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## Financing SMEs in Vlora city, Albania: between game theory and lack of information

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### Abstract

The SMEs (small and medium-sized enterprises) play a crucial economical role, especially in transition economies. However, the financing problem affects the SMEs' development. Information asymmetry between banks and enterprises is the main reason for the SMEs' gaining funds so hard; the banks do not know the operating conditions and credit situation of SMEs. The study focuses on the analyses of the game of (in) complete information and financing growth strategies of SMEs in the city of Vlora to face with challenges of a sustainable development and a competitive market.

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### 1. Introduction

Albania was the last country in Southeastern Europe to implement the principles of a free market economy after 1990. As a small country, its market is dominated from small and medium size firms. In this respect, the development of Albanian small and medium firms is now an important issue for policymaker and this process is broadly similar to that found in other transition economies. At the beginning of transition, competition was a new phenomenon of the market, and it went beyond the economic aspect: it had effect on the political and social life because the former centralized economic system had excluded competitiveness from all aspects. The State played the main role eliminating competition related to market price or, rather, competition as a regulator of supply and demand. Western Balkan countries have one thing in common: the path toward European integration (Gruda S. and Milo L., 2010). Various researchers and policy makers reveal the importance of small firms. Taking in consideration that Albania has a small scale economy; the paper addresses the question of: Which are the challenges on financing process and sustainable development of SMEs in Vlora? This is in context of implementation of a strong legislation for competition, the increase of effectiveness of the institution of Competition Authority, the consolidation of a strong cooperation, more transparency to the public, more market players' awareness of the fact that competition means

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economic prosperity, stronger institutional cooperation and greater transparency to the public, are the major recourses of the national competition policy. On branding processes in SMEs during the entrepreneurial growth stages over time (leading to the internationalization of the company), the external driver of market orientation and internal dynamic capabilities should be aligned in the SME to reach the desired intensity of brand equity and brand growth or internationalization rate (Berthon et al., 2008). Support for the planning process in small firms comes from a variety of writers in a number of forms (Gibb and Scott, 1985). It is often asserted that strategic planning is essential for a small as well as a large business for no other reason than that it helps them to take better advantage of the opportunities which lie in the future and to forestall the threats that it contains (Steiner, 1967).

## 2. Literature Review And Hypotheses

### 2.1. SMEs sector and transition process

It is well documented that the SMEs sector can play a crucial role in the economies in transition. These countries went through privatization process since the beginning and this caused the enlargement of the small and medium firms sector. It is well identified in theory and empirically that SMEs have a vital contribution to the labour market, levels of exports, innovation, regional and national growth.

Also, small and medium enterprises can be a promoter to competition, competitive forces and market efficiency as well. World Bank Group database provides comprehensive statistics on the contribution of the SME sector to total employment and GDP across a broad range of countries (Ayyagari et al, 2003).

Much of the economic theory of the growth of small firms has been concerned with the relationship between growth and firm size and a positive correlation is indicated due to the economies of scale (Cook et al, 2002). This because small and medium businesses face specific disadvantages such as: the economies of scale; accessing to financing and the costs of raising funds; the lack of real and updated information; capability to apply technological innovations; lack of resources and expertise to deal with complex tax and regulatory systems. In order to facilitate the small firm sector development, those factors should be considered and reflected in the industrial policy in transition countries.

The transition process in the Eastern Europe during years shows that the small and medium size firms are product of the privatization process and the restructuring process. Various researchers have identified some obstacles to growth of small and medium firm sector in those countries. "...In most transition economies there is a surplus of new firm entry" (Bartlett, 2002). Also the transition countries tend to make innovative use of regulatory policies and regimes where socially acceptable, but at the same time preserve significant features of their socialist heritage (Sturm, R., Muller, M.M. and Dieringer, J., 2000).

SMEs have advantages such as:

- The encouragement of entrepreneurship;
- The utilization of the labour intensive technologies with impact on employment rate ;
- The possibility to produce quick returns;
- The ability to encourage the process of both inter and intraregional decentralization;
- The notion that they may become a countervailing force against the economic power of larger enterprises, confirm the importance of the role of SME's in the economic growth in transition countries. (Gruda S. and Milo L.,2010)

There are several barriers that affect the development of SMEs such as:

- Institutional barriers;
- Internal organizational and resource barriers;
- External market barriers;
- Financial barriers;
- Social barriers. (Smallbone 2003; Bartlett and Bukovic, 2001)

Economists have argued that there are a lot of determinants of the small and medium size firms' growth such as:

- Macroeconomic and microeconomic environment (including procedural requirements for registration and licensing, number of institutions for entrepreneurs to report to, rules and regulations governing entrepreneurial activities, laws to protect property rights, etc.);
- Entrepreneurial and business skills (including entrepreneurial training and business education, availability of information, etc.); Aidis (2003) states: "...productive entrepreneurship cannot be taken for granted in

transition countries, and is influenced both by the current institutional weakness, as well as by historical legacies.”

- Social and economic condition for entrepreneurship (including public attitude toward entrepreneurship, presence of experienced entrepreneurs, existence of persons with entrepreneurial characteristics, etc.);
- Financial assistance to small and medium enterprises (including venture capital, alternative sources of financing, low cost loans, etc.);
- Nonfinancial assistance to small and medium enterprises (including counseling and supportive services, entrepreneurial networks, support for research and development, etc.)

The firm’s market access seems to be a crucial component of sustainable economic development for SMEs. Competition means low level of barrier to entry (new firms can enter when there are business opportunities) and the barriers to exit shouldn’t be excessive (the firms should be free to leave markets when they don’t operate effectively). The state of competition is a key part of the investments climate providing a playing field for national SMEs, an effective one should safeguard the rights of entrepreneurs to enter and to leave markets.

Entrepreneurs seek new profit opportunities in a world that is constantly changing. Schumpeter (1954) argued that the innovation and technological change of a nation come from the entrepreneurs and the agents that drive innovation are large companies which have the resources and capital to invest in research and development. In this respect, market size and structure affect dynamic efficiency which involves research and development expenditures designed to create new products and processes (Gal, 2004). Gal (2003) concluded that large firm size is more conducive to innovative activity than small firm size but the large size can be a disadvantage in facilitating innovation.

Knowing the theoretical context, it will facilitate the identification of opportunities for SME-s in Vlora, on financing process and sustainable managed development.

## 2.2. Development of Hypotheses

Aiming to find SMEs’ financing problem through game theory analyses, some hypotheses have been formulated.

*H1: Financial statements of SMEs aren’t prepared properly.*

*H2: Lack of innovative technology affects SMEs ability to repay bank’s loans.*

*H3: SMEs do not maintain proper licensing.*

*H4: The use of personal savings of the SME owner and ‘fconnections’ is negatively related with size.*

*H5: The use of personal savings of the SME owner and ‘fconnections’ is negatively related with age.*

## 3. Methodology

### 3.1. Research Goal

The main objective of the study is to find out the major problems and prospects of SME loan management of banks branches that operates in Vlora city. A field survey using two structured questionnaires was conducted.

### 3.2. Sample and Data Collection

This study is based on primary and secondary data. Primary data were collected through the first structured questionnaire. 15 employees of 5 local banks were interviewed. The second one was spread through local 50 SMEs chosen randomly in different sectors. Questionnaire was pre-tested and improved before conducting the survey. Those questionnaires were analyzed through the SPSS statistical program and five proposed relations were tested through regression analyses. Secondary data were provided from the published official statistics of INSTAT (The Albania Institute of Statistics), annual reports of concerned bank, Ministry of Finance, websites etc.

3.3. Analyses and Results

A five-point Likert type scale statements were used to measure the variables: 1- strongly disagree (very low) and 5- strongly agree (very high). After collection of primary data, hypotheses were formulated and tested 0.05 level of statistical significance.

Table 1: Hypothesis 1

Confidence Level	Z observed value	Z value	Decision
95%	1.04	1.64	Null hypothesis is accepted

This is explained by the fact that 46% of SMEs, part of the survey didn't have an employed accountant.

Table 2: Hypothesis 2

Confidence Level	Z observed value	Z value	Decision
95%	2.18	1.64	Null hypothesis is rejected

The crucial fact for the bank to approve the loan to the SME was the annual turnover and the age of SME.

Table 3: Hypothesis 3

Confidence Level	Z observed value	Z value	Decision
95%	2.16	1.64	Null hypothesis is rejected

The branches of banks which operate in the city of Vlora evaluate firstly the proper licensing of SMEs which do application for loan. This is the main condition for SMEs to be part of evaluation process.

Regression analysis is conducted to test the 4<sup>th</sup> and 5<sup>th</sup> defined hypotheses. The Table 4 shows the relations between variables as follow:

Table 4. Regression Analysis Results on tested H4 and H5 hypotheses

Regression Model	Independent Variables	Depended Variables	Standardized $\beta$	Sig.	Adjusted R <sup>2</sup>	F Value	Model Sig.
1	Age firm	Personal Savings of SME owner	-,160**	,027	,540	32.660	,027
2	Size firm	Personal Savings of SME owner	-,620**	,000	,371	29,953	,000

Notes: a LRF - Likert Response Format (Five point: 1=strongly disagree to 5=strongly agree)

In Table 4, it can be seen that the age firm has significant effect on using of personal savings of SME owner or “f connections”. Age firm ( $\beta=-,160$ ;  $p=,027$ ) has significant relationship to personal savings of SME owner. Moreover, size firm ( $\beta=-,620$ ;  $p=,000$ ) has also significant relationship to personal savings of SME. As 1 and 2 regression analysis results have showed, when the age and size firm increases, less personal savings of SME owner are used for SMEs financing. So, regression analysis results support H4 and H5 hypotheses.

With the game's basic assumption that the banks and SMEs have the entire information about their own possible benefit in each state during the game (we are talking about a dynamic game of complete information) the simplified payoff matrix of bank and SME is:

Table5: Game in complete information

	Interest of SME is zero	SME returns the loan repayment in time
The bank doesn't provide capital for SME	(0,0)	
The bank provides capital for SME		(+1,+1)

Since the information is asymmetric, the above state is difficult to meet in real life. Since the banks use the SMEs official annual statement as evaluation document of financial situation, the maintaining of dual accounting create a

lack of real financial situation of SMEs. The banks don't know which path reflects the true operating situation of the SMEs. There are three possibilities for the banks and SMEs which apply for a loan:

1. If banks accept the application:
  - i. they may get a profit (good economic efficiency SME);
  - ii. they may suffer a loss (bad economic efficiency SME);
2. If the banks choose not to accept the application, they would miss the opportunity of gain.

In the case of asymmetric information, there are costs of searching information, which directly affect the economic efficiency of commercial banks credit activities.

#### 4. Conclusion

This survey, which is conducted on 5 local bank's branches and 50 SMEs, highlighted the situation of lack of information for the real financial situation of SMEs in Vlora city. As the SMEs in Vlora city are habituated to operating in a semi-formal manner ("f connections") and banks are a formalized institutions, a gap exists that should be minimize by simple bank procedures. Banks should redesign their credit-rating system so that they can have more information about the reliability of their SME clients. It's recommended the build of national Credit Rating Agencies; rational banks would cooperate with those agencies to reduce its information costs for SMEs. A national mechanism of sharing information should be build; banks can identify the SME's credit more effectively by taking advantage of these systems. In modern society, long-term business between SMEs and banks should be constituted, especially for the SMEs who pursue long-term development. This brings the necessity of a database of the poor credit. In this way, banks can assess the SME's credit situation from historical records and redesign the terms of loan. From long-term perspective, cooperative relationship between banks and SMEs should be established. This relationship is helpful to reduce financing costs, increase credit profits, evade credit risks, and enhance the competitiveness of SMEs (Lin, 2012).

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