

## “BANK LENDING, A SIGNIFICANT EFFORT TO FINANCING SME”

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### Abstract

The SME's sector in Albania plays a significant role in the national economy. As we know SME's remain the main sectors who generate jobs, innovation and economic development. One of the main problem that a business in early stages of transition was to provide the necessary capital to start a private activity, to expand and strengthen it. For the private sector is very important to get the capital at the moment they needed it. Bank lending, initially was at low levels, but gradually began to turn into an important tool that encourage the development of a country; supports new manufacturing investment in the economy, increased the activity of production, trade and services. Although the general trend of credit over the years has been growing, but the rhythm has been low and that do to limited expertise in the banking business, resulting in the increase of bad loans. Business financing comes from two main sources: mikro-loans to family business through loans to businesses and foundations through formal banking system. This paper gives details at performance of Bank lending, but it also highlights many problems dealing with lending in business sector.

Keywords: Bank Lending, credit risk, SME.

### Introduction

Private enterprise structure, possible sources of their financing Albanian enterprises despite have reached the number of 45 thousand, in the majority of them are dominated by companies with limited liability. Thus about 65% of enterprises are SHPK, 28% are VIP and the rest are joint ventures. Possible alternatives to the financing of enterprises are as follows:



### Micro-credit and Bank credits- important mean supporting financially SME-s.

Credits are a very important instrument in supporting the development of a country. It supports the new productive investments in the economy, influencing on the increase of the productive activity, the market and the services. The bank credit consist of one the most important means of financing the economic activity of entrepreneurs, while the banks serve as instruments for realizing the circulation of the funds. While our country makes part in transition economy, bank credit must play the primary role for their financing.

Credit for the economy / billion All

| 2000 | 2001 | 2002 | 2003 | 2004 | 2005  | 2006  | 2007  | 2008 | 2009  | 2010 |
|------|------|------|------|------|-------|-------|-------|------|-------|------|
| 23,2 | 27,9 | 38,7 | 50,7 | 70   | 121,9 | 191,2 | 287,5 | 385  | 431,8 | 475  |

Source: Bank of Albania, Statistical Report

Albania is still a difficult environment for support of financial instruments in order to use nowadays. However the bank credit in Albania has had a considerable increase every passing year, only “13 % of the financed enterprises are realized through crediting. Albanian firms are mainly supported by their own saving, more than any other country of the region. In the region of Elbasan the financing of SME is due to 2 main sources: microcredits through Foundations and credit that are borrowed by the formal bank system.

#### - Micro credits

Micro –Credits means an offer to the poorest families of some very small amounts of loans in order to help them for starting a profitable activity or an increase of their small

business. Most of the credits operate as Foundations or non-banking institutions and organizations. They are non-profitable organizations who re-invest their possible profit of their global capital funds which they possess. They use these funds as credits for small businesses or to cover their costs in the long term operating periods. At the beginning they start with small loans and later on the client may get much larger loans and may pay them off in a later period of time. Their goal has been to help small businesses for their development and further increase. The required collateral is a combination of mortgages, personal guarantee and group guarantee, real and unreal estate and property etc. One of the important which operate in Elbasan are SHKK. It is something special the way how SHKK function. The

bases upon which the SHKK existed, it is the encouragement of the saving and to lend these saving with a lower cost from the position of the money saved. The principle of lending a credit is trustworthiness and the links of the people with their daily life.

**- Credit from the formal bank system for the businesses.**

The economic level of our country today needs strong and close relations between the banks and the businesses in order to have a constant progress. The banks with their services try to help the businesses in order to increase their productivity, their profit and the increase of their market. Today banks offer a several lending services in order to fulfill businesses needs.

All the banks which operates in the region of Elbasan, grant credits for the businesses in the form of the credit per circulating capital, credit for investment and credit for mortgage. Most of the banks offer credits mainly for SME-s such as BKT, ProCredit Bank, Raiffeisen Bank etc. On the other hand there are banks which greatly estimate granting credits to bigger and stronger businesses such as American Bank, Tirana Bank, Popular Bank etc.

Almost all banks helps the existing businesses, especially those who are exercising their activity for more than 6

months, but neglect the new businesses, because of the fact that they have lack of trust in the new businesses for returning the credits as the Albanian banks have a high rate of unpaid credits.

The SME's demand for credits from the banks is in considerable number and they try to express their goals and plans for their further development. But against this fact, there exist a disproportion between the offer and the demand for credits.

Some of the reasons why many request of businesses are reject from the banks are:

1. They are in lack of real estate which may serve as their collateral
2. They are in lack of information for the financial position of the applicant
3. The non-existence of the suitable reason for the use of the credit
4. The applicant may have other credits elsewhere, received from the other institutions and they may not be able to face with this additional one
5. The businesses do not have the necessary experience within the sort of the activity where they want to invest.

**- Current situation with Bank Lending during 2010**

Credit to the economy as a whole during 2010 increased by about 10 % compare with 2009, reaching 475 billion All where the businesses occupied the major part of them.

| Table 1- LOANS TO ENTERPRISES - CREDIT STANDARDS |        |                               |                               |
|--------------------------------------------------|--------|-------------------------------|-------------------------------|
|                                                  |        | REALISED<br>Net balances (%)* | EXPECTED<br>Net balances (%)* |
| Small and medium enterprises<br>(SME)            | H2 '07 | 0.5                           | 4.9                           |
|                                                  | H1 '08 | -15.2                         | -15.5                         |
|                                                  | H2 '08 | -51.4                         | -54.3                         |
|                                                  | Q1 '09 | -61.2                         | -2.9                          |
|                                                  | Q2 '09 | -18.2                         | 2.1                           |
|                                                  | Q3 '09 | -12.2                         | 4.6                           |
|                                                  | Q4 '09 | -7.9                          | 20.0                          |
|                                                  | Q1 '10 | -3.2                          | -8.2                          |
|                                                  | Q2 '10 | -10.9                         | 10.4                          |
|                                                  | Q3 '10 | 5.1                           | 16.2                          |
|                                                  | Q4 '10 | 8.5                           | 18                            |

(\*) Negative balances indicate that banks have tightened their credit standards, whereas a net positive balance indicates that banks eased the credit standards.

| Table 4 - LOANS TO ENTERPRISES - LOAN DEMAND |        |                               |                               |
|----------------------------------------------|--------|-------------------------------|-------------------------------|
|                                              |        | REALISED<br>Net balances (%)* | EXPECTED<br>Net balances (%)* |
| Small and medium enterprises                 | H2 '07 | 56.9                          | 72.9                          |
|                                              | H1 '08 | 25.4                          | 29.4                          |
|                                              | H2 '08 | 4.8                           | -23.8                         |
|                                              | Q1 '09 | -26.7                         | -19.0                         |
|                                              | Q2 '09 | -21.8                         | 13.5                          |
|                                              | Q3 '09 | -28.0                         | -20.0                         |
|                                              | Q4 '09 | -15.8                         | 37.5                          |
|                                              | Q1 '10 | -8.8                          | 23.8                          |
|                                              | Q2 '10 | 13.5                          | 9.5                           |

|  |        |       |      |
|--|--------|-------|------|
|  | Q3 '10 | -10.9 | 20.8 |
|  | Q4 '10 | -10.0 | 9.5  |

**Loan demand.** Businesses demand for loans improved over the fourth quarter 2010, but it still remains at negative levels. The net percentage of banks reporting higher loans demand during the fourth quarter of 2010, points to -1.9%. However, this development is positive compared to the previous quarter, over which net percentage of banks reporting for demand growth was -14.7%. Developments in loans demand are different, according to businesses' size; large enterprises demand was positive, net balance +6.2%, whereas the small and medium sized enterprises demand was negative, net balance -10%. The main factor driving loans demand over the fourth quarter of 2010 was represented by

Inventories and working capital financing needs. The contribution of this factor increased considerably relative to the three first quarters of 2010. The macroeconomic situation, investments financing needs and loans terms and conditions implemented from banks are other factors, which intensified their positive contribution to demand growth.

**Expectations.** For the first quarter of 2011, the banks experts' expectations are slightly optimistic, as regards to the persistence of credit standards easing and businesses loan demand. Credit standard easing is expected mostly for SME than for large enterprises and more for the inventories and working capital financing. While, higher demand is expected more from large enterprises rather than SMEs.

**- Some of the problems that are financing the businesses**

In order to improve the financial climate of SME-s during the last years, there are some of the measures taken, linked mainly with the application of the new schemes, concerning the safeguarding of the SME credit which are implemented, thanks to the five-year- partnership between USAID and Commercial Bank. These funds have been partly guaranteed, because of the support done only for

some categories and field defined, leaving outside most of them.

The problems that are brought out from SME-s, in connection with their possibilities for credits from the banks are:

1. The cost of the credit is estimated as relatively high and this later aggravates the expenses that the business is going to do
2. Some of the conditions that the banks require are not favorable for the businesses, the required collateral from their side varies in the levels of 120-150%
3. The credit interests are seen as financing problem from the businesses side.
4. The new businesses have less possibility for giving credits from the bank institutions.
5. There exist a bank culture which is orientated towards the use of the immovable properties as collaterals and secondly a way of purchasing of the businesses, where the majority of the transactions are performed in an informal way, in order to avoid the investments to the state.

Taking in consideration all these sharp problems we dare say that the SME-s needs a financial and an assisting revitalization.

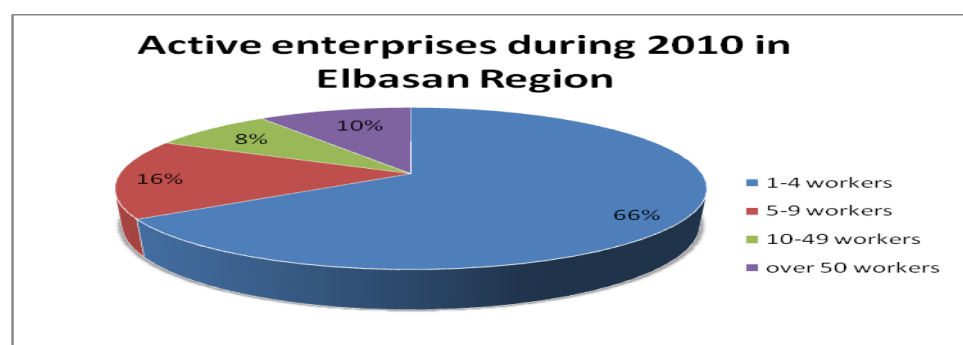
**- The situation of the businesses in the Region of Elbasan.**

During the period of transition, the structure of the business changed not only in the national level but also in the regional one. Before the time of transition, the large public enterprises dominated the trade, today the market is dominated by the Small and Medium Enterprises (SME), speaking for the region of Elbasan, as the whole country, the market is predominated by SME.

The following table shows active enterprises, for the year 2010.

| Total No | 1-4 workers | 5-9 workers | 10-49 workers | over 50 workers |
|----------|-------------|-------------|---------------|-----------------|
| 4,295    | 2,842       | 678         | 345           | 430             |

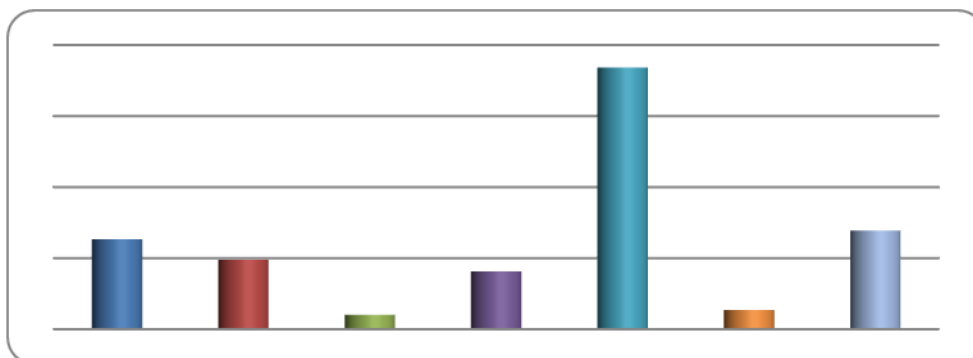
Source: Instat, the registration of enterprises\



As we see from the table, the most part of the businesses consist in small business about 82 % of total number of business which operate in region of Elbasan. In accordance with the change of the business structure there are changes of the branches of the economy. The greatest number of business is focused on the service activities, and that is mainly the trade market.

| Total No | Production | Industry | Construction | Transport | Market | Services | Others |
|----------|------------|----------|--------------|-----------|--------|----------|--------|
| 4,295    | 632        | 488      | 100          | 406       | 1,841  | 134      | 694    |

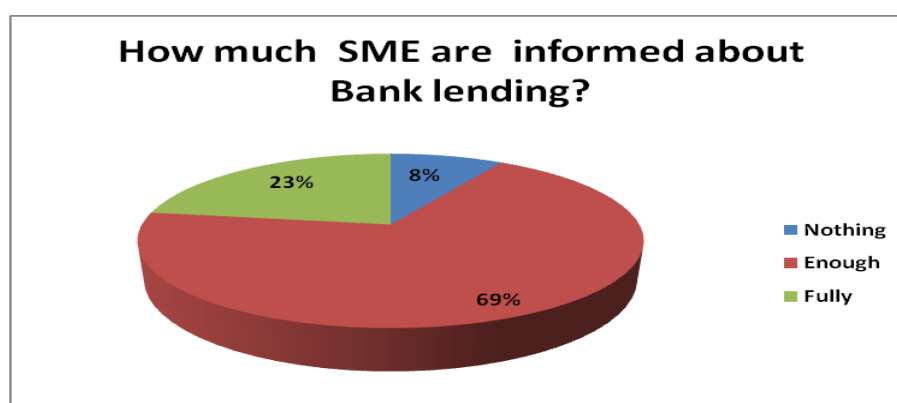
Source: Instat, the registration of enterprises



One of the main problems that accompanied the investments at the first steps of the transition period was providing the necessary capital in order to start a private activity, to extend and to enforce it. The personal savings of the population where used for the development of this private sector and later it was the remittances of the immigrants that helped this process. To show the effects of Bank Lending of SME, in Elbasan region, was prepared a questionnaire with several questions to the businesses. Some of them ( questions) are presented as follow. The questionnaires were distributed to proximately 150 Small and Medium Enterprises, who exercise their activity in Elbasan region. Data collected from the questionnaires are as follow:

- How much are you informed about the loans that banks offer?

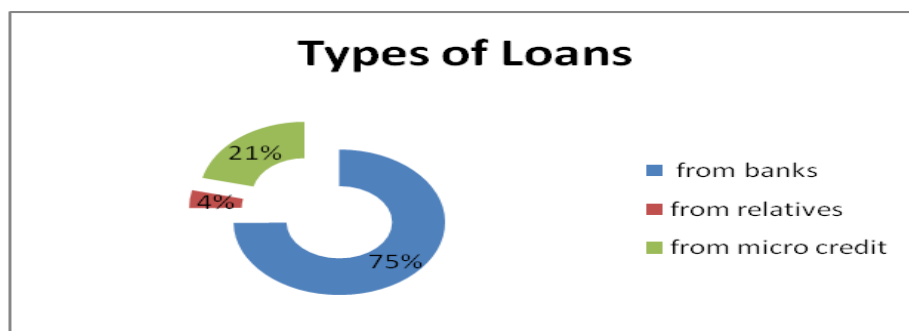
| Response  | Nothing Info | Enough Info | Fully Info |
|-----------|--------------|-------------|------------|
| No of SME | 13           | 103         | 34         |



From the questionnaires distributed, turn out that only 23% of businesses in this city are fully informed about the conditions of the loans that banks offer, as most of them think they have sufficient information for these conditions.

- If you don't have sufficient funds, how do you finance your business?

| Types of Loan | from banks | from relatives | from micro credit |
|---------------|------------|----------------|-------------------|
| No of SME     | 113        | 5              | 32                |

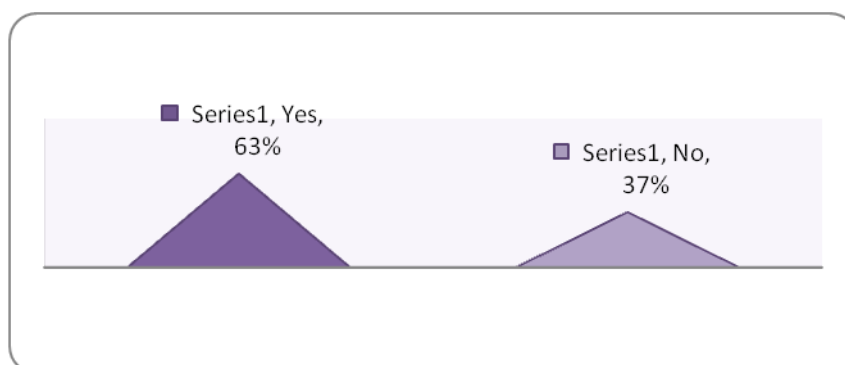


As we see from the graph, the majority of SME-s in Elbasan thinks that one of the best ways to finance their business is loan from banks with a percentage of 75% and very few of them think of financing through loans from relatives compared to the percentage of those that intend to borrow from micro credit institutions.

- **Have you ever applied for a bank loan?**

| Response | Yes | No  |
|----------|-----|-----|
| %        | 63% | 37% |

Despite the fact that most businesses think that loans are a good way to finance their activity, only 63% of them have taken loans from the banks. The rest of 37% stated that they have never applied for bank loans.

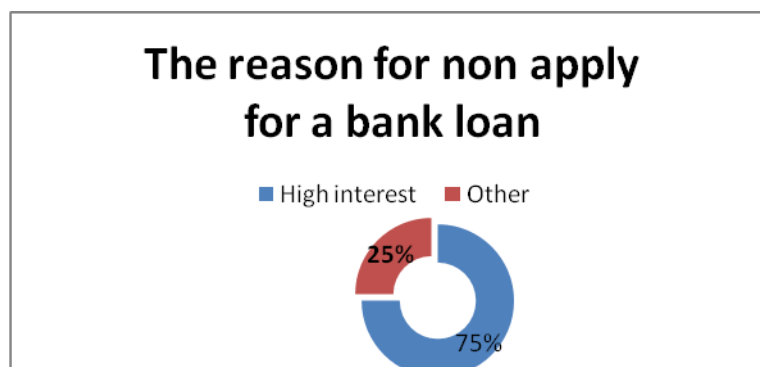


Certainly they have their reasons that have not applied for bank loan although they have a need for financing their activity. Reasons are given to the next question of the questionnaire.

- **You have not applied for bank loans because of what factors?**

In the chart below we see that one of the reasons why we have a small number of applications for credit loans, is high interest that banks applies.

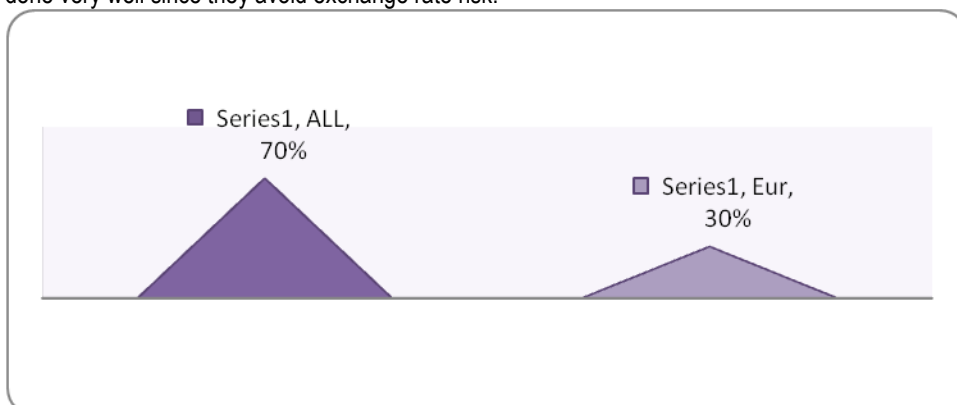
| High interest | Other |
|---------------|-------|
| 75%           | 25%   |



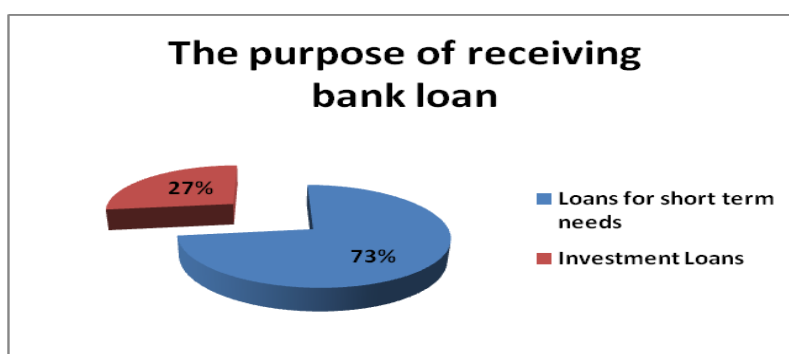
Therefore 37% of those who had never applied for bank loans (approximately 56 businesses), 75% of them list as the main factor, high interest that banks apply for loans. The rest of 25 % rank the other factors such as delays in loan approving, so much required documents etc.

#### - Which is the currency of loan that you acquire?

According to the results of the questionnaires, 70% of businesses surveyed inclined to take loan in local currency. Asked about the reason they responded that their incomes are in Albanian Lek (ALL). In addition based in finance theory they have done very well since they avoid exchange rate risk.



From the number of businesses surveyed come to the conclusion that 70% of them have used bank loans for investments, the rest to cover the short term needs.



#### Conclusions:

- SME-s make up the bases of the development of the region of Elbasan , that's why; the increase of the credit-givers for them, not only from the banks but also from the non-banking foundations is a very vital demand which will guarantee a sustainable development of the region and the increase of its competitive capability and capacity, in order to ensure the inter-border integration, regional and all over the area.
- The increase of the demand for credit from the businesses is stimulated by such factors as: the economic and monetary stability, the need for the increase of the investments and the extensions of businesses, creation of the new, serious and trustworthy businesses etc
- Some of the factors that restrain the credits are; the high level of risk, the

high level of credit interest, the difficulties and problems that have to do with the registration of the real properties (mainly the registration of the land); the lack of the banks in rural areas etc

- The structures for giving credit, the financial services and those which have to do with the technical assistance for the farmers in rural areas, are insufficient.

In order the financial institutions play their auxiliary role, it is required some changes in the businesses practice of the banks in the rural areas, such as: the promotion of the banks in order to enter the rural areas with financial services, the extension of the network of SHKK and maybe the establishment of a farmer bank which we consider actually a serious and suitable solution.

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