



**ENTERPRISE POLICY
PERFORMANCE
ASSESSMENT**

REPUBLIC OF ALBANIA

DECEMBER 2004



European Bank
for Reconstruction and Development



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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)

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, the Former Yugoslav Republic of Macedonia, Moldova, Romania, 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 monitoring of progress as well as identification of practical steps to **implement** reform and transition.

The work of the Investment Compact has been actively supported and financed by seventeen OECD member countries: Austria, Flanders (Belgium), Czech Republic, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Norway, Sweden, Switzerland, Turkey, United Kingdom and United States (see www.investmentcompact.org). The European Commission (EC) has, through DG Enterprise and Industry, contributed to the funding for this report.

The Enterprise Policy Performance Assessments (EPPAs) are an output of the SEE Enterprise Forum, a regional policy initiative sponsored by the Investment Compact for South East Europe. The EPPA reports have been jointly produced by the OECD and European Bank for Reconstruction and Development (EBRD), in consultation with the European Commission (DG Enterprise and Industry). The EPPA reports have been initiated by Declan Murphy, Programme Director of the Investment Compact, and their preparation has been co-ordinated by Antonio Fanelli (Principal Administrator, OECD), Francesca Pissarides (Senior Economist, EBRD) and Edward Tersmette (Desk Officer for the West Balkans, EC- DG Enterprise and Industry).

Background research and support for the 2004 Albanian EPPA report (2nd edition) was provided by the Tirana based Public Private Finance Institute, directed by Elida Reci, who provided the first draft. The report has benefited significantly from inputs and comments from Declan Murphy (OECD), Zbigniew Kominek (Economist, EBRD) and the assistance of Susan Hodgson (OECD) and Georgiana Pop (OECD). Ricardo Pinto (OECD Consultant) has provided expert guidance on the report.

The assessments and views expressed in this report are those of the Investment Compact Team of the OECD secretariat and of the EBRD Office of the Chief Economist and do not necessarily reflect the views of the OECD and EBRD member countries.

FOREWORD

In all countries the government and its agencies have a fundamental lead role to play in providing an environment favourable to business operations and conducive to private investment. This is especially true for small business. Small and medium-sized enterprises are the backbone of most economies today. In order to flourish and grow they need an environment that facilitates and enables business start-up, does not hamper them with excessive and costly regulations and facilitates access to finance and business services. In this respect there is an urgent need in South East Europe (SEE) to design and implement an effective enterprise policy, as the level of private investment still lags behind that of advanced countries.

For these reasons, in 2002 the OECD and the EBRD launched the Enterprise Policy Performance Assessments (EPPAs) in the framework of the Investment Compact for SEE Programme. The EPPAs consist of a series of reports covering all the countries of South East Europe, assessing the quality of the government policy for the SME sector and regularly monitoring its implementation. In 2003 the Investment Compact published nine country reports (separate reports were produced for Serbia and Montenegro, respectively) as well as a Regional EPPA report measuring progress on SME policy implementation in the SEE against a set of good practices and benchmarks.

As part of the 2004 EPPA programme the Investment Compact presents the 2004 edition of the Enterprise Policy Performance Assessment for Albania. The format of the report is the same as last year, allowing for a direct comparison of the progress achieved since the 2003 EPPA.

The 2004 report has been prepared by the OECD and the EBRD in close consultation with the European Commission, which also provided financial support to the programme. Excellent synergies have been developed between the EPPA and the European Union Charter for Small Business, with the EPPA providing a set of policy recommendations and priority actions to the government and small business community in those policy dimensions covered by the EU Charter. In order to improve the link between the EPPA and the EU Charter, the scope of the 2004 EPPA has been expanded. The EPPA reports now cover seven policy areas, adding entrepreneurship, vocational training and access to technology to the previous set of six policy dimensions (institutional framework, regulatory environment, tax policy, access to finance, advisory services, business incubators), bringing their scope closer to that of the EU Charter.

This Enterprise Policy Performance Assessment report is presented as an independent and constructive contribution to the debate on enterprise policy in Albania, with the principal aim of facilitating the reform implementation. The OECD, EBRD and European Commission will monitor progress and seek to provide active support on implementation in partnership with the SEE countries in 2005.



Manfred Schekulin
Director, Export and Investment
Policy Department
Federal Ministry for Economic
Affairs and Labour of Austria
Co-Chair, Investment Compact
Project Team



Rainer Geiger
Deputy Director
Directorate for Financial Fiscal
and Enterprise Affairs
OECD
Co-Chair, Investment Compact
Project Team



Milen Keremedchiev
National Coordinator
of the Stability Pact
Bulgaria
Co-Chair, Investment Compact
Project Team

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INTRODUCTION

Scope and Structure of the Enterprise Policy Performance Assessments (EPPAs)

In 2002 the OECD and the EBRD launched the Enterprise Policy Performance Assessments (EPPAs) with the aim of producing a regular independent and comprehensive assessment of enterprise and small business policy in each of the countries of South East Europe (SEE)¹.

The assessment was originally designed to address six policy dimensions, that form the core of effective enterprise policy and are based on extensive experience with OECD and transition countries.

Nine EPPA reports, one for each of the SEE countries, with Serbia and Montenegro being assessed separately, and a Regional SEE Assessment Report were published by the Investment Compact in 2003 and disseminated throughout the region. All of the reports are available on the Investment Compact web-site: www.investmentcompact.org.

In October 2003, following the endorsement by the SEE countries of the EU Charter for Small Business, the European Commission (General Directorate for Enterprise and Industry) decided to extend financial support to the EPPA programme, opening an opportunity for generating stronger links and mutual synergies between the EPPA programme and the initiatives conducted in the SEE region within the framework of the EC Charter for Small Business.

The 2004 EPPA Country Reports represent both a continuation and an expansion of the work started in 2002. The reports have been prepared by the OECD and the EBRD, in consultation with the EC (DG Enterprise and Industry) and with the support of a network of external consultants based in each of the SEE countries, in charge of organising and conducting the focus group research, the interviews with entrepreneurs and experts and conducting the desk analysis, and with the assistance of a team of international consultants.

The scope of the 2004 EPPA reports has been widened to include a seventh policy dimension covering entrepreneurship, vocational education and access to technologies, reflecting the need to better integrate the scope of the EPPAs with that of the European Charter on Small Enterprises.

The 2004 framework of research and analysis of enterprise policy performance thus consists of the following seven dimensions of good policy practice:

- Institutional framework for SMEs policy.
- Rule of law and regulatory framework.
- Tax policy for small business.
- Financial instruments for new and small companies.
- Business consulting services for new and small enterprises.
- Business Incubators.
- Entrepreneurship, vocational education and access to technologies.

The 2004 EPPA Country Reports are structured in two parts:

Part I includes an overall assessment of enterprise policy, looking at the progress made since the publication of the 2003 EPPA report. It also contains an updated list of policy recommendations and a set of priorities for short-term action.

Part II consists of two chapters. The first contains the insights of entrepreneurs and SME owners and managers, while the second chapter is dedicated to the analysis and assessment, including a progress report on the implementation of the policy recommendations listed in the 2003 EPPA Country Report.

The EPPA Methodology

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.

The policy assessments have been formulated on the basis of the following main inputs:

Focus group research:

Focus group discussions were held with SME representatives. The focus group discussions were guided by a question template, applied to all the SEE countries, derived from extensive case study work on good practice in transition economies and OECD country experience (OECD-UNIDO, 1999).

Individual SME interviews and expert interviews:

A number of individual SME interviews were used to cross check and validate the focus group research and to provide insights on key issues in each of the SEE countries. Expert interviews were conducted also to cross reference information from the focus groups and contribute to views.

Desk research and analysis:

Examination of existing reports, databases, documents, etc. was conducted by country-based experts/consultants, selected for their enterprise policy knowledge and experience, under the supervision of the OECD Investment Compact team.

Expertise from the OECD, the EBRD and the EU:

A team of experts from the OECD, EBRD and from OECD EU countries has reviewed inputs from focus groups, interviews and desk research and elaborated the country assessments.

A detailed description of the methodology used in the research is presented in Annex I.

NOTE

1. The countries covered by the EPPA programme are: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Moldova, Romania, Serbia and Montenegro. Separate reports are published for Serbia and Montenegro.

Part I

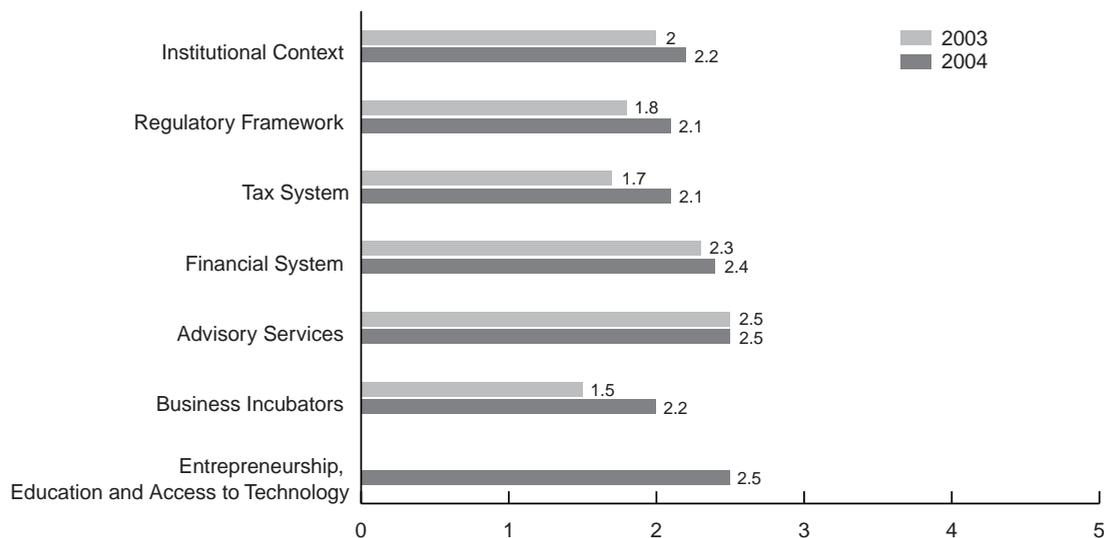
OVERALL ASSESSMENT AND POLICY RECOMMENDATIONS

Overall Assessment

The EPPA 2004 shows that since the completion of the previous EPPA report in September 2003, Albania has made progress in implementing better policies for the SME sector. But the overall picture is one of gradual and marginal progress over five of the seven policy dimensions covered by the EPPA report. Good initial steps have been taken on many policy issues, however, a significant and persistent follow-up process will be needed if measurable and lasting change is to be achieved.

The views of the SME owners and managers who participated in the focus group research in 2004 confirm a picture of gradual progress. The 2004 ratings by small business entrepreneurs for all policy dimensions, with the exception of advisory services, were marginally better than those of 2003. However, in absolute terms the policy performance ratings remain low, just above the “poor” rank with the exception of advisory services, confirming the general dissatisfaction of entrepreneurs with the current operational environment and the slow pace of reform. The low rating level also provides an indication of how much remains to be done in terms of policy implementation and communication with the business sector.

Figure I.1. Average Ratings by SME Owners and Managers of the Seven Dimensions of Good Practice, 2003 and 2004



Institutional Framework for SME Policy

Looking at the individual policy dimensions, the assessment shows that the institutional framework for SME development has been developed and strengthened, but further work is needed. The most important building blocks now appear to be in place, as far as institutions, policies and strategies are concerned. The Ministry of Economy's Business Promotion Department and the SME Agency will nevertheless need to work on raising entrepreneurs' awareness of their activities, and to ensure that SMEs obtain information and

are capable of contributing to the policy making process. Hitherto, during its gearing-up phase, the SME Agency has concentrated its activities on Tirana-based organisations, state institutions and donors, working on product and service development, on securing the support of bi-lateral and multilateral donors, on developing an internet portal for the access to business services and information for SMEs (Seebiz.net Albania) and on building a system to regularly monitor trends in the SME sector. Over the next year the agency needs to complete this phase and move to the implementation of specific SME support programmes, focusing in particular on the less developed regions, as indicated in the SME strategy. In parallel, the Government should review and update the current SME strategy, adjusting priorities and targets in line with demand and available resources. The Agency is promoting the establishment of working groups, made up of public institutions and private associations, to work on specific issues. This is a positive and pragmatic move, contributing to more effective dialogue between the Government and the small enterprise sector.

Rule of Law and Regulatory Environment

In terms of the rule of law and the regulatory environment for SMEs, there has been some progress in 2004. The Action Plan to Remove Administrative Barriers has been approved but the benefits are not yet perceived by small enterprises, which remain highly critical of the bureaucracy and corruption involved with the process of registration and licensing. Unlike various other countries in the SEE region, Albania has not yet reformed its company registration system, which is poorly rated by Albanian entrepreneurs. The Ministry of Economy is examining options for upgrading of the system. The establishment of a one-stop shop system and the introduction of more efficient as well as on-line registration should be seriously considered.

Tax Policy for Small Business

There has been limited improvement in the tax regime since 2003 and the tax system continues to be inimical to stimulating start-ups and growth of small enterprises. It is generally perceived as being unfriendly *vis-à-vis* small enterprises (too many taxes, pre-payments, unclear rules), and appears to be designed and administered with large enterprises in mind, rather than SMEs. There has been some progress on establishing a dialogue with the business community in relation to changes in taxes, rates and other regulations, particularly during the preparation of the 2005 budget measures. However, the government should undertake a wider and more systematic consultation process, engaging more directly the small business sector, (even if the sector is fragmented in several trade and industry associations) on issues such as tax administration reform and the fight against the informal economy. Finally, procedures such as centrally predetermined tax revenue collection targets, non-payment of legitimate VAT refunds and direct access to firms' bank accounts fuel resentment and flight by small business into the informal economy.

Financial Instruments for New and Small Business

The 2004 research indicates that entrepreneurs perceive some improvement in the financial system. The level of remittances from abroad is on the increase, albeit probably on a temporary basis, and the privatisation of the Savings Bank and other banking sector foreign direct investments have stabilised the sector, at the same time as stimulating competition. New enterprise services and products are being provided and interest rates are becoming more affordable, nevertheless, SMEs' access to finance from any source, other than family or friends and repatriation capital, remains limited.

Advisory Services and Business Incubators

Entrepreneurs gave Business Advisory Services the best rating among all the policy dimensions for the second time running. But the 2004 EPPA reveals little policy change since 2003, an issue that also applies to Business Incubators. Both continue to operate mainly in urban areas, at the exclusion of large geographical swathes of the country. As long as donors continue to prioritise private sector development, the existing business advisory services and incubators will continue to operate, but they have yet to achieve financial sustainability. The two existing Business Incubators continue to be largely unknown as far as entrepreneurs are concerned and the Ministry of Economy has yet to develop a formal policy position with respect to incubation.

Entrepreneurship, Vocational Education and Access to Technology

The general opinion is that although the education system in Albania provides a good grounding for business activity, there is a strong need to develop a culture of entrepreneurship and change attitudes towards business people. Moreover, although there is some information on business opportunities, this is poorly disseminated and entrepreneurs rely heavily on personal contacts in obtaining leads and opportunities.

Box 1: Republic of Albania and the EU Charter for Small Businesses

Albania signed the European Charter for Small Business in June 2003. The Charter, a Pan European initiative endorsed by all the EU member states, the EU candidate countries, the countries of the West Balkans, outlines ten policy areas which are instrumental in improving the business environment for small companies. These include regulatory reform, access to finance, business advocacy, entrepreneurship, education, competitiveness, *etc.* and broadly cover the same policy spectrum as the EPPAs. Under the framework of the EU Charter Process, the Albanian government identified in 2003 a set of targets related to initiatives designed to help small businesses.

Progress on target implementation is reviewed annually in a report prepared by the Albanian government and published by the European Commission, together with reports on the other countries in the Western Balkans. The second annual EU Charter Report for the Western Balkan Region, containing the country reports and a regional overview prepared by the European Commission, is scheduled to be published in January 2005.

The EPPA report contributes to the EU Charter process with an independent and business oriented policy implementation assessment. The list of the EU Charter targets for the policy dimensions covered by the EPPA, together with comments on the target implementation status is reported in Annex 4.

Overall, the targets set by Albania in 2003 appeared to be relevant for the small business sector and broadly in line with the EPPA 2003 policy recommendations. As it emerges from the 2004 EPPA, limited progress has been made. An Action Plan to Remove Administrative Barriers has been approved and a Working Group has been established, but a further study has been commissioned rather than proceeding rapidly to streamlining the business environment. The establishment of a Loan Guarantee Fund for SME capital financing has not yet been implemented and the other targets, such as the expansion of microcredit schemes, have yet to be addressed.

2004 Policy Recommendations and Priorities for Action

The 2003 EPPA report included a set of recommendations for each policy dimension in all 44 recommendations covered by the report, to provide inputs to policy discussion and policy making.

In the 2004 assessment, a more pragmatic and focused approach has been taken. Instead of listing a number of policy recommendations per dimension, leaving to the government the task of defining the terms of implementation and set the order of priority, as in 2003, the 2004 EPPA has this time identified a more restricted set of measures aimed at improving the small business environment.

The 2004 EPPA Report includes a new set of policy recommendations, consisting of a number of recommendations retained from last year, selected among those that have not yet been fulfilled and are still relevant and a limited number of new recommendations related to recent policy developments.

In addition, for each policy dimension a single Priority for Action that should be implemented over the short term (less than one year) has been recommended.

The implementation of the 2004 set of Policy Recommendations and Priorities for Action will be regularly monitored through the Investment Compact monitoring process.

Priority Reform Issues for Action

1. Ensure that SMEA develops a detailed Action Plan to guide its activities in 2005, related to the priorities of a revised SME strategy and the level of resources available for implementation.
2. Prioritise the implementation of the Action Plan for Reducing Administrative Barriers and secure sufficient funds and capacity for effective implementation.
3. Ensure that VAT refund are paid within one month.
4. Speed up the implementation of the restitution law and assist the completion of the registration of real estate. (The restitution Law is an important factor in the completion of registration of real estate and consequently in the possibility for local SMEs to use their real estate as collateral to access bank finance).
5. Revitalise the network of business support services to generate greater financial sustainability and focus on improving quality and standards for all business service providers by introducing internationally recognised certification and accreditation.
6. Develop good practice materials on the nature of business incubators and best practice in relation to implementation and financial sustainability. Materials should be widely disseminated to relevant public institutions, think tanks, business associations, local authorities and other relevant players.
7. Establish a Task Force to prepare the education curricula for primary, secondary and graduate schools that embed the development of business skills and entrepreneurship in the education system.

Institutional Framework for SME Policy

Priority for Action

1. Ensure that SME Agency develops a detailed Action Plan to guide its activities in 2005, related to the priorities of a revised SME strategy and the level of resources available for implementation.

SME Agency (SMEA)

2. Secure financial resources, commensurate with the responsibilities of the SME Agency (SMEA).
3. Ensure that financial sustainability is secured for the long-term.
4. Ensure that the Supervisory Board is selected on the basis of merit and experience.

SME Strategy

5. Review the SME strategy once the SMEA has been established.
6. Ensure wide dissemination of the revised SME strategy and other key documentation.

Consultation and Dialogue

7. Review the Business Advisory Council (BAC) to ensure that it is an effective mechanism for effective dialogue and representation involving government and small business.
8. Ensure that the SMEA establishes a representative consultative body.

Rule of Law and Regulatory Environment**Priority for Action**

9. Prioritise the implementation of the Action Plan for Reducing Administrative Barriers and secure sufficient funds and capacity for effective implementation.

Business Registration

10. Abolish the central Tirana District Court registration system and introduce a “one-stop-shop” system.
11. Move away from active court approval for company registration.
12. Introduce a single registration form and “on-line” registration of enterprises.

Business Simplification

13. Monitor the implementation of the Action Plan for Reducing Administrative Barriers on a regular basis in order to ensure progress.
14. Introduce the principle of “silence is consent” as soon as practical.

Public Procurement

15. Facilitate SME participation in public procurement / tenders.

Tax Policy for Small Business**Priority for Action**

16. Ensure that VAT refunds are paid within one month.

Policy Principles

17. Create a simple, stable and clear tax policy.
18. Sensitise the fiscal administration to the special needs of the MSME sector.
19. Consult with MSMEs or their nominated representatives regularly.

Tax Payment

20. Minimise the number of taxes that must be prepaid by small enterprises.
21. Ensure that taxes are based on historic information such as profits.
22. Ensure enterprise taxes are paid at year end, once profits are known.
23. Enable enterprises to submit tax returns electronically through the Internet.

Value Added Tax

24. Review and reform the complex criteria for eligibility of VAT refunds.

Financial Instruments for New and Small Business

Priority for Action

25. Speed up the implementation of the Restitution Law and assist the completion of the registration of real estate. (The Restitution Law is an important factor in the completion of registration of real estate and consequently in the possibility for local SMEs to use their real estate as collateral to access bank finance).

26. Increase monetisation of the economy by expediting payment of public sector salaries directly through the banking system.

Improve Bank Intermediation of Emigrants' Remittances

27. Lower the administrative barriers and costs to transfer migrants' remittances from abroad into the Albanian banking system – this 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).

Advisory Services

Priority for Action

28. Revitalise the network of business support services to generate greater financial sustainability and focus on improving quality and standards for all business service providers by introducing internationally recognised certification and accreditation.

Financial Sustainability

29. Prioritise support to start-ups and early growth firms through subsidised business support services.
30. Extend the network of business support services to geographical areas not currently covered.

Co-ordination of International Support

31. Ensure coordination of enterprise development initiatives to increase sustainability.

Customer Charters

32. Encourage business advisory centres to develop and publish customer charters.

Business Incubators

Priority for Action

33. Develop good practice information materials on the nature of business incubators and “best practice” in relation to implementation and financial sustainability. Materials should be widely disseminated to relevant public institutions, think tanks, business associations, local authorities and other relevant players.

National Policy

34. Transfer policy responsibility for business incubation to the Ministry of Economy.
35. Develop a business incubator policy and secure commensurate resources.
36. Evaluate the use of incubators to support the agribusiness and high-tech sectors.
37. Evaluate the effectiveness and financial sustainability of the business incubators.

Entrepreneurship, Vocational Education and Access to Technology

Priority for Action

38. Establish a Task Force to prepare the education curricula for primary, secondary and graduate schools that embed the development of business skills and entrepreneurship in the education system.

Education and Training

39. Introduce training programmes in all primary and secondary schools to ensure that teachers are equipped to develop and teach courses on business and entrepreneurship.
40. Encourage third level colleges to provide diplomas in Entrepreneurship Studies and Business Management.

Entrepreneurial Culture

41. Foster an entrepreneurial culture, including campaigns to promote the benefits to society and change the image of entrepreneurs.
42. Create national competitions (among pupils, students, businesses, etc.) which stimulate business awareness, skills and innovation.

Technology Transfer

43. Evaluate the effectiveness of the Technology Information Promotion Service (TIPS) in order to stimulate greater innovation and technology transfer among small enterprises.

Part II

Chapter I

VIEWS OF THE SME OWNERS AND MANAGERS

Chapter II

ANALYSIS AND ASSESSMENT

Chapter 1.

VIEWS OF THE SME OWNERS AND MANAGERS

1.1. Introduction

This section contains the analysis of the results of the focus group research on seven dimensions of good practice for the SME business environment. The analysed data were collected from the SME focus groups and experts during March and June 2004 and the questionnaires completed by the participants. The research conducted in 2004 includes the opinions of entrepreneurs and experts on an additional new dimension of *Good Practice - Entrepreneurship, Competition, Access to Technology*, as well as the opinions on targets relating to the implementation of the EU Charter for Small Enterprises. This was not included in the 2003 EPPA report for Albania, limiting comparison. In addition, some of the questions have been amended and are not directly comparable with the questions in the previous study. In these cases no comparison is given.

The analysis of SME business environment is made on the basis of assessment of the following seven dimensions of good practice:

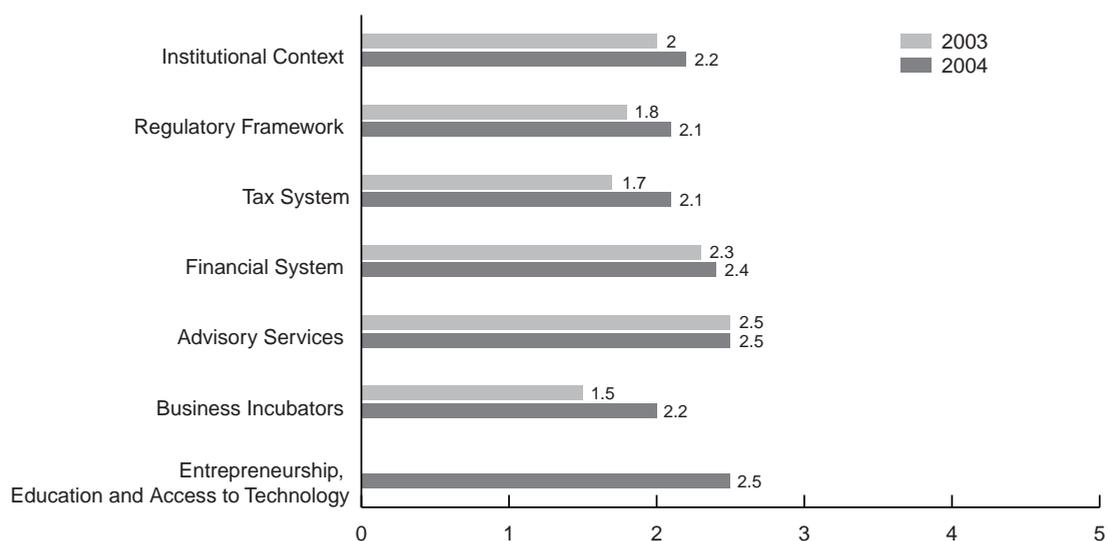
- Institutional framework for SME policy.
- Rule of law and regulatory environment.
- Tax policy for small businesses.
- Financial instruments for new and small businesses.
- Advisory services for new and small businesses.
- Business Incubators.
- Entrepreneurship, vocational education and access to technology.

The questionnaire which served as the basis for discussion by focus group participants and experts and which was subsequently completed individually by them, consisted of two groups of questions, one set comprised yes/no questions, and the other comprised questions in which participants rated their opinions on a scale of 1 to 5: **1 = very poor, 2 = poor, 3 = satisfactory, 4 = good and 5 = very good**. At the beginning of the analysis of each of the seven dimensions of good practice, we present the average results of the participants' ratings on the particular dimension.

The average ratings of dimensions of good practice in the 2003 and 2004 EPPA reports for each of the seven dimensions are presented in Figure 1.1 below. This analysis indicates a slight improvement in the SME business environment compared with 2003. In the previous report, the average ratings given for all dimensions were below the "poor" level, with the exception of advisory services and the financial system.

The views of the SME owners and managers who participated in the focus groups in 2004 were slightly more positive when compared to the average of the opinions expressed in 2003, but the ratings are still only slightly above the "poor" range. This is confirmed by the general views expressed during the focus group discussions that not much progress has been noticed in most of the dimensions of good practice in the past year or so. Advisory services and the financial system continue to be assessed relatively better than other policy dimensions in 2004, albeit below the "satisfactory" level.

Figure 1.1. Average Ratings by SME Owners and Managers of the Seven Dimensions of Good Practice, 2003 and 2004



1.2. Institutional Framework for SME Policy

The following issues were researched under this heading:

- Clear assignment of organisational responsibility for the development of SME policy.
- The effectiveness of organisation/s in developing an environment to encourage entrepreneurship and the development of SMEs.
- Awareness of SME development strategy and the quality and effectiveness of the SME development strategy.
- The local and regional governments' mandate and resources (funding, people and skills) to promote SME development.
- The information provided and awareness by business people of the Government's institutions, policy and programmes to support new entrepreneurs and develop existing SMEs.
- Awareness of consultations between Government and the private sector on SME policy.
- The quality and regularity of consultation between Government and the private sector on SME policy and its performance and assessment.
- The performance of government institutions in supporting small business since March 2003.

The institutional framework for SME development is rated marginally better in 2004 (2.2) than in the previous report (2.0). It remains to be seen how efficient the new SME Agency will be in coordinating and implementing SME policy. In the opinion of focus group participants, most aspects of the institutional framework have not changed very significantly since 2003. Although the indicators suggest a degree of improvement since 2003, the overall situation remains "poor."

Organisational Responsibility

	2004	2003
1. Do you know if a clear organisational responsibility for the development of SME policy been assigned by Government?	Yes: 33% No: 67%	n/a

67% of the businesses when asked about whether the Government has assigned clear organisation responsibility for development of SME policy think that this is not the case, compared with 33% that do. The enterprise owners and managers participating in the focus groups were critical of this issue:

“We don't know which responsibilities have been assigned by the Government. We cannot see a better business environment or more transparent and fair regulations... If there were clear responsibilities, then they should know what to do.”

Although most of the entrepreneurs are aware of the existence of the Business Promotion Department at the Ministry of Economy, very few respondents, no more than a handful, were aware of existence of the new SME Agency. It appears as if the SME Agency had not yet taken steps to introduce itself to the SME community throughout Albania and this was reflected in the discussions.

Effectiveness of Government Organisation

	2004	2003
2. How do you rate the effectiveness of the organisation/s in developing an environment to encourage entrepreneurship and the development of SMEs?	3.0	2.1

The effectiveness of the relevant government organisations in developing an environment that encourages the growth of small business was assessed as being on average “satisfactory” by the SME participants. Many of the participants have heard of the role of Business Promotion Department, within Ministry of Economy, and felt that it was working for their benefit:

“The Business [Promotion] Department seems to be improving the conditions for businesses.”

SME Development Strategy

	2004	2003
3. Do you know if a government SME development strategy exists?	Yes: 35% No: 65%	n/a

3.1 How do you rate the quality and effectiveness of the SME development strategy?	2004	2003
Overall	2.1	2.4
Quality	2.4	n/a
Effectiveness	1.8	n/a

Despite the fact that the SME Development Strategy was adopted in February 2001, only 35% of the participants are aware of it. The great majority of businesses participating in the focus group discussions were not aware of its existence and proved to be critical of strategies in general:

“We hear about many strategies, however, we have to run our businesses without any support or direction. Let the Government prepare its studies and strategies!”

“If we do not know what it is, then there is no benefit for us in it.”

Despite the negative tone of the discussion by some, the effectiveness and the quality of the SME strategy are rated as being close to “satisfactory”. Indeed, some business people were well aware of the contents of the SME strategy:

“The strategy talks about lower taxes, guaranteed funds, direct support to SMEs, etc. These are all fine, but if there is no implementation and no change we cannot believe it. It is just empty promises.”

Local and Regional Government

4.1 Do local and regional government have the mandate to promote SME development?	2004 Yes: 26%, No: 40% Do not know: 34%	2003 n/a
4.2 Do local and regional government have the resources (funding, people, and skills) to promote SME development?	2004 Yes: 16% No: 39% Do not know: 45%	2003 n/a

The issue of local and regional government mandate was also discussed during the focus groups. The ongoing decentralisation reforms should lead to an increase in the responsibilities and resources available to local government. For the moment though, few of the focus group participants think that local and regional governments have both the mandate and resources (funding, people and skills) necessary to promote SME development: only 26% of them think that local government has a mandate and 16% think that they also have the resources. A large proportion simply does not know.

A Shkodra-based businessman who was aware of the capabilities of local authorities to promote SME development stressed that:

“One should not expect anything from local government, as they only obtain funds for salaries for municipal employees and for cleaning and greening the city. Decisions about SME development funding are made in Tirana and municipalities can’t influence them.”

Information Provided and Awareness of Government Programmes

5.1 How do you rate the information provided by business people of the government’s institutions, policy and programme to support new entrepreneurs and develop existing SMEs?	2004 2.3	2003 2.0
5.2 How do you rate the awareness by business people of the government’s institutions, policy and programme to support new entrepreneurs and develop existing SMEs?	2004 2.4	2003 2.0

Most of the small businesses participating in the research think that the government has made some effort to provide information on their programmes to support SMEs. Governmental institutions are said to

have done so by providing booklets, summaries of their programmes of activity, creating comprehensive websites, *etc.* These developments are noted by businesses, resulting in a slightly improved rating compared with 2003.

“There are more publications on SME programmes, but I cannot say whether they [programmes] are efficient.”

Most participating businesses mentioned that although it is useful to have better information, a greater focus on effective implementation of the programmes and policies is still missing. As a result, the value and use of the information is compromised.

Consultations between Government and the Private Sector

	2004	2003
6. Are you aware of regular consultations between government and the private sector?	Yes: 47% No: 53%	n/a
7. How do you rate the quality and regularity of consultation between government and the private sector on SME policy and its performance and assessment?	2004	2003
Overall	2.2	1.6
Quality	2.2	n/a
Effectiveness	2.2	n/a

Almost half of entrepreneurs participating in the focus group discussions are aware of the existence of consultations between the Government and businesses. Nevertheless, in four out of the five focus group locations (except Tirana), the small enterprise owners and managers were firmly of the view that they are never involved in providing any feedback about the business environment to the Government. Entrepreneurs from Vlora were more explicit about this issue:

“We only know that something is happening when we see it on TV. And even then, only when we have electricity, which is four hours a day.”

“Such consultations are a ‘show’ more than a dialogue. They usually involve businesses closely associated with the government.”

Despite these blunt comments, the rating for consultation improved slightly in 2004. It is possible that lobbying by businesses for a fairer fiscal package in 2004 has demonstrated that it is possible to influence Government, thus positively affecting the SMEs’ opinions in this respect. Allied to this, there was some awareness that the Ministry of Economy’s Business Advisory Council is more active. Meetings are held more regularly and a wider range of issues are being discussed in the forum.

Changes in the Institutional Framework

	2004		
	Worse	No change	Better
8. How do you rate the performance of government institutions supporting small business since March 2003?	76%	15%	9%

Although the institutional structure was added to in the form of the new SME Agency in 2003, this does not appear yet to have affected perceptions of performance, as the majority (76%) of the focus group

participants actually perceived a deterioration of the performance of government institutions supporting small business. Only 9% of the participants think that Government institutions have performed better.

1.3. Rule of Law and Regulatory Environment

The following issues were researched under this heading:

- a) The formalities for new company registration and comment on the process
- b) The procedures for obtaining licenses, permits and certificates necessary for business operations
- c) 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
- d) Awareness of Government approved programmes for reducing the impact of corruption
- e) The quality and effectiveness of the programme for reducing the impact of corruption
- f) The quality and regularity of consultation between Government and the private sector / SME policy community on draft legislation and regulations that affect business.

Results of the 2004 EPPA show a slight improvement in the rating for the legal and regulatory environment (2.1) compared with 2003 (1.8). Most entrepreneurs are of the opinion that there has been little change in practice and that there *remains* significant scope for improvement. For example, the focus group participants think that although registering and obtaining licenses appear on paper to be quick and inexpensive, but if one has to go through the process, deal with the relevant institutions, try to obtain licenses and have to pay informal fees along the way, then it becomes rapidly apparent that the regulatory environment remains costly and problematic.

Company Registration Process

	2004	2003
9. Please comment on the formalities (number of steps, time needed, and cost) for new company registration .	1.9	1.8

According to the research, there has been little change since 2003 in the formalities regarding the company registration and this is reflected in the ratings. The process is still too lengthy, complex and costly (see also EPPA 2003). In addition, businesses participating in the focus groups expressed concerns regarding unofficial procedures and "grease" payments, as well as other obstacles which hinder the process of company registration:

"With the registration of a company, you come across the first disincentive to start a business."

Procedures for Obtaining Necessary Licenses, Permits and Certificates

	2004	2003
10. Please comment on the procedures for obtaining licenses, permits, and certificates necessary for business operations.	2.0	2.0

The focus groups reveal a situation in which no obvious improvements or changes have taken place since 2003 to the procedures for obtaining licenses and permits for business operations. Several examples were highlighted of licenses being issued on the basis of personal contacts and/or bias in favour of certain businesses. The discussions also covered the issues of the costs of obtaining licenses and permits. The general opinion is that they are:

[Licenses and permits are] "... as costly as the officials wish them to be."

Programme for Reducing Administrative Barriers

11.1 Are you aware of a government approved programme for reducing legal/administrative barriers for business?	2004 Yes: 41% No: 59%	2003 n/a
11.2 How do you rate the quality and effectiveness of this programme?	2004	2003
Overall	2.3	2.0
Quality	2.3	n/a
Effectiveness	2.3	n/a

The Government has been implementing a programme for reducing the legal/administrative barriers for businesses, but the 41% of participants that were aware of this, rated its quality and effectiveness as being fairly “poor”. Although the implementation of this programme has yet to begin in earnest, some businesses were already aware of it and considered it to be a starting point in improving the business environment in Albania:

“At least they have put down on paper the concerns that we have been expressing.”

Programme for Reducing the Impact of Corruption

12. Are you aware of government approved programmes for reducing the impact of corruption ?	2004 Yes: 64% No: 36%	2003 n/a
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The issue of corruption has been widely discussed in the media and business forums. Various reports, including Transparency International, indicate that corruption is a serious problem in Albania. Despite the high profile of this issue among business people, only 64% of the participants were aware of the fact that the Government has a programme to reduce corruption. Despite its existence, the participants expressed a widespread lack of credulity in the Government's willingness to address this issue:

“There is still too much tolerance towards corruption to expect a serious commitment to reduce it.”

13. How do you rate the quality and effectiveness of this programme?	2004	2003
Overall	2.2	1.7
Quality	2.3	n/a
Effectiveness	2.0	n/a

The 2004 ratings suggest a slight improvement in the quality and effectiveness of the Government's anti-corruption programme, however, in line with the preceding discussion, it is considered to be “poor” and remains a significant challenge for the Government. There is a need to increase the visibility of the results of the Anti-Corruption Programme and find effective mechanisms to actively involve the business community, thus creating important allies in the fight against corruption.

Consultation between Government and the Private Sector

14. How do you rate the quality and regularity of consultation between government and the private sector/SME policy community on draft legislation and regulations that affect business?	2004	2003
Overall	2.2	1.6
Quality	2.2	n/a
Effectiveness	2.1	n/a

The quality and regularity of consultation between government and the private sector is perceived to have improved since 2003, but remains “poor”. Most of the SME managers and owners that participated in the focus group discussions felt dissatisfied with the dialogue they have with the government. However, the opinions vary from region to region. Tirana-based firms are more involved in the consultation process and rated this question higher. Businesses located outside Tirana stressed that they are neither involved nor represented, but still provided slightly better ratings for the consultations between government and private sector:

“At least we are being considered and invited to the table before legislation is approved. Businesses also have a role to play in making the consultation process more effective, in the hope that the Government will leave the door for dialogue open.”

“Businesses are appearing more often in the media, as part of the process of dialogue with the Government. But out here [Peshkopia], we are not part of it. It is as if we were in a different country and unaffected by the changes.”

Despite the last quotation, there is some awareness that the main existing consultative body, the Business Advisory Council, is now meeting more regularly than was the case in the past and is being consulted with regard to draft legislation and regulations affecting businesses.

Changes in Regulatory Framework

14.1 How do you rate the change in the regulatory environment (registration, licenses, permits, etc.) since March 2003?	2004		
	Worse 40%	No change 37%	Better 23%

The above perspectives fed into the rating for the changes in the regulatory environment since March 2003. At that time the vast majority (77%) had witnessed either no change or a deterioration, in line with the preceding discussions.

1.4. Tax Policy for Small Businesses

The following issues were researched under this heading:

- Whether the present tax policy encourages new enterprise and the rating of the tax system in terms of the encouragement, support and ease of use that it provides to new and existing SMEs.
- The stability and transparency of the tax system for small enterprises.
- Percentage of net profits SMEs typically pay in tax.
- Consultation and communication between Government and the private sector on tax rates and incentives for enterprises.
- Consistency of tax policy with other Government policies.
- Change in the taxation regulatory environment.

In the period between the two EPPA reports (2003 and 2004) few changes were made in tax policy. The rating has improved from being regarded as worse than “poor” (1.7) to marginally better (*i.e.* 2.1). Overall, however, entrepreneurs feel that small enterprises are not being encouraged to start-up or expand; that the tax burden is excessive; and that tax administration could be improved, such as VAT repayments.

Encouragement of Enterprises

	2004	2003
15. Does the present tax policy encourage new enterprise?	Yes: 11% No: 89%	n/a

Tax Policy in terms of the Encouragement/Support to SMEs

15.1 Rating given to the tax policy in terms of the encouragement / support and ease of use that it provides to new and existing SMEs.	2004	2003
Overall	2.0	1.6
Quality	1.9	n/a
Effectiveness	2.1	n/a

About 90% of the focus group participants think that the present tax policy does not encourage new enterprise. While the ratings suggest that there have been some improvements to tax policy since 2003 (from 1.6 to 2.0), this continues to be rated as “poor”. Indeed, business representatives use the word “discouragement” rather more than “encouragement”, when discussing the tax system:

“Activists have established NGOs to protect human rights. Business people need to establish a ‘business rights’ organisation to protect them from violations in the normal operation of businesses.”

Entrepreneurs are also critical of the balance of rights and responsibilities:

“The tax authorities have the right to turn up at our premises, stop our activities without prior notice or explanations, freeze our bank accounts, define the amount of tax and fines we have to pay and when we should pay them!”

There were also complaints that the burden of national and local taxes is excessive, encouraging many businesses to go partly or wholly informal, an issue whose validity is acknowledged by both the tax authorities and the experts interviewed. There is a belief among experts that the size of informal economy is growing because many businesses are finding it hard to comply with the increasing administrative and tax burden:

“The tax authorities turn up when they set their tax revenue collection targets. They define the amount of tax that we have to pay, irrespective of our accounts or level of turnover.”

“If you go informal, you will not be in their target list. At least you can run a business without frequent intervention by them.”

Tax System Stability and Transparency

16. Rating given to the stability and transparency of the tax system for small enterprises.	2004	2003
Overall	2.2	1.7
Quality	2.2	n/a
Effectiveness	2.2	n/a

The general perception is that the stability and transparency of the tax system is far from satisfactory, although it is now rated slightly above "poor". Examples of improvements in the transparency of the tax system highlighted by the representatives of SMEs include the production of tax legislation booklets, the tax web page, publication of tax changes in the Official Gazette and the circulation of some draft changes for comment.

"The tax collectors used to come up with new, unknown forms and ask us to sign them 'in white' [no data filled in]. Therefore, publications with standard forms and ways of calculating taxes are a real step forward in terms of transparency."

"They [Tax Office] publish a lot of things, but they do not seem to have been written in the Albanian language when it comes to the implementation of what is published."

Percentage Share of Taxes in SMEs' Annual Net Profits

No information was obtained on this issue from participants.

Consultation and Communication on the Tax Policy Measures

17. Rating given to the consultation and communication between government and the private sector on tax rates and incentives for enterprises.	2004	2003
	1.9	1.9

Since 2003, more consultation and communication has taken place between private sector and government on tax policy. Several meetings have taken place, however, it remains to be seen whether the recommendations made by the business sector will be taken into consideration. As far as the discussions in the focus groups are concerned, this indicator remains unchanged as compared with 2003.

"It's like a bad movie. We pretend that we were listened to and they pretend they were listening. The end result for us is zero, while they get some credit for consulting."

"We don't know who asked them to consult us because it seemed as if they are doing it just to be politically correct. It has now been about three years ... and they have changed nothing in tax policy."

Consistency of the Tax Policy with Other Government Policies

18. Is the tax policy consistent with other government policies aiming at improving the operational environment for small business?	2004	2003
	1.9	1.7

Efforts are being made to improve the co-ordination of tax policy with the overall government policy, such as meetings and intergovernmental discussions. Nevertheless, the focus group participants remain sceptical of the Government's willingness and capacity to achieve consistency:

“Every public institution seems to come up with different taxes and rates. They just keep adding to the cost of doing business.”

“Any time that the Government comes up with an initiative, such as building a road, this leads to a new tax ... there will then be an initiative for goodness-knows-what, and the result is another tax. And so on.”

Changes in Tax Environment

19. Rating given to the change in the tax environment since March 2003?	2004		
	Worse	No change	Better
	57%	31%	12%

As illustrated in the preceding discussions, there have not been any fundamental changes to the tax system since March 2003. As a consequence, the dominant perception (88%) among the SME owners and managers is that the tax policy situation is either worse or not changed since 2003.

1.5. Financial Instruments for New and Small Businesses

The following issues were researched under this heading:

- a) The stability, competitiveness and services of the banking system.
- b) The commercial banks' interest/attitude in extending credits to the SME sector and their lending attitude with respect to the SME sector.
- c) The SME access to the following main sources of finance:
 - Own/family capital
 - Repatriation capital (from family / friends abroad)
 - Commercial banks
 - Micro finance
 - Leasing
 - Venture capital/Equity
 - Others (*e.g.* credit unions)
 - Bank personnel skills.
- d) The availability of funding for
 - Working capital
 - Capital investment
 - Technology investment
- e) Change in the banking environment since March 2003 for
 - Provision of services and
 - Lending

The overall average ranking improved marginally since the previous study (to 2.4 from 2.3). Business representatives give high ratings to the banking sector in terms of access, lending, services, etc., reflecting the latest development in the banking and financial sector in Albania.

Stability, Competitiveness and Services

20. How do you rate the stability, competitiveness and services of the banking system?	2004	2003
Overall	2.7	2.6
Stability	2.7	n/a
Competitiveness	2.8	n/a
Services	2.7	n/a

The perceptions of the stability, competitiveness and services provided by the banking sector are slightly better than in 2003, but remain less than “satisfactory”. The focus group participants think that the banking system has generally improved due, among other things, to an increased presence and supervisory activity on the part of the Bank of Albania, the expansion of the branch network by commercial banks within the country, the opening of the first two Albanian owned banks and the full privatisation of Savings Bank at the end of 2003. These developments are seen to have resulted in greater competitiveness in the banking sector. The participants think that this will improve further due to the fact that more banks are opening branches throughout Albania.

“Banks are getting better by the day. In the last year, three branches opened in Vlora alone. This means more services and more stability. We are happy with this trend.”

The story is rather different in Shkodra (and Peshkopia), where no new branches have opened:

“As in Vlora, we have the sea and a lake, but everyone ... bypasses Shkodra. Banks do not play an active role in our development. We are marginalised by the Government and the banks go where Government provides scope for development.”

Commercial Banks' Interest in Developing the SME Sector

21. How do you rate the commercial banks interest in developing the SME sector? And the lending attitude of the commercial banks to the SME sector?	2004	2003
Overall	2.5	2.1
Interest	2.2	n/a
Lending attitude	2.8	n/a

Most of the SME managers and owners are slightly more convinced about the commercial banks' interest in developing the SME sector than they were a year ago. Part of the explanation stems from the recent changes in the banking sector discussed above, which are thought to have resulted in an enhanced level of lending to the enterprise sector. Moreover, entrepreneurs anticipate that there will be a further reduction in the interest rates charged for enterprise credits (interest rates range from 6-8% for long term credit to 10-12% for short term loans). The situation is expected to improve further once credit restrictions are lifted and the Savings Bank is able to re-enter the market.

In almost all the locations of the focus group discussions, the small businesses notice a change in the lending attitude towards SMEs:

“The bank has accepted our business plan and is now much more flexible in crediting us. It is such a relief to finally gain access to loans and see their procedures being streamlined.”

“Almost all banks are now interested in financing us. This is because we produce better business plans and they are no longer just financing the Government. Unfortunately interest rates have remained static. They say we are risky, but we are 95% of all businesses!”

Access to Finance

22.1 Rating of access to the various main sources of finance.

Table 1.1 Relative Importance of Main Financial Sources Accessed by SMEs

Financial sources	2004 Rating	2004 Rank	2003 Rating
Family or own capital	3.3	1	2.8
Repatriation capital	2.7	2	2.2
Leasing	2.4	3	1.5
Micro-finance Funds	2.3	4	2.3
Others (e.g. credit unions)	2.3	4	1.9
Commercial banks	2.3	5-6	2.0
Venture / Equity Development funds	2.2	5-6	1.4
Credit reference sources	N/A	N/A	2.1
Average of the financial sources	2.4		2.0

In line with the results of the 2003 EPPA, the focus group participants rank capital from family and friends as the single most accessible form of finance. This source of funds, in particular family savings, is still considered by entrepreneurs to be much more attractive when seeking to start or expand business operations and is thought to be much simpler compared with the conditions imposed by banks. The small business representatives noted that, due to the high interest rates, their main and primary source of financing remain the family savings:

“It is better to get it from our families. It is cheaper and we are ‘with each other’.”

“If they are sure that you are serious about your business, they will lend. Banks in Tirana are time consuming and expensive.”

The normalisation of rule of law and an attractive property market have contributed to an increased inflow of repatriation capital. Based on the focus group discussion, emigrants are not just contributing to start-ups through their remittances, they are increasingly investing in new technology and introducing their own human capital, as they return and re-establish themselves in Albania:

“Once the basic conditions were re-established, namely public order, buying and renting accommodation and a workable economic system, we came back. We’re armed not just with money, but with knowledge and experience. We are keen to work for our families, for our own country!”

The overall average rating for financial sources improved between 2003 and 2004, with the most notable change taking place in relation to leasing. The fact that the legal basis is under preparation has resulted in an increased awareness of leasing as a potential source of finance for small enterprises, although its eventual impact as a source of finance remains to be seen.

The only other notable change relates to the general banking system. In addition to the greater level of competitiveness that is evident, and thus the slight improvement in the rating for this source of finance, SME representatives in the focus groups think that the quality and skills of bank personnel have improved, something which bodes well for the future.

The Quality of Banking Personnel Skills

22.2 Rating of the quality of bank personnel skills.	2004	2003
	3.2	2.6

“The banks are increasingly becoming a source of finance for us. This was not the case some years ago. When we knocked at their door, they were just not interested in us.”

“The banking services are great. If interest rates were reduced, we could fulfil all our financial needs through the banks.”

Bank Funding for SMEs

23.1 How do you rate bank funding for: working capital; capital investment and technology investment?

Table 1.2 Relative Importance of Different Purposes of Bank Funding Accessed by SMEs

Bank Funding	Rating	Rank
Technology Investments	2.5	1
Working Capital	2.4	2
Capital Investments	2.2	3

The banking sector has just started to provide funding for working capital, but it is only available for limited amounts and at high interest rates. Most of the businesses participating in the research were not aware of this development. They also saw banks as a source of capital and technology investment.

Change in the Banking Environment

23.2. Rating given to the change in the banking environment for SMEs since March 2003.	2004
Change in the banking environment	2.7
Provision of services	2.8
Lending	2.7

The SME owners and managers participating in the focus group discussions think that the changes in the banking sector since March 2003, including the provision of services and lending to SMEs, is now approaching the “satisfactory” level.

1.6. Advisory Services for New and Small Businesses

The following issues were researched under this heading:

- a) Use of advisory services and satisfaction with the range and quality of advisory services available to new entrepreneurs and SMEs, rating of the services and comment on the changes needed.
- b) Efficiency of advisory services operations.
- c) Responsiveness of advisory services provided to the demands and the needs of enterprises.
- d) The skills, experience and quality of the staff providing business advisory services.
- e) The continuity of business advisory services available.
- f) The change in the provision of advisory services since March 2003

The quality of business advisory services is deemed close to “satisfactory” by focus group participants, with an average rating of 2.5 both in 2003 and 2004. There is satisfaction with the range of services being provided, even if these tend to be concentrated in the capital city; and about half the respondents feel that the services correspond with their business needs.

Use of Professional Business Advisory Services and their Range

When the focus group participants discussed the issue of Business Advisory Services, there was a significant reduction in response rates. Based on the very limited response, Albanian entrepreneurs use the private sector as much as Government and/or donor supported consultants to provide for their business needs.

24. Satisfaction with the range of advisory services available to new entrepreneurs and SMEs?	2004	2003
Overall rating	3.0	2.5

Businesses are happy with the range of business advisory services on offer and rated them as being “satisfactory”. The respondents stressed that the range of advisory services provided is fairly wide in Tirana, including accounting, auditing, advertising, tax, standards, training, business plan preparation, *etc.* However, the offer is much more restricted outside the capital city:

“We can’t find a good accountant or tax advisor. Training is mostly provided according to the donors’ priorities but these do not always match with our needs.”

Efficiency of Operation of Advisory Services

25. Do advisory services operate efficiently ?	2004	2003
	Yes: 83%	n/a
	No: 17%	n/a
Overall	1.5	2.5
Private	1.3	n/a
Public	1.7	n/a

Consistent with the preceding discussion, a large proportion (83%) of small enterprises are satisfied with the efficiency of advisory services available to the SME sector in Albania. However, the rating given to this efficiency is much lower. Moreover, the participants rated the government / donor supported advisory

services slightly better than those provided by private consultant, contrary to the pattern elsewhere in the SEE region.

Responsiveness of Services Provided to the Needs of Enterprises

26.1 Are services provided responding to demand and the needs of enterprises?		2004	2003
		Yes: 41% No: 58%	n/a n/a
26.2 Satisfaction with the services provided ?		2004	2003
	Overall	2.7	2.0
	Private	2.9	n/a
	Public	2.5	n/a

Generally, the focus group participants believe that the available advisory services do respond to the demands and needs of small business. This view was expressed by 63% of participants, with a rating close to “satisfactory”. The private advisory service providers are assessed by the 2004 focus group participants to be slightly better than the public ones:

“When I need specialised business services, I go to a private consultant, but if there are more general needs, such as training or business plan preparation, I would turn to the existing donor-supported programme.”

Skills, Experience and Quality of Consultants

27. Rating given to the staff providing business advisory services received by your company.		2004	2003
	Overall	3.5	2.7
	Skills	3.3	n/a
	Experience	3.5	n/a
	Quality	3.6	n/a

The skills, experience and quality of the staff providing the services to the SMEs are considered by the participants as being on average between “satisfactory” and “good”, a marked improvement since the 2003 EPPA. Focus group participants attribute this improvement to the upgrading of business skills through a variety of programmes such as SEED and other donors active in the country. The Regional Development Agencies were also praised for the quality of their staff. Entrepreneurs noted that when the business advisors were capable:

“It is worthwhile paying for the service.”

But others were of the opinion that there was no point in using certain professions:

“With the Tax Office you don't need good accountants and lawyers. You need to spend time and money in restaurants and bars with the tax inspectors.”

“What is the point of having a good set of accounts, when they [tax authorities] don't even look at them? Likewise, why do I need a lawyer if there is no particular law that they [tax authorities] follow.”

Continuity of Business Advisory Services Available

28. Rating given to the continuity of business advisory services available.	2004	2003
	3.6	2.6

Continuity in the provision of business advisory services is thought to be better in 2004. An explanation for this is that various donors and international organisations continue to actively create private sector development projects in Albania. Nevertheless, the small enterprises participating in the focus groups stress that they find it difficult to afford the commercial fees charged by private business service providers. Most tend to receive donor supported services, which are either free of charge or subsidised. The issue as to how the business advisory services providers will attain financial sustainability remains unresolved.

“We have been operating as an SME for many years and ... there has been continuity. Look at the Regional Development Agencies. They were here 10 years ago and more or less the same people continue to provide business services.”

Change in the Provision of Business Advisory Services

29. Rating given to the change in the provision of Business Advisory Services for SMEs since March 2003.	2004		
	Worse	No change	Better
	10%	27%	63%

Small business representatives were asked to assess the changes in the provision of Business Advisory Services for SMEs since March 2003. 63% of the small enterprise owners and managers participating at the focus group discussions think that changes have occurred for the better but there is still considerable scope for improvement of Business Advisory Services, not least in relation to securing financial sustainability.

1.7. Business Incubators

The following issues were researched under this heading:

- Awareness of Business Incubators and the use of and the experience with business incubators; and the rating assigned to the value of Business Incubators to entrepreneurs and existing SMEs.
- The efficiency of the Government policy and programme for encouraging business incubators.
- The response of Business Incubators to the needs of local entrepreneurs.
- Awareness of other government/ donor supported schemes for start ups.
- The change in government policy towards Business Incubators since March 2003.

Despite limited awareness and experience of business incubators, small entrepreneurs remain optimistic about the potential offered by business incubators for the creation of new businesses and thus employment. The overall rating improved from 1.5 in 2003 to 2.2 in 2004.

Awareness of Business Incubators

30.1. Are you aware of what Business Incubators are?	2004	2003
	Yes: 23% No: 77%	n/a

30.2. Use of or experience with Business Incubators.	2004 Yes: 3% No: 97%	2003 n/a
30.3. Perception of importance of Business Incubators for new entrepreneurs and SMEs .	2004 2.0	2003 1.5

The great majority (77%) of focus group participants have not heard of business incubators. With the exception of one participant from Shkodra, none had any form of direct experience of business incubators. Although there are two business incubators in Tirana and Shkodra, the first question posed during the focus group discussions was: *“What are these incubators? What do they do?”*

The remainder of this section reports the results of the research but due to the very limited knowledge of business incubators, the responses are given for indicative purposes only.

Government Policy for Business Incubators

31.1. Is the government policy and programme of encouraging the establishment of Business Incubators efficient?	2004 Yes: 43% No: 67%	2003 n/a
31.2. Perception of efficiency of government policy and programme of encouraging the establishment of Business Incubators.	2004 2.5	2003 n/a

Most participants (67%) believe that the policy and programme to encourage incubators cannot be efficient since they were hardly aware of them.

32. Perception of relevance of Business Incubators' activities to the needs of local entrepreneurs.	2004 2.2	2003 n/a
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The average rating given to the relevance of Business Incubators' activities for the needs of local entrepreneurs “poor”.

33. Awareness of other government/donor supported schemes for start-ups.	2004 Yes: 24% No: 76%	2003 n/a
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Only 24% of the focus group participants are aware of other government / donor supported schemes for start-ups.

34. Change in the government policy towards Business Incubators since March 2003.	2004		
	Worse 42%	No change 32%	Better 26%

74% of the participants believe that there has been no significant change in the Government policy towards business incubators since March 2003.

1.8. *Entrepreneurship, Vocational Education and Access to Technology*

The following issues were researched under this heading:

- a) Contribution of the educational system to the creation of an entrepreneurial spirit.
- b) Awareness of training schemes for entrepreneurs.
- c) The quality of vocational training, the effectiveness of apprenticeships and difficulty in recruiting staff with the right skills.
- d) Rating of government's provision of information about business standards and opportunities.
- e) Rating of governments programmes to improve the technological capacity of small enterprises.
- f) Rating of the change of image of entrepreneurs since March 2003.

As these questions were not asked last year, there is no comparative information and all the data relate to 2004.

The overall rating received by this dimension was between the "poor" and "satisfactory" mark (2.5). Entrepreneurs appreciate the practical skills provided by the education system and consider the Vocational Education Training (VET) system to be fairly effective. However, entrepreneurs are critical of the low esteem with which they are held by Albanian society, despite their significant contribution to economic activity.

Entrepreneurship and Vocational Education

35. How much is the education system contributing to the creation of an entrepreneurial spirit in your country?	2004
	3.2

The focus group participants awarded a "satisfactory" rating for the role played by the education system in the creation of an entrepreneurial spirit. It was noted that the primary schools system introduced general skills thorough practical classes, such as mechanical work, handicrafts, electronics, etc. At the secondary school level, such knowledge was developed and extended to include finance, accounting, tourism, engineering, construction, *etc.* although none of it related directly to the development of entrepreneurship:

"Several classes provide the 'hints' you need to go into business. If you are sufficiently resourceful, you can get out there and start using them to your benefit."

"We acquired the basic knowledge and the general entrepreneurial spirit at school, but we missed out on issues such as the market economy and business finance."

36. Awareness of training programmes for entrepreneurs.	2004
	Yes: 51%
	No: 49%

About 50% of the participants are aware of the existence of the different training schemes and programmes for entrepreneurs but stressed that these were concentrated in the capital city. This meant, for example, that business people from places such as Peshkopia and Shkodra were not aware of these opportunities.

37.1. Perception of vocational education quality .	2004 2.9
37.2. Perception of apprenticeship effectiveness .	2004 2.8
37.3. Perception of opportunities for a particular business to recruit staff with the right skills.	2004 2.7

There is a long history of vocational education training (VET) in Albania and the vocational schools furnish the labour market with a variety of skilled workers. The quality of VET is rated close to “satisfactory”. Most of participants in the focus groups think that: “...*there are many skilled people out there.*” and that what is required is more specific on-the-job training.

The apprenticeship system is considered to fairly effective and is also rated as being close to “satisfactory”. Most of the SME owners and managers participating in the focus groups argue that they encounter few difficulties in employing skilled labour for their businesses, and they regard the situation in vocational training and apprenticeships as being between “poor” and “satisfactory”.

38.1. The perception of government’s provision of information about business standards .	2004 2.2
38.2. The perception of government’s provision of information about business opportunities .	2004 2.2

The Government’s provision of information about business standards as well as business opportunities for SMEs is assessed as being “poor”. The participants expressed critical views about the dissemination of information on business standards and opportunities:

“Most of my business leads come through friends and family. The Government does publish some information, but it is always pretty clear who will benefit from it. Sometimes, a business will spring up overnight and win the contracts immediately.”

Part of the focus group discussion revolved around the role of the Chamber of Commerce in providing information on business opportunities to members via its monthly newsletter. Although most participants were members and obtained this material, none had actually benefited from this source. They stressed once again the important of networks of personal contacts, friends and family. As for business standards, most businesses participating in focus groups mentioned that although they have heard about these and were generally aware of their importance in relation to EU accession, they had not come across any useful information on standards.

Access to Technology

39. Perception of government’s programmes for improvement of small enterprises’ technological capacity .	2004 2.1
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The Government’s activities and programmes aimed at improving the technological capacities of the SME sector are assessed as being “poor”. Most of the small enterprise owners and managers think that Government is not fully aware of the importance of this issue, even though technology has been a centrepiece of national policy since 1992. One the other hand, the fact that imported equipment / machinery is tax-free is widely recognised by businesses as being important. Some of the participants are also aware

of a credit line that has been established to provide small firms with access to the latest technology. Nevertheless, the general tone of the discussion was that businesses would be capable of dealing with access to technology themselves, were the Government to focus on improving the basic business environment:

“Technology should be the last concern of Government. If they only taxed less, we could invest in the technology ourselves. With our after tax profit, we can only afford outdated, second-hand machinery and technology.”

“I am surprised that the Government has programmes to improve technological capacity. Affordable commercial credit would be sufficient help, together with information on the main producers of technology.”

40. Change in the image of entrepreneurs since March 2003.	2004		
	Worse 41%	No change 47%	Better 12%

12% of the focus group participants think that the image of Albanian entrepreneurs has improved in the last year but 41% consider that it has actually deteriorated. Almost half (47%) think that there has been no significant change in the public perception of entrepreneurs. In general terms, they do not perceive that the public image of entrepreneurs is positive and argue that this is the consequence of social values and attitudes, which are still deeply suspicious of entrepreneurs, especially successful ones.

Chapter 2.

ANALYSIS AND ASSESSMENT

2.1. Institutional Framework for SME Policy

Situation in the Institutional Framework

The institutional framework covers such issues as policy design, national strategy, implementation agency and consultation mechanisms. The EPPA report for Albania (OECD-EBRD, 2003) covers these issues in greater detail so this section provides an update of the main issues and developments since 2003.

The Ministry of Economy (MoE) is the main government institution responsible for SME development in Albania. Within the MoE, the *Business Promotion Department* has the responsibility to prepare, monitor and oversee SME policies and programmes. Its main tasks are as follows:

- Prepare and update the strategy for SME development.
- Follow up the implementation of the strategy and other business promotion policies.
- Consult with the business community on businesses issues, such as discussions on draft legislation, fiscal package, regulatory and licensing system, *etc.*
- Coordinate the Working Group responsible for implementing the business simplification action plan.
- Maximise SMEs' access to financial support.
- Create institutional infrastructure to support entrepreneurship and competitiveness.

The MoE co-operates with other ministries on business and SME related issues, especially with the Ministry of Finance (taxes and budget), Ministry of Transport (trade and transport facilitation), Ministry of Local Government (local economic development and local taxes), Ministry of Agriculture (licensing), Ministry of Health (regulations), Ministry of Environment (environmental standards), Ministry of Education (vocational education and training), Ministry of Labour and Social Work (business incubators), as well as various government and governmental agencies such as the Patents and Trademark Office, Agency for Export Promotion and Agency for Foreign Investment Promotion.

A key role in the implementation of the SME strategy is played by the Small and Medium Enterprise Agency (SMEA), an institution that has been established since the publication of the EPPA 2003. Since August 2003, SMEA has developed a work plan on how to involve stakeholders in SME development and how to use national and international resources to implement the strategy at the national and regional level.

SMEA's main responsibilities are 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.
- Develop, collect, analyse and disseminate SME information to all interested parties.
- Evaluate incentives for SMEs and formulate proposals to improve finance for SMEs.

SMEA has an administrative budget of €70,000 and employs 7 full time staff. This staff complement may increase in future, depending on whether it obtains programming/operational funds or not. There are five people on the Board of Directors, three of whom are politicians (deputy ministers of Economy, Finance and Labour and Social Affairs); as well as two representatives of the business community (Regional Development Agency Network and the Association of Banks).

There is a degree of uncertainty as to the reporting structure of SMEA. Although it was created by a Council of Ministers' decision (No. 56/2003) and in principle should report to the Council of Ministers, in practice its funding comes via the Minister of Economy (MoE) and thus reports on a monthly basis to this ministry. The director of SMEA participates in weekly meetings with the MoE, together with the directors of two other recently created government agencies, namely the Investment Promotion and the Export Promotion Agencies.

The implementation of the SME strategy calls for a strong public-private partnership and close co-operation with the local stakeholders, as well as the international donor community. In February 2004 SMEA established a Forum for SME Stakeholder Co-ordination. This forum includes the main governmental institutions, existing business networks such as the Regional Development Agency Network, the business community, donor funded projects or/and development organisations, as well as think tanks and civil society. The subsequent meetings of the Forum will determine the extent to which SMEA is able to co-ordinate international private sector development funding and influence the international communities' development priorities. Since SMEA lacks funding for anything other than its administrative costs, the success of this initiative is of critical importance.

The international community, such as SEED/IFC, has been providing support to SMEA; Small Business Credit Assistance (USAID) is providing assistance to SMEA to create an implementation plan for the SME strategy; and others, such as the Italian government, are looking to support SMEA and the SME sector. In recognition of the fact that the current SME strategy is somewhat dated, SMEA has identified a new set of priorities as the focus of its activities:

The adoption of European Charter of Small Enterprises (the Charter) is an important development, which has occupied the MoE and ASME. In 2004, a national report was published on the implementation of the Charter, following a questionnaire (in 2003) on the compatibility of the current situation and requirements for adoption of European Charter of SMEs. Achieving the 10 commitments associated with the Charter is a priority for the MoE and ASME (see Annex 1).

Since 2000, there has been an ongoing decentralisation initiative in Albania. Reforms are leading to an increase in both the responsibilities and resources of local government to address the issue of local economic development. It is anticipated that as this process develops, that municipalities may increasingly be in a position to provide support to business development in their localities.

Several attempts have been made by the government to increase the participation of the SME stakeholders in a Government-business consultative process. The MoE sees the Business Advisory Council (BAC), which was established in 2000, as its main source of regular dialogue on business-related legislation and procedures. The BAC is Chaired by the Minister of Economy, but this mechanism is in need of further reform (regular meetings, secretariat, balanced representation, clear agenda, *etc.*) if it is to play an effective role. The general consensus is that consultations are taking place more often and at an earlier stage of legislation/policy development, thus allowing the voice of the business sector to be heard. For example, in May 2004 the Ministries of Finance and Economy established a Working Group to work on the 2005 fiscal package.

Assessment

The establishment of SMEA (as well as the export and FDI agencies) represents a significant step forward in addressing the key small enterprise institutional gap. However, this institution is still in the process of

establishing itself and small enterprises do not yet perceive any change in the services and support that they obtain from such public institutions. SMEA has focused its early activities on Tirana based state institutions, rather than seeking to raise awareness of its role and activities among the small enterprises in and outside Tirana. This is a natural consequence of SMEA's strategy of attaining financial sustainability through the state budget, however, it will have to develop a strategy for linking up with its stakeholders, if it is to be successful in identifying and meeting the needs of the small enterprise sector. Although efforts are being made to work with the Regional Development Agency Network, a coherent approach of outreach to SMEs in the region is not yet evident. SMEs outside of Tirana have not heard of SMEA and are not aware of the fact that they have an institution designed to champion their interests. It is not yet clear that SMEA is fully aware of the degree of scepticism exhibited by entrepreneurs in both the 2003 and 2004 EPPAs or that it has a strategy to tackle this.

The relationship between the Ministry of Economy and the SMEA is now clear and regular reporting has been established but some tension remains since the Agency is theoretically meant to report to the Council of Ministers. The Director of SMEA participates in the weekly meetings of the senior staff of the Ministry of Economy. In addition, the MoE requires the Director of SMEA to report on the activities of SMEA on a monthly basis to the *Chef de Cabinet*.

Lack of funding to implement SME projects and programmes is a major concern and a great deal will depend on the SMEA's capacity to coordinate the international community activities and funds. The funding for the Agency is provided by the state budget and its second annual budget has increased by 6%, signifying a degree of commitment on the part of the Government. Additional funding requests are being made to the SMEA's Board of Directors, which would enable it to lobby for further funding. The SMEA considers state budget funding as being the main source of long term financial sustainability and efforts are underway to secure this objective.

The current SME Strategy was prepared in 1996 and approved in 2001, yet 65% of entrepreneurs are not aware of its existence. It is essential to revise and update this document, thus ensuring that it reflects the actual needs of the Albania business environment.

The results of the EPPA 2004 suggest that the SME strategy (and related documents) needs to be both widely disseminated and implemented, both at the central and local government levels. The Business Promotion Department and SMEA recognise that dissemination is important and intend to do this once the SME strategy has been reviewed. For the moment, the business representatives involved in the EPPA 2004 do not perceive an SME strategy to exist and/or that it is a useful tool to guide SME development in the country.

The MoE has made efforts to review the Business Advisory Council (BAC) so as to secure effective small business representation. BAC meetings are more regular and the scope of discussion is widening. However, the perception remains amongst small businesses that the BAC is politically biased and overly focused on Tirana, without wider geographical representation. Since the BAC makes no allowance for type or size of enterprise, SMEs are not represented in this body in a formal sense. Since SMEA does not have a small enterprise consultative body, the recommendations made in EPPA 2003 continue to remain valid.

2.2. Rule of Law and the Regulatory Environment

Situation in the Rule of Law and Regulatory Environment

According to the Commercial Company Law and the Civil Code, an enterprise can either be a legal or physical person and can take 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 to come to the capital city in order to register their businesses. Further information on the registration and the licensing procedures is set out in box 2-1.

Box 2-1. 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 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 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.

Source: PPF1

The notary services for registering an enterprise are officially about €200 but the estimated costs are €350-€650 (Guide for Investment in Albania, 2002) and there is also a minimum deposit required 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 part dealing with commercial disputes. There is currently no arbitration system, a gap that is acknowledged by the Ministry of Justice and work on changing this is at an early stage. The procedures for settling commercial disputes are long and complex.

According to the law on Public Procurement, the National Procurement Agency is responsible for developing and monitoring the public procurement process. 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 and has been subject to measures included in the National Anticorruption Plan (Council of Europe and US, 2002).

The informal economy has an extensive influence on economic development generally and SME development, specifically in Albania. The number of companies that participate partly or fully in the informal economy is increasing beyond the official estimate of about 30% of GDP (INSTAT). Recognising its importance, the MoE is undertaking, with the support of the OECD, EBRD, European Training Foundation and others, a study to measure the degree of informal economy (OECD, February 2005). This study identifies a series of policy recommendations focusing on the small enterprise sector and has led to the creation of a Working Group at the Ministry of Economy. Furthermore, it is expected to lead to the creation of a government-approved strategy for harnessing the informal economy in 2005.

Corruption represents one of most serious constrains to more rapid economic development. It affects entrepreneurs' willingness to register their businesses and raises the cost of doing business. In addition, nepotism, political patronage and bribery are 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 level of corruption remains one of the main obstacles to business development. The government's anticorruption efforts focus on the Action Plan for Preventing and Fighting Corruption which has been revised and includes measures to strengthen the rule of law and prevent abuse in public services and civic education/participation. The responsibility for monitoring, co-ordinating and reporting on progress with the action plan lies with the Prime Minister's Office and to the Anti-corruption Monitoring Group. To further improve governance, an agency has been established to implement the law on asset declaration.

The government has sought to increase the accountability and transparency of civil servants' activities. The Law on the Status of Civil Servants seeks to de-politicise public institutions by providing equal access to public institutions, thereby avoiding nepotism but it is unclear how much progress has been made. In addition, the legal framework in Albania has been improved by the adoption of several laws, such as on Internal Auditing in the Public Sector, Ethical Rules in Public Administration and improvements to the public procurement rules.

Finally, a study on the simplification of public services was undertaken, providing recommendations on legal and regulatory changes for procedures such as licenses and regulations. This links up with a FIAS report on Removing Administrative Barriers to Investment (2003), which analysed the situation and recommended a series of actions to counteract the problems. Based on this report, the Albanian Government adopted an Action Plan which identifies the existing barriers in the areas of customs and tax administration, land ownership and construction, appeal system and the provision of licenses for the non-food sector, including recommendations and time-bound actions to be taken in order to tackle the barriers.

Assessment

With the assistance of FIAS, the MoE has started to implement the Action Plan to Remove Administrative Barriers. This is not before time as the focus group research in both the 2003 and 2004 EPPAs illustrates the

point that entrepreneurs are highly frustrated about the business entry barriers such as the time, cost, complexity, as well as the “high hidden costs and corrupt practices”. In addition to the process of registration, the licensing issues remain problematic. The small enterprises are largely unaware of any Action Plan to improve matters and are oblivious to any progress being made.

The necessity to register at the Tirana District Court continues to be a problem for firms located outside the capital city, moreover no progress is being made to allow on-line registration. Based on the focus group research, the private sector remains highly critical of the registration procedures and are convinced that greater effort should be made to simplify the licensing and permits procedures, perhaps combined with the introduction of the principle of ‘silent consent’.

The issues of corruption and the informal economy continue to be of concern to small entrepreneurs. Although the majority of enterprises are aware of the Preventing and Fighting Corruption initiatives, they are sceptical of their effectiveness in reducing the levels of corruption. In this context, the Ministry of Economy’s on-going initiative to harness the potential offered by the informal economy is appreciated by the entrepreneurs operating legitimately. The success of this initiative is likely to be greater if efforts are made to involve the relevant stakeholders in the process, not least the wider business community.

2.3. Tax Policy for Small Businesses

Situation on Tax Policy for Smaller Businesses

The Albanian government has introduced a number of reforms to tax legislation, policies and administration. Efforts were undertaken to improve the level of information and transparency in the taxation system, including using the media to disseminate information from the Ministry of Finance to businesses. In 2003 the Taxation Directorate established a website providing information on tax legislation, tax procedures, tax offices and their coordinates, and the draft fiscal package. Furthermore, in compliance with the Law on Tax Procedures, in 2003 the composition of independent Tax Appeals Commission was expanded to include two representatives of the business community.

The tax system includes the following key taxes: profit, income, property, value-added (VAT), excise and a collection of national and local taxes applicable to both large firms and small enterprises.

The *Corporate Income Tax* (CIT) applies to all legal entities undertaking commercial activities in Albania, whether domestic or foreign. A profit tax of 25%² is applied to all types of activity. 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 it can take months for reimbursements to be made.

A *value-added tax* (VAT) rate of 20% was introduced in 1997. There are very few exemptions (*e.g.* financial services), but exports are zero-rated. Businesses were required to register for this tax if their annual turnover exceeded Lek 2 million (about €14,000), subsequently revised upwards to 8 million (€66,000), following a decision by the Ministry of Finance (No.7, 10.02.2004). For imports, the taxable value is based on customs valuations determined in accordance with Law 7609 on Customs Tariffs.

VAT taxpayers are required to issue receipts containing their VAT identification number 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 and 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 normal for eligible firms not to receive VAT reimbursements at all. Even when VAT refunds are agreed, the tax authorities simply use it as a prepayment for the following year’s VAT. The IMF is also critical of this

situation and in 2003 included VAT refunding as one of the country's benchmarks, however, the procedures are still being established and a material improvement is yet to be noted. According to the IMF (2004, p.47) the Government has not yet completed re-drafting of VAT law to ensure the consistency and this is now planned for the 2005 fiscal package.

The SME tax is applicable to businesses that have a turnover up to Lek 8 million (about €66,000). The first payment is fixed for turnover over Lek 2 million (about €16,000); and the second payment is 4% of the rest of the turnover. The fixed part is payable in two tranches in January/February and in June. The second part of the tax is also paid in two instalments in September and November. The SME tax payers are divided into three categories, each involving specific cities. In the case of SMEs that operate in villages associated with a named city, the tax is 50% of the SME fixed tax. This means that if, for example, an SME has activities in two cities and a village, it is expected to pay the SME tax in all three places. The Government intended to introduce a simplified registration procedure for the SME tax in December 2004 but this is now only expected to take place once the collection of social security contribution from SMEs is fully transferred to the General Directorate of Taxation in early 2005.

All officially registered 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 41.9%, which is a reduction of 4% compared with 2003 (30.7% employer contribution and 11.2% employee contribution) of the wage, based upon the official wages of the State employees in a range between the minimum of 10,400 Lek (approximately €80) and the maximum of 18,120 Lek (approximately €144).

All persons classified as resident are subject to *Personal Income Tax* (PIT) 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 their Albania income. The tax itself is progressive, with a top marginal rate of 20%. Employers and contractors are responsible for withholding tax from wages and transferring it to the state when the wages are paid. However, since almost all salaries are paid at the minimum income level, the PIT tax revenue is minimal (1% of GDP in 2003).

The *property tax* applies to agricultural land and buildings. The Ministry of Finance administers 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 is applied 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 range from 5% - 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. Survey results indicate that bribing of public officials is 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 is weak.

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 since this has potential cash flow implications. For example, the profit tax is required to be paid before the profit is 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 consider 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.

It is common for the tax authorities to issue tax collection targets to local Tax Offices, leading to taxes being imposed on businesses which relate to the targets, rather than the actual turnover and other business factors. This issue has often been criticised by the business community and the Ministry of Finance has adopted legislation for the establishment of a Tax Policy and Revenue Forecasting Unit, so as to forecast public revenues in a more efficient manner.

Since 1992, the tax authorities have also 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. Both national and foreign businesses consider this to be one of the biggest impediments to doing business in Albania and the issue has attracted the attention of international donors and IFIs active in trying to improve the business climate. The Taxation Directorate is now committed to abolishing it.

Assessment

The tax system is heavily criticised by the private sector - 78% of the small enterprises participating in the research think that it discourages new enterprise much more than encouraging it. A key concern continues to be a perception that the overall tax burden is excessive and, in this respect, Albania is no different from the countries of SEE and beyond.

Another area of concern focuses on the highly non-transparent nature of the tax system. The Taxation Directorate's monthly tax revenue targets, which have to be collected by the local Tax Offices, pay scant attention to the actual tax liability of firms, fuel mistrust and contribute directly to an unstable tax environment. Thus, as entrepreneurs expect to be treated unfairly, this encourages many of them to operate informally.

There are no indications that the tax administration is becoming more sensitised to the needs of small businesses through its rules and regulations. The informal economy remains extensive and it is not surprising that the Ministry of Economy is developing a Programme to Harness the Informal Economy, a process that the Ministry of Finance should participate in. All the evidence suggests that most SMEs are operating at least in part in the informal economy through measure such as underreporting turnover, paying minimum wages and topping up incomes in cash (thus avoiding social security contributions), operating in cash without receipts, *etc.* (see also OECD, February 2005).

Consultation with SMEs and their nominated representatives on tax issues is being carried out more frequently but SME owners and managers feel strongly that insufficient emphasis is placed by Government on consultation and that there is a need to develop the mechanisms for regular, timely and credible tax consultation with SME representatives, including working with the private sector representative bodies. There are also some improvements, in relation to information provision through the Internet.

The VAT refund system continues to present severe difficulties to small enterprises. In other countries of the region, it is not unusual for firms to have to wait for longer for the VAT refund, typically double the official statutory period, however, the focus group research highlights that there is no evidence of

improvement in the administration of the VAT refund, despite the Government's commitments. Albania is alone in operating a system of either not refunding VAT at all or using refunds due as tax credit for the following fiscal year.

Businessmen, especially the SMEs, continue to fear and mistrust tax authorities and their methods. Tax inspectors are considered to be intrusive, time consuming and unfair, unless bribed. Significant efforts are required to improve the tax administration, focusing on reform of the tax inspectorate, introduction of clear procedures and stamping out unfair and corrupt practices.

Finally, despite more than five years of criticism, the law enabling tax authorities to have direct access to business bank accounts remains in effect. The most that has been achieved is an agreement between the Bankers' Association and Taxation Directorate to abrogate this right, but it is unclear when this will happen.

2.4. Financial Instruments for New and Small Businesses

Situation on Financial Instruments

The economy remains largely cash-driven and the majority of transfers and payments are carried out outside the banking system.

The Albanian banking sector now consists of a total of 16 majority privately owned banks. The sale of the country's largest state-owned bank, the Savings Bank, to the Raiffeisen Group in the first quarter of 2004 brought the entire banking sector in Albania under majority private ownership. The Savings Bank had not been allowed to extend credit to private customers during the seven-year period preceding its privatisation. The post-privatisation restructuring was expected to result in fast growth of bank loans to the SMEs and household sector, as well as in increased efficiency in the financial sector as a whole. However, the newly renamed Raiffeisen Bank plans to initiate its lending activity with loans to large corporate clients, with annual turnover of over four million euro, with lending to SMEs to follow in a successive phase of its restructuring. Retail banking is a more immediate target, with emphasis being placed on the opening of 100 ATM machines, whilst the number of branches was shrunk from 200 to 82. The state is planning the sale of its remaining minority stakes in Banca Italo Albanese and United Bank of Albania.

One bank is dedicated to the financing of SMEs; Procredit Bank Albania. Set up by KfW in 1996, and converted into a commercial bank in early 1999, is also owned by EBRD, IFC and IMI (International Micro Investitionen). It had extended more than 22,000 loans of US\$7,500 average size by September 2004, through ten branches.

Private credit in Albania grew by 34% year-on-year during the first half of 2004 from the low basis of about 7% of GDP at the end of 2003. Financing of the high government deficit remains nevertheless one of the core functions of the commercial banks. Credit to the public sector remains substantial, at 27% of GDP in 2003. At the end of 2003, treasury bills accounted for about half the balance sheets of Albanian banks. Lending to the private sector constituted only 13.5% of total bank assets, although it had grown by 31% compared to 2002. It is hoped that the direct sales of treasury bills to non-banking clients would put pressure on commercial banks to further develop their lending activities. Confidence in the banking sector appears to have increased with local and foreign deposits growing in the 12-months until July 2004 by 9.7% and 13.6%, respectively.

Efforts to reduce the use of cash and foster banking intermediation continue, including the improvement of accounting standards and a strengthening of supervisory capacity by the central bank. The Ministry of Finance and the Bank of Albania have continued their campaign to reduce the volume of cash transactions and encourage the greater use of bank accounts. One of the suggestions made by the IMF in this respect concerns state sector wage payments to be made directly into employees' bank accounts. The authorities

have agreed to implement this although only gradually during 2005, as they fear that current inefficiencies in the banking system would negatively affect access to wages for public sector employees.

The recently introduced real-time gross settlement system is operating well and an automated clearing house is expected to be in operation by mid-2005.

Leasing is an increasingly popular source of finance for SMEs. Until now it is however completely unregulated and unsupervised. With the assistance from SEED/IFC, the government has drafted a law to regulate leasing activity.

Although the Tirana Stock Exchange was issued with a definitive license to operate in the country's capital market, its activities are likely to be limited to a secondary market of government's treasury bills and obligations. Listing and trading of shares of Albanian companies remain long-term objectives.

The Albanian authorities are working to set up a legal framework for credit guarantee funds and financial leasing. The latter would complement operational leasing transaction in offering diversified financing options to local companies.

Assessment

The privatisation of the Savings Bank completed the transfer of the banking sector into private hands and has the potential of significantly increasing the private sector access to finance. The rapid growth of credit to private sector experienced in the past year is still insufficient to address the private sector's demand for finance. A significant increase in the level of banking intermediation cannot be achieved only through privatisation and restructuring of banks. Other factors play an important role in Albania. One of them is the difficulty experienced by Albanian migrants to remit their wages through the host country banking system into the Albanian banks. Alternatives to host country bank channels are extremely expensive and act as a deterrent from channelling remittances through formal channels. Given that remittances are estimated in Albania to account for 17 per cent of GDP, the potential of channelling such funds through the banking system should not be underestimated. Steps to channel wage payments through the banking system are also important to change both household and business behaviour.

The lack of effective land registries and cadastres has so far precluded firms from using property as collateral. As a consequence commercial banks traditionally require high levels of collateral, thus affecting the ability of firms to borrow from formal channels. A system of immovable property registration has been recently established. The process of land registration and cadastres in rural areas is almost complete except for property title problems / remote areas. The registration of real estate in urban areas was initiated at a later stage, so that at present only few properties in urban areas have been registered. Given that a large number of urban properties expropriated in the 1940s were sold without clear titles during the transition period, it is important that the restitution law discussed by parliament since November 2003 be adopted and implemented. This would allow small businesses to use the real estate they own as collateral.

The adoption and implementation of the law regulating leasing activity should be an important factor in attracting foreign investors and increasing the efficiency of this increasingly important source of finance for local SMEs.

2.5. Advisory Services for New and Small Businesses

The Situation on Advisory Services

A number of institutions provide advisory services almost exclusively to enterprises and entrepreneurs. These organisations are particularly important since they assist small businesses with their everyday

problems, delivering services such as training, advice, information, planning and consultancy. A recent survey by SEED/IFC (2003) highlighted the fact that the main business services demanded by SMEs include accounting, auditing, taxation services and business planning.

There are approximately 50 business support centres in Albania, typically providing:

- 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 founded 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. They 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 income) and fees charged to local businesses (balance of income). 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 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 co-ordinate their activities and receive assistance from USAID (Small Business Credit Assistance), thus enabling them to continue providing business planning and management training.

UNOPS has set-up *Local Economic Development Agencies* (LEDAs) in Shkodra, Vlora and Durres. The LEDAs promote local economic development through co-operation with the public and private sectors and 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. In addition, in co-operation with Credins Bank, a mutual guarantee fund for SMEs is being prepared.

The *Agro-Business Management Centre* is located in Tirana. 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, 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 mandatory membership fees:

- Physical persons: Lek 10,000 (€74).
- Ltd companies: Lek 20,000 (€147).
- Joint stock companies: Lek 30,000 (€221).

If the fees are not paid, fines may be imposed and all businesses are required to pay this fee before they can obtain their annual license from the tax office. The CoC's senior management is appointed by the Ministry of Economy and it is a member of the business forums. It 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 and is answerable to the Ministry of Economy.

There are numerous other business associations operating on a not-for-profit basis. They tend to focus on a particular sector and are often supported by international donor projects such as the National Farmers' Union, Association of Beekeepers, *etc.* (American Chamber of Commerce, 2001). The Construction Association

was created about three years ago and has been successful in lobbying and advocating on behalf of its members, resulting in an improved image and rising membership.

Some progress is being made towards the certification and accreditation of business services. This initiative is being led by SMEA, in co-operation with foreign donors, with the aim of providing a stronger professional basis to business services in the country.

Assessment

Many donors continue to target aid for private sector development activities, including the delivery of business advisory services, as a key component of their technical assistance. One of the priorities of SMEA's work is to review the current SME initiatives, develop a framework for future technical assistance in this area and coordinate donor initiatives. A second meeting on this subject is being organised, but it remains to be seen whether SMEA will be successful in coordinating international funds.

There is continuing donor support for advisory services, however, the business support centres remain a long way from achieving financial sustainability. There has been a slight extension of the existing network of business support services since 2003 (LEDAs), but the focus group research suggests that large areas of the country are devoid of business support services and that the concentration of services in Tirana is forcing small enterprises to come to the capital in order to obtain the normal range of business services.

A key development that has occurred is that SMEA has decided not to establish its own regional network and has instead signed a Memorandum of Co-operation with the Regional Development Agency Network. This is a positive development to the extent that it avoids a proliferation and thus overlapping of providers. Such a move should enable SMEA to attain geographical outreach whilst at the same time assisting the existing network to become sustainable in due course.

However, it is still not clear whether either SMEA or the network will have long-term funds to secure their financial sustainability. SMEA's operational costs are funded from the state budget but other activities are subject to the availability of international funds. The state funds are limited, despite a 6% increase in the budget, and in practice business support services cannot rely on SMEA to secure their financial sustainability. They will need to contract directly with other clients, if they are to continue operating. That said, the focus group research was quite positive in terms of extent to which they are seen as operating efficiently and being responsive to the demands and needs of small enterprises.

Improving the quality of the business services delivered by consultants would assist the process of attaining financial sustainability. An understanding is evolving of the importance of having a system of certification and accreditation of business advisory bodies and services. Different donors are now supporting SMEA to create certification and accreditation, however, these efforts appear to be fragmented, with SEED/IFC, GTZ and USAID separately working on various aspects of this issue.

The business advisory services in Albania have yet to develop 'Customer Charters', promotion materials and highlight their prices and services in a coherent manner. Such a development could be stimulated through the SMEA's activities in conjunction with the RDA network .

2.6. Business Incubators

Situation in the Area of Business Incubators

There are two Business Incubators in Tirana and Shkodra. These were set-up with World Bank assistance and are the responsibility of the Ministry of Labour, rather than the institution responsible for enterprise

development, namely the Ministry of Economy. The business incubators were subsidised for the first three years of their operation and are now operating on a self-financing basis, except for their premises which will remain rent-free until 2005.

To become members of the business incubators, all tenants must be start-ups. They can remain as tenants benefiting from the subsidised rents for a maximum of three years, after which they must pay the full rental costs. The subsidised services include office services such as telephone, fax, reception, *etc.*; training such as starting and improving businesses; and legal advice. It is not clear whether the business incubators are operating as foreseen and have attained financial sustainability. No evaluations have been undertaken of these initiatives identifying the potential for extension to other parts of the country.

Assessment

There has been no progress in the development of business incubators since 2003. No official policy exists and there is no preparatory work to assess other potential locations for future incubators or to identify funds for creating additional incubators.

The focus group research reveals that the great majority (83%) of focus group participants have not heard of business incubators. All their responses are, therefore, coloured by this lack of knowledge. Despite a relatively long track-record with business incubators in Albania, the key relevant organisations remain largely ignorant of business incubators' objectives, functioning and general effectiveness. No progress has been made in disseminating information and promoting the role of business incubators to ministries, local authorities, as well as leaders of business associations, such as Chambers of Commerce and others.

2.7. Entrepreneurship, Vocational Education and Access to Technology

The Current Situation on Entrepreneurship, Education and Access to Technology

Education and Entrepreneurship

General business oriented skills are provided at different levels of the formal education system. This begins at the primary school level and continues in secondary schools, through courses on such issues as technology, information technology and business skills.

Such skills are also imparted through vocational schools, especially in the ones focusing on economics and finance, agro-business, hotels and tourism. Other vocational schools specialise in electronics, industry, mechanical engineering, construction, *etc.* and many schools have established partnerships with SMEs. Students obtain access to job tasters, training and internships leading to permanent employment, while SMEs gain an opportunity to recruit a more skilled labour force.

There are no academic courses dealing specifically with entrepreneurship, leading to the conclusion that there is a need to:

- Increase the number of courses for entrepreneurship, especially at university level.
- Improve the quality of entrepreneurship education.
- Improve the linkages between theoretical and practical work in educational institutions.

Access to Technology

Albania has sought to address the issue of improving access to technology since 1996, when the office of Technology Information Promotion Service (TIPS) was created within the Ministry of Economy. TIPS establishes business-to-business contacts and links buyers and sellers of technology, services and products

through the Internet. It has already assisted companies in sectors such as in the agro-industry, construction, pharmaceuticals, biotechnology, tourism, energy and textiles.

The Open Society Foundation also seeks to enhance the level of entrepreneurship and access to technology, for example through funding provided to the Regional Development Agency Network and other institutions. The Adriatic and Ionian initiative, financed by the Italian Government, aims to improve access to information and communication. There are also projects financed by USAID and GTZ to strengthen the technological capacities of SMEs by developing clusters.

Several industry-specific research institutes exist, but their skills and equipment have been deteriorating since 1992. As the market economy evolves and the number of SMEs increase, it is possible that the demand for their services may increase in areas such as seismology and construction materials.

UNDP is addressing Information and Communication Technology (ICT) development. It has supported the creation of a national ICT strategy, prepared a National e-readiness Assessment Report and is supporting the implementation of an Action Plan to address e-government, e-education and e-commerce issues.

However, there remain serious obstacles to efficient technology transfer to small enterprises such as:

- Improving technical education and skills.
- Raising finance for new technologies.
- Improving legislation and strategies.
- Building institutional capacities.
- Improving information dissemination.

Assessment

The 2003 EPPA did not include recommendations for entrepreneurship, education and access to technology. Therefore, this section of the research takes as its starting point the relevant principles enshrined in the EU Charter for Small Enterprises.

Firstly, education and training for entrepreneurship refers to the need to nurture entrepreneurial spirit and new skills from an early age and for general knowledge about business to be taught at all school levels. Some progress is being made, however, the Government needs to examine ways of systematically introducing business and entrepreneurship in the educational curricula at primary, secondary and college levels. Entrepreneurs participating in the research underline the value of such a development. They recognise that although the education system provides general courses, it does not tackle the issue of developing an entrepreneurial spirit directly. Furthermore, only 12% of the focus group participants think that the image of entrepreneurs in Albania has improved in the last year, suggesting a need to address the public image of entrepreneurs and raise awareness of their value and contribution to society.

Secondly, availability of skills refers to training institutions, in-house training, skills adapted to small business needs, lifetime training and consultancy. The availability of such skills and training is limited but improving. There are some specialist private sector firms beginning to cater for these needs, but these are concentrated in the capital and other large cities. As a result, only about 50% of the participants were aware of the existence of the different training schemes and programmes for small entrepreneurs. The issue of business service providers has already been discussed elsewhere in this report.

Thirdly, strengthening the technological capacity of small enterprises refers to technology dissemination to SMEs, increase capacity of small business to use technologies and foster inter-firm technology co-operation. There is some awareness of the Technology Information Promotion Service (TIPS), but the Government's activities and programmes aimed at improving the technological capacities of the SME sector are thought to be "poor", despite being a centrepiece of national policy. The fact that equipment and

machinery import is tax-free is recognised as being important but businesses stress that if the Government were to concentrate on getting the basic business environment right, firms would be able strengthen their own technology capacity without state support.

Lastly, improving online access refers to electronic communication of public authorities with SMEs. However, there is currently no on-line information specifically targeted to small enterprises.

2.8 Report on the implementation of the 2003 EPPA Policy Recommendations

In this section we assess progress in implementing the 2003 EPPA recommendations.

EPPA 2003 Recommendations on Institutional Framework	Progress since EPPA 2003³
<i>SME Agency (SMEA)</i>	
1. Move rapidly to implement and develop the SME Agency (SMEA).	Significant Progress
2. Secure financial resources, commensurate with its task.	Limited Progress
3. Ensure that financial sustainability is secured for the medium to long-term.	Limited Progress
4. Establish a transparent relationship between SMEA and Ministry of Economy.	Significant Progress
5. Ensure that the Supervisory Board is selected on the basis of merit and experience.	Limited Progress
6. Ensure that any regional structure is financially sustainable and accountable.	Limited Progress
7. Ensure that the SMEA staff obtains technical assistance.	Limited Progress
<i>SME Strategy</i>	
8. Ensure wide dissemination of the SME strategy and other key documentation.	No Progress
9. Review the SME strategy once the SMEA has been established	No Progress
<i>Consultation and Dialogue</i>	
10. Review the Business Advisory Council (BAC) to ensure that it is an effective mechanism for government-business dialogue and representation.	Limited Progress
11. Ensure that the SMEA establishes a representative consultative body	No Progress

EPPA 2003 Recommendations on the rule of Law and the Regulatory Environment	Progress since EPPA 2003
<i>Business Registration</i>	
12. Abolish the Tirana District Court registration system and introduce a “one-stop-shop”.	No Progress
13. Move away from active court approval for company registration.	No Progress
14. Introducing a single registration form and “on-line” registration of enterprises.	No Progress
<i>Business Simplification</i>	
15. Introduce a Government approved Action Plan for Reducing Barriers to Business	Significant Progress
16. Establish a Working Group on Reducing Barriers to co-ordinate the process.	Significant Progress
17. Ensure that the Working Group is adequately resourced, staffed and consults widely.	Limited Progress
18. Introduce the principle of “silence is consent” as soon as practical	No Progress
<i>Public Procurement</i>	
19. Make it easier for SMEs to participate in public procurement tenders.	Limited Progress

EPPA 2003 Recommendations on Tax Policy for Small Businesses	Progress since EPPA 2003
<i>Policy Principles</i>	
20. Create a simple, stable and clear tax policy.	Limited Progress
21. Sensitise the fiscal administration to the special needs of the MSME sector.	No Progress
22. Amalgamate taxes.	No Progress
23. Consult with MSMEs or their nominated representatives regularly.	Limited Progress
24. Explain the tax system with regular, simple and up-to-date information.	Limited Progress
<i>Tax Payment</i>	
25. Minimise the number of taxes that must be prepaid by small enterprises	No Progress
26. Ensure that taxes are based on historic information such as on profits.	No Progress
27. Ensure enterprise taxes are paid at year end, once profits are known.	No Progress
28. Enable enterprises to submit tax returns electronically through the Internet.	Limited Progress
<i>Value Added Tax</i>	
29. Ensure that refunds are processed and paid within one month.	No Progress
30. Review the complex criteria for eligibility for VAT refunds.	No Progress

EPPA 2003 Recommendations on Financial Instruments	Progress since EPPA 2003
<i>Strengthening Competition in the Banking Sector</i>	
31. Privatised the main commercial bank, the Savings Bank in order to foster competition in the banking sector and increasing the private sector's (SMEs' in particular) access to finance.	Significant Progress
<i>Improving Bank Intermediation of Emigrants' Remittances</i>	
32. Lower 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.	Limited Progress
<i>Creating Effective Land Registries and Cadastres</i>	
33. 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.	Limited Progress

EPPA 2003 Recommendations on Businesses Advisory Services	Progress since EPPA 2003
<i>Financial Sustainability</i>	
34. Prioritise support to SMEs through subsidised business support services.	Limited Progress
35. Extend the network of business support services to areas currently not covered.	Limited Progress
<i>Co-ordination of International Support</i>	
36. Ensure coordination of enterprise development initiatives to increase sustainability.	Limited Progress
<i>Quality and Accreditation</i>	
37. Introduce independent certification and accreditation of business advisory providers.	Limited Progress
38. Encourage business advisory centres to develop and publish customer charters.	No Progress

EPPA 2003 Recommendations on Business Incubators	Progress since EPPA 2003
<i>National Policy</i>	
39. Transfer policy responsibility for business incubators to the Ministry of Economy.	No Progress
40. Develop a business incubator policy and secure commensurate resources.	No Progress
41. Evaluate the use of incubators to support the agribusiness and high-tech sectors.	No Progress
42. Disseminate information and promote the role of business incubators.	No Progress
43. Evaluate the effectiveness and financial sustainability of the business incubators.	No Progress
44. Develop training and education programmes for business incubator managers.	No Progress

NOTES

2. The corporate income tax rate will be reduce to 23% starting from the 1st of January 2005.
3. **Recommendation implemented** *i.e.* law / policy approved and implemented, effective strategy approved and being implemented efficiently or agency fully operational and achieving results on the ground; **Significant progress** *i.e.* law / policy approved, preparatory work for implementation completed and progress made on the ground; **Limited progress** *i.e.* some preparatory work done, legislation drafted or agency beginning implementation; **No progress** *i.e.* no progress since last EPPA.

Annex I

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Annex II

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Albanian Government: <http://www.mininf.gov.al>

Albanian Securities Commission: <http://www.asc.gov.al/>

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

Council of Europe Information Office in Albania: <http://www.coealb.org/>

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

Chamber of Commerce and Industry of Tirana, Albania: <http://www.cci.gov.al/>

Delegation of European Commission in Albania: <http://www.delalb.cec.eu.int/en/index.htm>

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

European Stability Initiative: <http://www.esiweb.org/>

Institute of Insurances (INSIG): <http://www.insig.com.al/>

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

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

International Organization for Migration in Albania: <http://www.iomtirana.org.al/Home Page.php>

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

Ministry of Economic Cooperation and Trade: <http://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>

National Agency of Privatization: <http://www.akp.gov.al/>

National Commercial Bank (BKT): <http://www.bkt.com.al/>

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

OSCE Presence in Albania: <http://www.osce.org/albania/>

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

Stability Pact for South Eastern Europe: <http://www.stabilitypact.org>

Tirana Municipality: <http://www.tirana.gov.al/>

USAID in Albania: http://www.usaid.gov/regions/europe_eurasia/countries/al/index.html

US Chamber of Commerce Office in Albania: <http://www.amcham.com.al/home/index.php>

UNDP in Albania: <http://www.undp.org.al/>

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

Annex III

METHODOLOGY

EPPA Methodology

Five focus group discussions took place in Tirana (capital city), Shkodra (less developed industrial region, north) Vlora, (developed region, south), Elbasan (somehow Peshkopia (less developed region, northeast). In all, 53 entrepreneurs took part in the detailed discussions, covering the following sectors of activity: industry, agriculture, trade and construction. The participants included representatives of micro, small and medium-sized companies, ranging from start-ups to established firms. Standard templates were used for the discussion and the collection of ratings. Comparisons are made with ratings derived from focus group discussions carried out in (February – March) 2002. The EPPA 2003 involved 31 entrepreneurs participating in three focus group discussions. The EPPA 2003 ratings are reported here as background information. Together with the last questions for each dimension of good practice, addressing the direction of change in the preceding year, the ratings provide an indication of the direction of change in perceptions. The focus group research commenced in February 2004 and other interviews and desk research extended into June 2004.

Individual interviews with 12 MSME experts were carried out as part of the research, allowing for a wider perspective than the focus group discussions and to cross reference the information that was obtained in the focus group discussions. The organisations included the following: Ministry of Economy / Business Promotion Office, Ministry of Finance, Taxation Office, Agency of SMEs, Union of Chambers of Commerce, Chamber of Commerce in Tirana, Construction Association of Albania, SEED/IFC, SBCA/USAID, EU Delegation, *etc.*

The analysis in this report is based on the methodologies described above and the Introduction to this report, and is complemented by European Commission and EBRD assessment. All information has been analysed by the consultants engaged within Albania (Public Private Finance Institute (PPFI) in cooperation with Network of Regional Development Agencies (RDAN)), OECD, EC and EBRD, resulting in the assessment presented in this EPPA.

NOTE: The notation SMEs and small enterprises in this report also includes micro-enterprises, which according to the EU definition (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 enterprises 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.

Annex IV

Attainment of the EU Charter for Small Enterprise 2003 Targets⁴

Field of the Charter: Taxation and Financial Matters

Objective: Establishment of a Loan Guarantee Fund for SME capital financing.

EPPA Comments: The agreement with the Italian Government is still pending on the Italian side. It was ratified by the Italian Parliament in June 2004, however, no details have been provided leading to the establishment of a loan guarantee fund for SMEs. Based on the interviews with SME experts, this loan programme has been discussed for some time, but until it is confirmed, it is not expected to have an impact on SME development in the near future.

Field of the Charter: Education and Training for Entrepreneurship

Objective: Development of a training programme for the internalisation of SMEs, focusing on increasing SME competitiveness in the European market.

EPPA Comments: The SME Development Agency (SMEA), in cooperation with donors, has designed a programme to coordinate all existing business training projects in the country, the so-called "Albanian Value Chain of Qualified Training Services." A draft training programme is being prepared, which aims to enhance the capacities of Albanian SMEs to deal with international markets generally, including the European markets. There is also a commitment on the part of the Government to address the issues of developing market research capacities in key sectors for SME development and develop the information capacity on SME performance indicators within the SME Agency. This document is currently a draft for discussion and it is unlikely that this Charter target will be attained in 2004, as originally anticipated.

Field of the Charter: Better Legislation and Regulation

Objective: Removing administrative barriers in the field of investment.

EPPA Comments: An Action Plan to Remove Administrative Barriers has been approved and a Working Group has been established. However, there is limited funding available to assist the activities of the Working Group and the major barriers remain to be addressed. At a donor meeting in June 2004, the Government requested a further study, which has been commissioned and it is being carried out. This may mean a further loss of time, as the new report is not likely to reveal any major new barriers to doing business, but may well delay implementation of the Action Plan. The 2003 and 2004 EPPAs demonstrate beyond doubt the urgent necessity get on with improving the business environment.

Field of the Charter: Development of Stronger, more Effective Representation of SME Interests

Objective: Increase the effectiveness of the Business Advisory Council.

EPPA Comments: A draft programme has been prepared by SEED/WB, in cooperation with the Ministry of Economy. The only information available is that this is now being discussed internally by the government structures, but little progress has been made in terms of implementation.

Field of the Charter: Taxation and Financial Matters

Objective: Support and expand microcredit schemes, in cooperation with donors.

EPPA Comments: The main aim of the SME Agency is to fully implement the SME strategy, as well as provide outreach programmes of business support at the local level. Since it lacks a regional structure, SMEA has requested the assistance of the Regional Development Agencies Network (RDAN) and institutionalised this cooperation in the form of a Memorandum of Understanding which is expected to be signed shortly. Such cooperation may help to achieve this Charter target, but it remains unclear how exactly additional microcredit will be made available and expanded, since the RDAN is not a financial institution, or indeed how exactly the objectives of National Strategy for Socio-Economic Development will be attained. Since the Memorandum of Understanding has not yet been signed, this objective is unlikely to be implemented in 2004, as originally foreseen.

NOTE

4. European Charter for Small Enterprises - **Report on Small Enterprises in the Republic of Albania**, according to European Commission Questionnaire for 2004, Ministry of Economy of the Republic of Albania.

Annex V

LIST OF CONTACTS

INVESTMENT COMPACT FOR SOUTH EAST EUROPE

COUNTRY ECONOMIC TEAMS

Albania

Mr. Bashkim Sykja (*CET Leader*)
Head of SME and FDI Unit
Ministry of Economy
Bulevardi "Zhan d'Ark" 3
Tirana

Tel.: (355 4) 36 46 73
Fax: (355 4) 22 26 55
bsminek@yahoo.com

Bosnia and Herzegovina

Mr. Dragisa Mekic (*CET Leader*)
Assistant Minister
Ministry of Foreign Trade and Economic Relations of BiH
Sector for Foreign Trade Policy and Foreign Investments
Musala 9
71000 Sarajevo

Tel/Fax: (387 33) 220 546
Dragisa.Mekic@mvteo.gov.ba

Mr. Marko Tutnjevic (*Deputy CET Leader*)
Project Manager
Foreign Investment Promotion Agency

Tel.: (387 33) 278 095
Fax: (387 33) 278 081
tutnjevic@fipa.gov.ba

Bulgaria

Mr. Pavel Ezekiev (*CET Leader*)
President
Invest Bulgaria Agency

Tel.: (359 2) 985 55 00
Fax: (359 2) 980 13 20
p.ezekiev@investbg.government.bg

Ms. Iva Stoykova (*Deputy Leader*)
Director, Marketing Service
Invest Bulgaria Agency

Tel.: (359 2) 985 55 34
Fax: (359 2) 980 13 20
i.stoikova@investbg.government.bg

Republic of Macedonia

Mr. Stevco Jakimovski (*CET Leader*)
Minister
Ministry of Economy
Jurj Gagarin 15
1000 Skopje

Tel.: (389 2) 3093 408/412
Fax: (389 2) 3084 472/471
Stevco.Jakimovski@economy.gov.mk

Moldova

Mr. Marian Lupu (*CET Leader*)
Minister
Ministry of Economy
Government Building
Piata Marii Adunari Nationale, 1
MD-2033 Chisinau

Tel.: (373 22) 23 46 28
Fax: (373 22) 23 74 90
mlupu@moldova.md

Romania

Mr. Cosmin Dobran (CET *Leader*)
Counselor to the Minister
Ministry of Foreign Affairs
33 Aleea Alexandru
Bucharest

Tel: +40 (21) 230 7570
Fax: +40 (21) 230 7961
cosim.dobran@mae.ro

Serbia and Montenegro

Montenegro

Ms. Slavica Milacic (CET *Leader*)
Special Advisor for Economic Affairs
Office of the Prime Minister
91000 Podgorica

Tel.: (381 81) 225 568
Fax: (381 81) 225 591
slavicam@mn.yu

Serbia and Montenegro

Serbia

Dr. Miroljub Labus (CET *Leader*)
Deputy Prime Minister
Nemajina 11
11000 Belgrade

Tel.: (381 11) 361 55 66
Fax: (381 11) 361 75 97
labus@g17plus.org.yu

Serbia and Montenegro

Ms. Snezana Filipovic (CET *Leader*)
Minister Plenipotentiary
Federal Ministry of Foreign Affairs
Kneza Milosa 24 - 26
11000 Belgrade

Tel.: (381 11) 361 8034
Fax: (381 11) 361 8041
demri@smip.sv.gov.yu

STABILITY PACT FOR SOUTH EASTERN EUROPE

Dr. Erhard Busek

Special Co-ordinator of the Stability Pact

Tel: (32 2) 401 87 01
Fax: (32 2) 401 87 12

Mr. Fabrizio Saccomanni

Chairman, Working Table II

Tel: (44 207) 338 74 98
Fax: (44 207) 338 69 98

Mr. Bernard Snoy

Director, Working Table II
Rue Wiertz 50, B-1050 Brussels,
Belgium

Tel: (32 2) 401 87 15
Fax: (32 2) 401 87 12
bernard.snoy@stabilitypact.org

BUSINESS ADVISORY COUNCIL FOR SOUTHEASTERN EUROPE

Mr. Nikos Efthymiadis (Chairman)

Redestos Efthymiadis Agrotechnology Group
Industrial Area of Thessaloniki,
P.O. Box 48
57022 Sindos, Greece

Tel.: (30 2310) /568 753
Fax: (30 2310) /568 764
n.efthymiadis@redestos.gr

Mr. Aldo Fumagalli Romario (Vice Chairman)

SOL S.p.A.
 CEO & Managing Director
 Piazza Diaz n° 1
 I- 20052 Monza, Italy

Tel.: (39 039) 2396 225
 Fax: (39 039) 2396 264
 a.fumagalli@sol.it

Mr. Muhtar Kent (Board Member)

Efes Beverage Group
 President and CEO
 81440 Kartal
 Istanbul, Turkey

Tel: (90 216) 586 8011/12
 Fax: (90 216) 586 8016
 muhtar.kent@efespilsen.com.tr

Mr. Christian A. Hufnagl (Board Member)

Deutsche Telekom AG
 Im Langenfeld 2d
 D-61350 Bad Homburg vdH
 Germany

Tel.: (49 6172) 969 257
 Fax: (49 6172) 969 258
 hufnagl@telekom.de

Ms. Vera M. Budway

Expert & BAC Liaison Unit
 SECI –OSCE Hofburg
 Heldenplatz 1 – A – 1600 Vienna, Austria

Tel.: (43 1) 531 37 423
 Fax: (43 1) 531 37 420
 Seci3@osce.org

CO-CHAIRS OF THE INVESTMENT COMPACT PROJECT TEAM**Austria****Mr. Manfred Schekulin**

Director, Export and Investment Policy
 Federal Ministry of Economic Affairs and Labour
 Stubenring 1
 A-1010 Vienna

Tel: (43 1) 711 00 51 80
 Fax: (43 1) 711 00 15 101
 manfred.schekulin@bmwa.gv.at

Bulgaria**Ms. Lydia Shouleva**

Deputy Prime Minister and Minister of Economy

Tel: (359 2) 940 7638
 Fax: (359 2) 981 0980

Mr. Milen Keremedchiev

National Coordinator of the Stability Pact
 Council of Ministers
 1 Dondukov Blvd.
 1000 Sofia

Tel: (359 2) 940 2707
 Fax: (359 2) 940 2154
 m.keremedchiev@government.bg

OECD**Mr. Rainer Geiger**

Deputy Director, Directorate for Financial,
 Fiscal and Enterprise Affairs
 2, rue André Pascal
 75775 Paris Cedex 16
 France

Tel: (33 1) 45 24 91 03
 Fax: (33 1) 45 24 91 58
 rainer.geiger@oecd.org

Mr. Declan Murphy

Programme Director, Investment Compact for South East Europe
2, rue André Pascal
75775 Paris Cedex 16
France

Tel: (33 1) 45 24 97 01
Fax: (33 1) 45 24 93 35
declan.murphy@oecd.org

Government and its agencies have a fundamental lead role to play in providing an environment favourable to business operations and conducive to private investment. This is especially true for small business. In order to flourish and grow they need an environment that facilitates and enables business start-up, does not hamper them with excessive and costly regulations and facilitates access to finance and business services.

In 2002 the OECD and the EBRD launched the Enterprise Policy Performance Assessments (EPPAs) in the framework of the Investment Compact for South East Europe (SEE) Programme. The EPPAs consist of a series of reports covering all countries of South East Europe. They assess the quality of government policy for the SME sector and regularly monitor its implementation. The 2004 edition of the EPPAs has been prepared by the OECD and the EBRD in close consultation with the European Commission. Synergies have been created between the EPPA and the European Union Charter for Small Business, covering seven policy dimensions: institutional framework; regulatory environment; tax policy; access to finance; advisory services; business incubators; entrepreneurship, vocational training and access to technology.

This Enterprise Policy Performance Assessment report is presented as an independent and constructive contribution to the debate on enterprise policy in Albania, bringing forward the views of the small business sector and providing a set of priority actions and policy recommendations to the government and the small business community.