SMEs have easier access to financing. Also the perception of the banks toward SMEs have to change and they have to start looking at these enterprises like attractive line of business and have to develop effective monitoring systems like credit score models etc. for overcoming the information asymmetry problem. This recommendation goes especially to most of the smaller banks in the country which as argued on a previous study by Musta & Shehu (2015), considering their small marked share, in order to survive, have to look more into specializing on servicing this business categories. Also as literature suggests it’s a common sense for banks to realize that many future holders of conventional accounts start as micro-enterprises, greater attention to this market segment will pay off in the longer run.

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7. Appendix

Tab. 2 Ndërmarrjet, të punësuarit, shitjet neto, investimet sipas madhësisë së ndërmarrjes, 2013
Enterprises, employed, turnover, investments by size class of enterprise, 2013

Madhësia e ndërmarrjes	Ndërmarrjet Enterprises		Të punësuarit Employed		Shitjet neto Turnover		Investimet Investments		Size class of enterprise
	nr. / no.	%	nr. / no.	%	mln Lekë/ mlln ALL	%	mln Lekë/ mlln ALL	%	
Gjithsej	**84.790**	**100**	**344.528**	**100**	**1.637.015**	**100**	**162.899**	**100**	**Total**
1-4 të punësuar	75.823	89	118.988	35	259.485	16	25.773	16	1-4 employed
5-19 të punësuar	6.957	8	58.619	17	393.137	24	28.170	17	5-19 employed
20-79 të punësuar	1.561	2	58.427	17	352.603	21	21.165	13	20-79 employed
80+ të punësuar	449	1	108.494	31	631.790	39	87.791	54	80+ employed

Source: INSTAT, (2014). Results Of Structural Survey Of Economic Enterprises

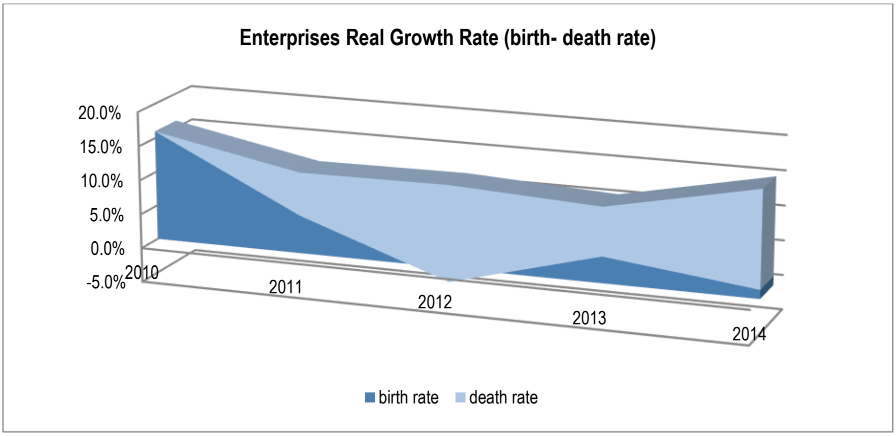


Chart 4 . Source: INSTAT - Business Register 2014, calculations and chart build by authors

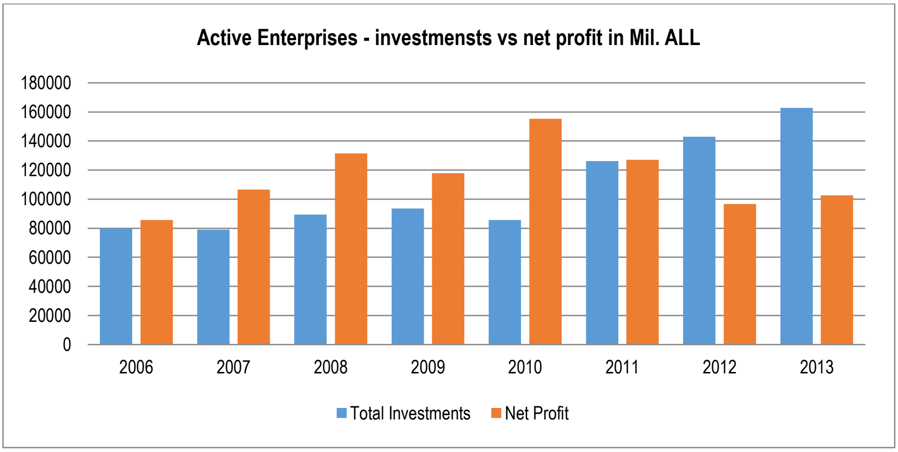


Chart 6. Source: INSTAT – Statistical databases, chart build by authors

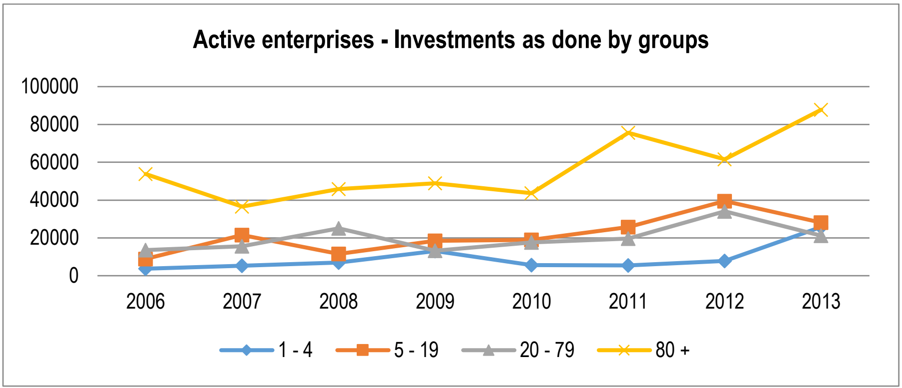
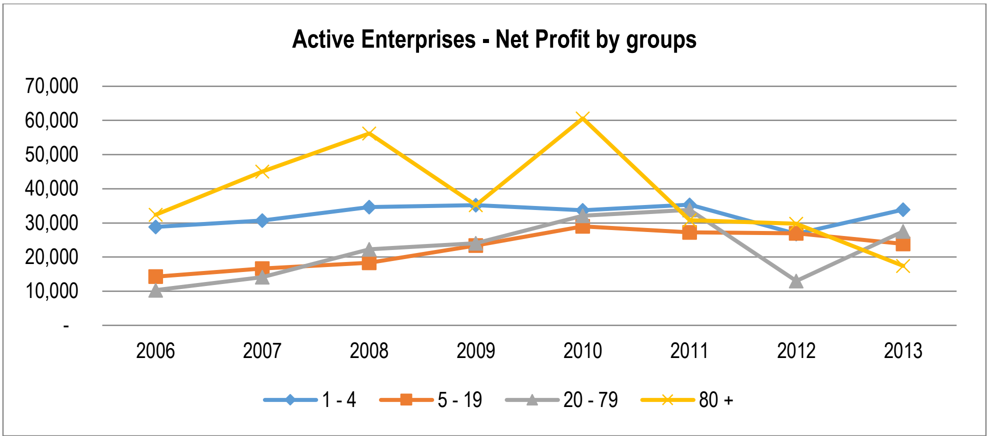


Chart 7. Source: INSTAT - Business Register 2014, chart build by authors



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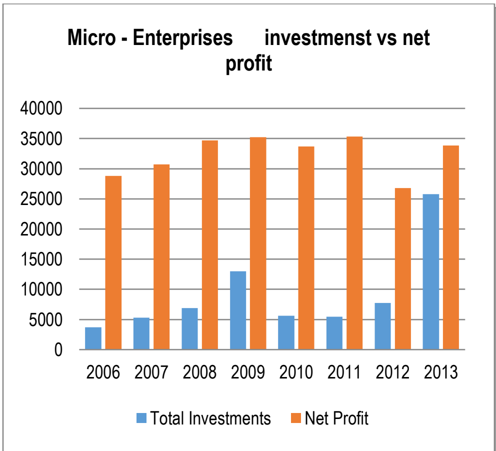

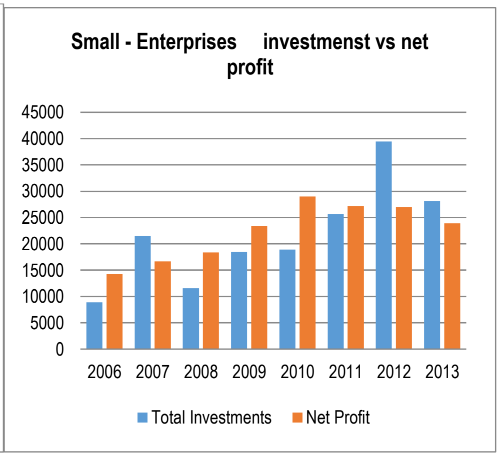

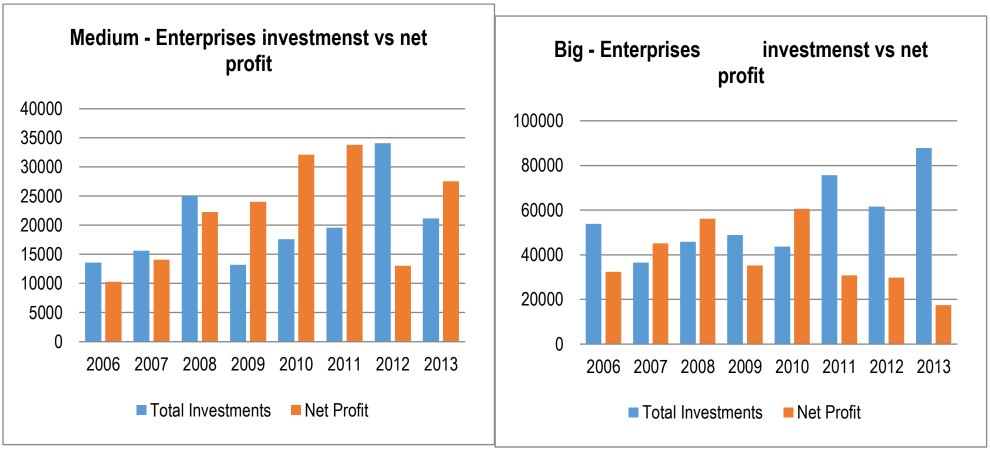

Chart 9. Source: INSTAT – Statistical databases, chart build by authors