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Albania MSME Finance for Growth Assessment

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Abbreviations

AML/CFT	Anti-Money Laundering / Combating the Financing of Terrorism
ALL	Albanian Lek
ATM	Automated Teller Machine
BIH	Bosnia and Herzegovina
BoA	Bank of Albania
CGS	Credit Guarantee Scheme
CRS	Credit Reporting Systems
EBRD	European Bank for Reconstruction and Development
EU	European Union
FYROM	Former Yugoslav Republic of Macedonia
G2B	Government to Business
GoA	Government of Albania
IMF	International Monetary Fund
INSTAT	Albanian Institute on Statistics
MOFE	Ministry of Finance and Economy
MSME	Micro, Small and Medium Enterprise
MFI	Microfinance Institution
NBFI	Non-Bank Financial Institution
NPL	Non-Performing Loan
PE	Private Equity
POS	Point of Sale
PSP	Payment Service Provider
PSD	Payment System Directive
RXIL	Receivables Exchange of India Ltd
SLA	Saving and Loan Association
TREDS	Trade Receivables Discounting System
VC	Venture Capital
QR	Quick Resolution
WB	World Bank

Executive Summary

Despite being the backbone of the Albanian economy, micro, small and medium sized enterprises (MSMEs) face difficulties in accessing finance which impedes their growth. MSMEs in Albania are significant contributors to the economy. In 2016, MSMEs comprised 99.9 percent of active enterprises and 81 percent of the total number of employed people.[1] According to the World Economic Forum Global Competitiveness Report[2] access to finance is the third biggest constraint in Albania for enterprise development and competitiveness after tax rates and corruption. This is in line with a recent EC survey which found that only 17 percent of MSMEs believe that there are no obstacles to obtaining finance, a number significantly lower than in other comparable economies.[3] The number of MSMEs having used bank financing is low compared to the European Union (EU) average at 29 percent for overdraft/ revolving facilities and 14 percent for other bank loans respectively. At the same time, the number of Albanian MSMEs which financed their operations from retained earnings stands at 24 percent, while 15 percent stated using informal third-party finance (family, friends, etc).[4] The MSME sector is generally characterized by high informality (especially in agriculture), limited availability of collateral, low levels of financial capability, and limited uptake of digital transactions.

Bank lending represents a key element of financial intermediation which needs to be further developed. The financial sector is dominated by banks which are characterized by high levels of liquidity, strong risk aversion after the financial crisis, increasingly conservative policies from their parents, and lack of proper incentives or capacity to explore new and innovative approaches to finance. Provision of credit to MSMEs is further undermined by weak law enforcement, shallow secondary markets for collateral, and in some instances stringent customer-due diligence and documentary policies. Strengthening financial sector infrastructure as well as the legal and regulatory framework for secured transaction and credit reporting could support an expansion of lending to MSMEs. Measures include the creation of an enabling legal framework allowing for the development of private credit bureaus and alternative data processors with appropriate data and consumer protection safeguards. Improvements are needed with regard to the movable collateral registry in order to enable seamless real-time access and registration of notices creating security interests.

The availability of a wider range of financing instruments that meet the varying needs of MSMEs should be further enhanced. Microfinance institutions (MFIs), the second largest providers of finance, especially in rural areas, face difficulties in either accessing affordable wholesale funding or appropriate risk sharing mechanisms. Financial leasing is limited mainly to motor vehicles, with a weak secondary market for repossessed equipment presenting the biggest constraint for its development. Venture capital funds and/or angel investors networks that would target start-up or scale-up ready MSMEs are also missing. Accounts receivable based finance (e.g. factoring or invoice discounting) is barely practiced. Measures that could be beneficial to increase availability of alternative sources of finance include:

- Explore options for non-deposit taking MFIs to increase their access to wholesale funding and ensure proportionality of the regulatory framework;
- Introduce partial credit guarantee schemes based on international best practices to facilitate lending to MSMEs;
- Take measures to increase usage of electronic invoices linked to the tax administration and explore the development of platforms for reverse factoring or invoice discounting;
- Develop grant and financing programs to efficiently facilitate early stage finance (seed finance) of innovative firms. This should accompany support for development of networks of well-organized incubators / accelerators providing appropriate mentorship programs, especially in business skills;
- Explore the feasibility of establishing a regional platform for cross-border sale of re-possessed equipment to improve liquidity and attractiveness of financial leasing for financial services providers;

[1] INSTAT, *Statistics on small and medium enterprises*, 2016.
[2] World Economic Forum, *The Global Competitiveness Report 2017-18*, available at https://www.weforum.org/reports/the-global-competitiveness-report-2017-2018.
[3] European Commission, *Survey on the access to finance of enterprises – Analytical Report*, 2017.
[4] European Commission, *Survey on the access to finance of enterprises – Analytical Report*, 2017.

- Consider development of a warehouse receipt financing strategy to support agribusinesses in accessing post-harvest finance for working capital needs, as well as the options of fostering other underdeveloped agri-financial products (e.g. agri-insurance).

Promotion of digital transactions and digitalization of the economy, including through finance for e-commerce could further enhance MSME's access to finance. Penetration of digital financial services is very low limiting the potential to reduce information asymmetries and decreasing transaction costs. Banks recently started investing in digital channels (on-line banking primarily) and point of sale (POS) systems are becoming more and more accessible, however the level of innovation and uptake of digital payments is still low. This is primarily due to the still high costs of POS services, lack of new entrants into markets with innovative approaches (disruptors) pushing incumbent players to innovate, inaccessibility of access points in rural areas, and the cash-based culture in general. Fintech companies offering specialized cloud-based business services to MSMEs (accounting, supply chain management, e-commerce, payments, etc.), partnering with credit providers to offer alternative data processing, or offering stand-alone finance (payment) services do not yet appear to have entered the market. Innovation in the financial sector should be supported through the development of a Fintech strategy encouraging innovation. Moreover, payments system regulation should be introduced that will facilitate usage of application programing interfaces, seamless access to payments hubs (interoperability infrastructure), and facilitate development of alternative payments providers and/or products.

The Government appears committed to improve MSME finance to support MSMEs' contribution to economic growth, but better coordination and structure is needed to facilitate implementation of initiatives and regulatory reforms. There is a piecemeal approach to MSME access to finance development and coordination of donor driven projects. In addition to policy initiatives, various MSME funding facilities that vary in sizes, conditions of finance, and focus have been established. However, these initiatives are fairly small and could benefit from better targeting. There is a lack of resources and capacity to support development of MSMEs is scattered through various agencies and public institutions without proper coordination. An organized, transparent, and accountable public stakeholder coordination structure is needed for access to finance activities across all major sectors of the economy. It is suggested that a dedicated unit or department is established within the Ministry of Finance and Economy (MoFE) to promote relevant policies for MSME access to finance and coordinate and streamline existing ones.

Lack of consolidated and reliable data on MSMEs presents an obstacle to the efficient prioritization and implementation of MSME development policies, including on access to finance. Clarity on the size and diversity of the MSME sector enables authorities to identify realistic opportunities for growth and to efficiently formulate adequate reform measures. Mapping MSMEs, collecting and processing MSME disaggregated data using a uniformly applied definition, and implementation of regularly updated analytical practices should therefore be a priority for the authorities.

Government to business (G2B) payments volumes can be leveraged to unlock potential finance for MSMEs and attract Fintech investments under certain conditions. Market participants report that long payment terms and weak payment discipline in both G2B and business to business transactions continue to put pressure on MSMEs as the weakest participants in the transaction chain. Improving payment discipline by strict implementation of the late payments laws and offering G2B (MSME) invoices for discount on on-line platforms could significantly improve conditions for working capital finance of MSMEs and serve as an anchor for Fintech companies interested in this market.

MSMEs low financial and business capacity, and gaps in the financial consumer protection framework, should be addressed. Many MSMEs, especially in the agricultural sector, lack understanding of financial products and the potential benefits which various formal financial solutions might have for their businesses. Financial reporting practices need to improve as the quality and credibility of financial statements remains low especially for MSMEs. Relatively narrow consumer protection regulation and its implementation contributes to the status quo of mistrust some MSMEs exhibit towards formal financial services, showing preference for informal sources of finance. Capacity building programs including linked to financial support facilities, improved levels of consumer protection as well as enhanced financial reporting practices are required to further strengthen the bankability of MSMEs.

[5] Technological innovation in the financial services spaces is rapidly growing, technology companies are more and more offering financial services (FinTech) in a nontraditional manner. These FinTech companies are often defined as disruptors as they lower the cost of financial services, and improve financial products and delivery techniques, pushing incumbents also to innovate.

Table 1. Summary of key recommendations

Recommendation	Authority	Timeframe
GOVERNMENT POLICIES AND PROGRAMS IN SUPPORT OF MSMES		
Designate unit/department within or subordinated to the MoFE with the overall responsibility for MSME development and a specific mandate to enhance MSMEs' access to finance.	GoA, MoFE	Short term
Improve coordination of existing public and donor-funded empowerment funds and risk-sharing facilities for MSMEs to increase economies of scale and promote linkages between these facilities and business advisory initiatives.	GoA, MoFE, donors	Medium term
Develop grant and financing programs to efficiently facilitate early stage finance (seed finance) of innovative firms.	GoA, MoFE	Medium term
Introduce partial credit guarantee schemes based on international best practices to facilitate lending to MSMEs.	GoA, MoFE	Short term
Strengthen reporting of MSME disaggregated data from regulated financial institutions and the enterprise sector more broadly based on a uniformly applied definition of MSMEs.	GoA, BoA	Short term
Allow public sector accounts payables to MSMEs to be offered for sale on web-based invoice discounting platforms and strengthen enforcement of the late payment law.	GoA	Short term
FINANCIAL INFRASTRUCTURE		
Improve the movable collateral registry to enable seamless real-time access and registration of notices of creation of security interests. Review the need for participation of public notaries in movable collateral contract creation / registration process, and applicable fees.	MoFE, MoJ	Medium term
Create an enabling legal framework allowing for the development of private credit bureaus and alternative data processors (e.g. postpaid utility services, payments data, etc.) with appropriate data and consumer protection safeguards.	GoA, MoFE	Short term
Improve retail payments infrastructure to enable interoperability between bank accounts and e-money accounts to facilitate development of alternative payments providers, reduce transaction costs for MSMEs and support development of e-commerce.	BoA, GoA, MoFE	Short term
PROVIDERS REACH, DIVERSITY AND SUSTAINABILITY		
Revisit prudential regulations of non-deposit taking institutions based on principle of proportionality and strengthen focus on AML/CFT, fit and proper management and financial consumer protection.	BoA	Short term
Conduct a feasibility study outlining options for non-deposit taking MFIs to increase their access to wholesale funding.	MoFE, BoA	Medium term

Recommendation	Authority	Timeframe
Support innovation in the financial sector by developing and adopting a Fintech strategy.	BoA, MoFE, associations, private sector participants	Medium term
PRODUCT DIVERSITY AND APPROPRIATENESS FOR MSMES		
Take measures to increase usage of electronic invoices linked to the tax administration, in particular by mandating B2G electronic invoicing and exploring the development of platforms for reverse factoring/ invoice discounting.	MoFE, BoA	Medium to Long term
Explore feasibility of creation of regional e-platforms for exchange/ sale of repossessed collateral among lenders with the aim to increase the efficiency of movable collateral execution and hence its perceived value.	BoA, MoFE, MoJ	Medium to Long term
Establish a regulatory framework that supports creation of venture capital funds.	MoFE, Albanian Financial Supervisory Authority	Medium term
Conduct a feasibility study on the need for public warehousing services in agriculture and develop a warehouse receipt financing strategy to support agribusinesses in accessing post-harvest finance for working capital needs.	MoEF, MoA	Medium to Long term
Support development of agri-insurance products accompanied by business development activities for farmers	MoFE, Albanian Financial Supervisory Authority, industry	Medium to Long term
CONSUMER PROTECTION AND FINANCIAL CAPABILITY		
Enhance financial consumer protection through adoption of strengthened rules on fair treatment of consumers (including financial advice and product suitability), cover micro-enterprises and provide guidelines on complaints handling at the level of providers of financial services.	BoA, MoFE	Short term
Conduct a study on usury/informal lending.	BoA, MOFE	Medium term
Introduce targeted financial capability programs focused on improving MSME's financial reporting, financial management and business planning capacity.	MoFE, Business associations	Medium term

1 MSMES: OVERVIEW OF ECONOMIC AND FINANCIAL CONDITIONS

General Overview

Although an official legal definition of micro, small, and medium enterprises (MSMEs) exists in Albania it is not uniformly used in practice. The Law on Small and Medium Enterprises[6] defines MSMEs based on the number of employees and annual turnover (Table 2). The Albanian Institute on Statistics (INSTAT), however, categorizes MSMEs by the number of people employed rather than by employees, and local banks, claiming that the current legal definition is too broad, have adopted their own definitions based on exposures. The Albanian definition also differs from that used by the European Union (see Table 2), which is broader and would include many enterprises not considered locally as MSMEs.

Differences between the existing legal definition of MSMEs and the definitions used by banks makes it difficult for the Bank of Albania (BoA) and other relevant government authorities to gather and analyze lending data in a consistent manner. The lack of standardization, although not unique to Albania, limits the ability to efficiently process and analyze data on MSMEs, including data on lending to MSMEs and MSMEs access to finance in general.[7] This in turn undermines the prioritization and implementation of policies that would successfully target different needs of MSMEs depending on the stage of their development (see Box 1). A uniformly applied definition of MSMEs would allow clearer reporting of MSME disaggregated data from regulated financial institutions and the broader enterprise sector, and enable efficient prioritization of policy actions.

Box 1. Different stages of MSMEs' funding

New MSMEs tend to be highly risky with intangible assets, a lack of trading history, and informational opacity. The most important sources of initial and seed stage financing for small businesses are the personal savings of entrepreneurs, family, and friends, as well as second mortgages on property.

At the second phase of development during the start-up stage, external sources of funding become necessary. Investment in small businesses at this stage is still regarded as high risk and the business is not large enough to attract the attention of venture capitalists. Government grants or other programs for seed funding become relevant, especially for innovative firms. Wealthy individuals, like business angels, can also fill the gap between personal funds and institutional finance.

After the small business has passed through the early stages a further injection of capital is required to fund growth. The MSME may still not qualify for longer term debt financing due to its reliance on intangible assets, inability for investors to assess its future growth prospects, low profitability, and short track record. This is where alternative lending products such as leasing and factoring, invoice discounting platforms, marketplace finance platforms, integrated on-line merchant platforms, and alternative credit scoring are useful.

Once the firm has established a track record, has the ability to provide collateral and information regarding its performance, and has become more transparent it may access longer term lending. Development of corporate governance structures, real-estate registries, as well as debt and potentially equity capital markets become relevant in this stage.

[6] Law No.8957 of 2002, as amended in 2008

[7] For example, the INSTAT *Statistics on small and medium enterprises* and the *Survey on the access to finance of enterprises* conducted by the European Commission use two different definitions.

Table 2. Definition of MSMEs in Albania and EU

	Albania		European Union[8]		INSTAT	
	Turnover	No. of Employees	Turnover	No. of Employees	Turnover	No. of Employees
Micro Enterprise	≤ Albanian Lek (ALL) 10 million (ALL equivalent to EUR 70,000) turnover and/ or balance sheet	< 10 employees	≤ EUR 2 million turnover or balance sheet	< 10 employees	Same as legal definition	Same number as legal definition but based on people employed and not employees[9]
Small Enterprise	≤ ALL 50 million (EUR 360,000) turnover and/ or balance Sheet	< 50 employees	≤ EUR 10 million turnover or balance sheet	< 50 employees	Same as legal definition	Same number as legal definition but based on people employed and not employees[10]
Medium Enterprise	≤ ALL 250 million (EUR 1.8 million) turnover and/ or balance sheet	< 250 employees	≤ EUR 50 million turnover and/or ≤ EUR 43 million balance sheet	< 250 employees	Same as legal definition	Same number as legal definition but based on people employed and not employees[11]

Source: Art 4 of the Law on Small and Medium Enterprises

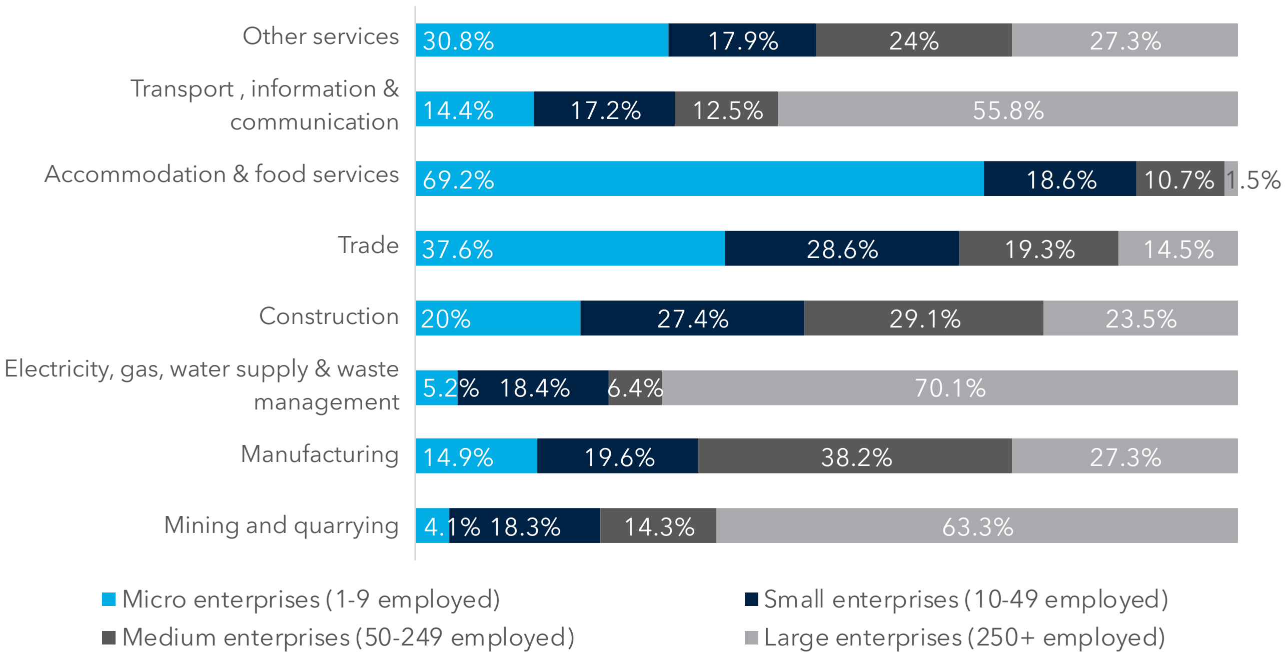
[8] The category of micro, small and medium-sized enterprises (MSMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro.
[9] Employed are people who work at the enterprise regardless of whether they are paid or not. Thus, employed includes employees, owners and unpaid family members.
[10] ibid
[11] ibid

MSMEs' Contribution to the Economy

MSMEs in Albania are significant contributors to the economy. In 2016, according to INSTAT, 99.9 percent of active enterprises were MSMEs[12], employing 81 percent of the total number of employed people (see Table 3).[13] The highest number of MSMEs were in the trade sector (41.5 percent), followed by the services sector (20 percent). 66.9 percent of value added was realized by MSMEs in 2016, compared to 66.3 percent in the previous year. The highest percentage of value added in micro-enterprises is realized in the accommodation and food services sector (69.2 percent). The trade sector has the highest percentage realized by small enterprises (28.6 percent). Medium enterprises realized the highest percentage of value added in manufacturing industry (38.2 percent). See Figure 1.

Sectors of the economy dominated by MSMEs are characterized by high levels of informality. Many MSMEs in Albania operate on an informal basis. Despite recent progress in increasing the number of registered businesses (Figure 2), they often still do not declare taxes or workers and mainly transact in cash. Informal businesses generally have lower productivity than formal businesses, which is both a drag on firms and a drag on the economy. Workers in the informal sector lack social protection, especially insurance and pension benefits. Public revenues are reduced by hidden economic activity, resulting in diminished provision of public goods. Business conducted outside the regulated economy raises safety, health, and environmental risks for workers and communities. Widespread informality impedes not only the development of those businesses that decide to remain informal but is also a hindrance to the formal companies faced with competition from the informal sector. By being outside the formal economy these companies lack the opportunity to benefit from access to formal finance, access to formal markets, and from the legal protection of their property,

Figure 1. Structure of value added by economic activity and size of enterprise, 2016



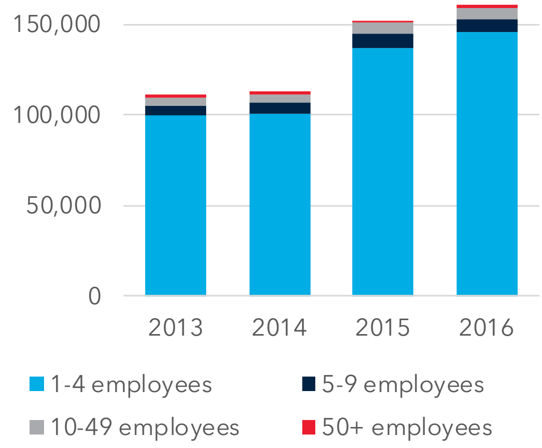
Source: INSTAT, 2016

[12] This is according to the INSTAT's definition used in Albania, which slightly differs from the official one and also from the European Union's definition. See Table 2 for further information.
[13] INSTAT, *Statistics on small and medium enterprises*, 2016.

contracts, and investments. The Government of Albania has previously taken measures aimed at increasing registration of companies, greater declaration of workers, improving tax collection, and granting of fiscal amnesties. To allow businesses to better contribute to the economy it is important that the government continues to invest substantially in formalizing these MSMEs, through efforts that go beyond mere registration.

The quality of MSMEs financial reporting in Albania needs to improve to increase credibility with providers of finance. The legislative and institutional financial reporting framework, and professional capacity in financial reporting and auditing have improved recently. Albania has achieved a high degree of alignment of corporate financial reporting legislation with the EU acquis communautaire. The public availability of financial statements of MSMEs is currently being improved. However, these positive developments have not yet adequately translated into an increased quality of financial statements, especially for MSMEs. According to anecdotal evidence, while commercial banks ask for financial statements and audit reports (where applicable) they rarely trust this information and instead base their financing decisions on alternative sources of data and their own verification methods. An Action Plan for Non-Performing Loans (NPL)[14], endorsed by the Prime Minister and BoA, requires banks and NBFIs to grant loans based only on tax-compliant statements starting from January 1, 2018. This might significantly reduce the ability of MSMEs to attract lending in the short run, thereby limiting their growth potential.

Figure 2. Number of registered businesses over recent years



Source: INSTAT, 2016

Table 3. Overview of the enterprise sector in Albania

Enterprises size class	Enterprises		Employed		Turnover		Investments		Value Added	
	no.	%	no.	%	min ALL	%	min ALL	%	min ALL	%
Total	108,526	100	469,665	100	1,881,662	100	221,404	100	491,026	100
MSME (1-249 employed)	108,373	99.9	380,302	81	1,464,739	77.8	165,844	74.9	328,591	66.9
Micro enterprises	*102,965*	*94.9*	*194,015*	*41.3*	*480,991*	*25.6*	*30,397*	*13.7*	*116,583*	*23.7*
Small enterprises	*4,413*	*4.1*	*87,796*	*18.7*	*563,124*	*29.9*	*86,318*	*39*	*107,491*	*21.9*
Medium enterprises	*996*	*0.9*	*98,491*	*21*	*420,624*	*22.4*	*49,130*	*22.2*	*104,518*	*21.3*
Large enterprises (250+)	152	0.1	89,363	19	416,923	22.2	55,559	25.1	162,435	33.1

Source: INSTAT Survey 2016

Recommendation

Reporting of MSME disaggregated data from regulated financial institutions and the enterprise sector more broadly should be strengthened, based on a uniformly applied definition of MSMEs. Definitions should be harmonized to better reflect the realities of the market and enable relatively seamless reporting for financial institutions and the enterprise sector as a whole. Another potentially useful source of data could be the credit registry and the BoA should review the ability to process and make use of this data, in an aggregate form, for government and BoA policymaking purposes.

Reducing informality amongst MSMEs should be a priority; however, it should be undertaken in a balanced manner to avoid curbing existing economic activity. A detailed review of the impact and success of measures already taken is suggested in order to learn from past experiences in this area. The Government should continue to implement carefully balanced measures[15] that provide the right controls and incentives while minimizing moral hazard created by forgiving non-compliant taxpayers. A new policy requiring lending decisions to be based only on financial statements that have been certified for tax declaration purposes should be adjusted in line with Action 11 of the formally endorsed National Action Plan on Non-Performing Loans. A tiered (as per exposure) and gradually phased-in approach is recommended to mitigate the risk of financially excluding informal and semi-formal MSMEs. Measures to reduce informality should be accompanied by strong efforts to increase access to finance, productivity, and bankability of MSMEs.

MSMEs' Access to Credit Products

Access to finance for MSMEs in Albania is significantly constrained, much more than in other comparable economies in the region. Hindered access to finance for MSMEs in Albania impairs their growth and development. Many MSMEs are dependent on internal funding or borrowing funds from family and friends to finance their operations. While this would be understandable in the early phase of business development, it seems to be the case regardless of the stage of the development of an enterprise in Albania. Only 17 percent of Albanian MSMEs believe that there are no obstacles to obtaining finance, a number significantly lower than in other comparable economies.[16] Lack of appropriate finance significantly impedes the competitiveness of local MSMEs. According to the World Economic Forum Global Competitiveness Report[17] access to finance is the third most problematic factor influencing low competitiveness in Albania, following tax rates and corruption. In comparable economies such as Greece, Croatia, and Serbia access to finance is ranked 6th, 7th, and 2nd respectively in terms of the most problematic factors for doing business.[18]

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[14] Action Plan for Non-Performing Loans was endorsed by the Prime Minister and BoA's Governor in August 2015: https://www.bankofalbania.org/Supervision/Action_plan_for_non-performing_loans/. Action 11 of the Plan requires introduction of the obligation for banks and NBFIs starting from January 1, 2018 to grant loans only based on tax-compliant statements (above a certain threshold exposure).

[15] In the past governments have undertaken several measures including fiscal amnesties, tax exemptions, actions to punish tax evaders and informality preceded by awareness campaigns.

[16] European Commission, *Survey on the access to finance of enterprises* – Analytical Report 2017.

[17] World Economic Forum, *The Global Competitiveness Report 2017-18*, available at https://www.weforum.org/reports/the-global-competitiveness-report-2017-2018.

[18] ibid

Figure 3. Perception of obstacles in obtaining access to finance and its impact on doing business

Source: World Economic Forum Global Competitiveness Report 2017/2018 and European Commission Survey on the Access to Finance of Enterprises – Analytical Report 2017

Table 4. Overview of MSMEs access to finance in the Western Balkans region

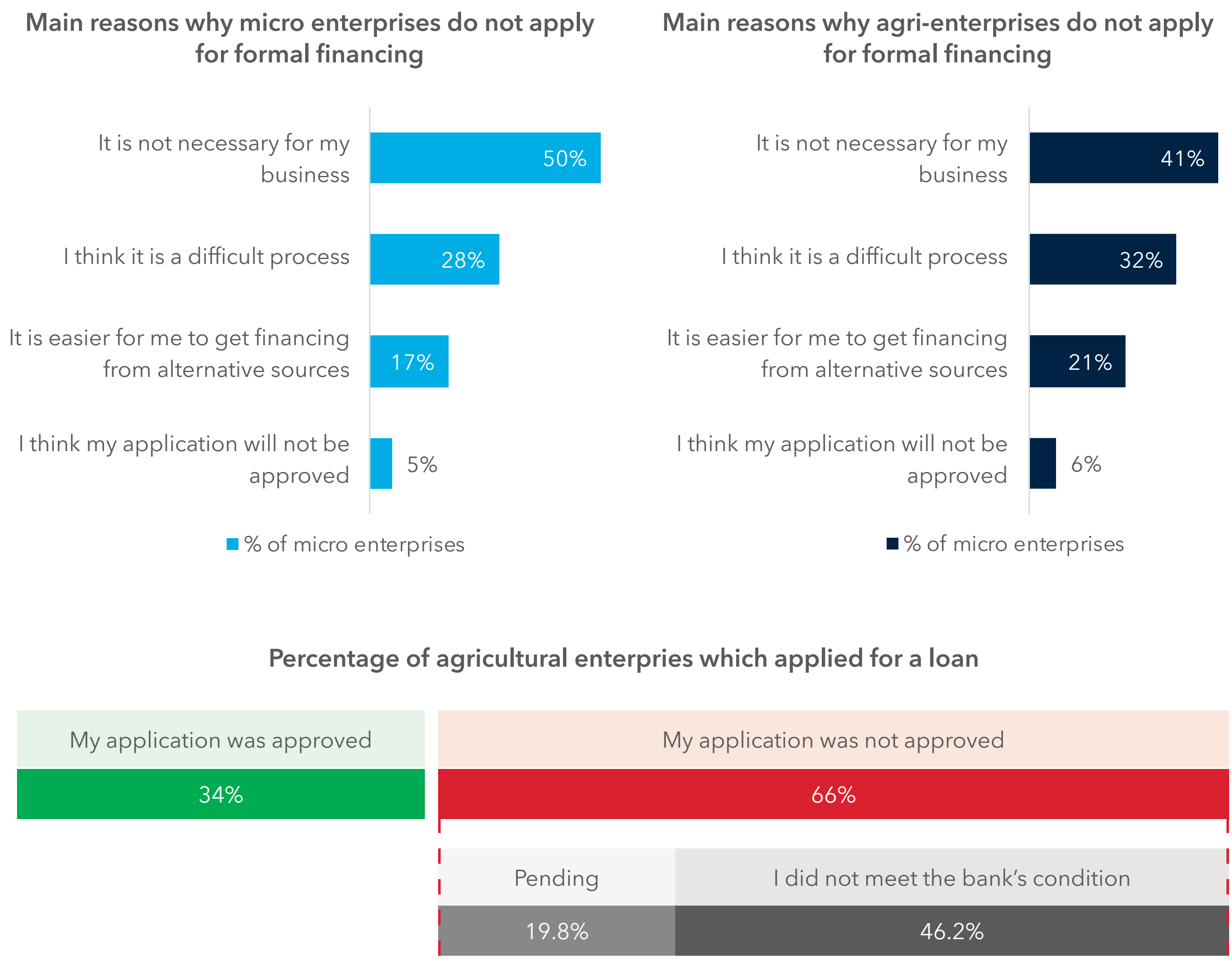
Economy	Percent of firms with a checking or savings account	Percent of firms with a bank loan/ line of credit	Proportion of loans requiring collateral (%)	Value of collateral needed for a loan (% of the loan amount)
Europe & Central Asia	**91**	**37.7**	**78.7**	**191.9**
Albania (2013)	73.4	28.2	90.9	255.2
small	*68*	*20.1*	*85.3*	*366.3*
medium	*88.6*	*57.5*	*98.4*	*149.2*
large	*96.6*	*55.9*	*93.9*	*N/A*
Bosnia and Herzegovina (2013)	98	66.3	82.4	190.1
Croatia (2013)	99.2	53.7	86.2	192.7
Macedonia, FYR (2013)	95.7	45.4	90.7	275.5
Montenegro (2013)	96	54.9	89.9	243.4
Serbia (2013)	100	40	66.4	149.8

Source: World Bank Enterprise Survey

Smaller firms are particularly disadvantaged in access to formal finance when compared to medium and large ones. While this would be expected, the difference in terms of uptake of accounts, access to credit, and the demand for collateral, is telling of the underprivileged position smaller firms find themselves in. According to the World Bank Enterprise Survey the average collateralization of loans offered to small firms stands at 366.3 percent. This significantly limits the potential to access formal credit, which is reflected in only 20.1 percent of small firms having a bank loan / line of credit.

Rejection rates for MSMEs seeking formal finance are high. These rejections are mainly caused by strict lending standards, high collateral demand, low business capacity, and high opacity (informality) of MSMEs. Rejection rates are especially high in the agricultural sector and among microenterprises. The majority of agricultural enterprises which applied for a loan in 2017 saw their loan rejected. Many micro enterprises did not even apply for loans because they either feared they will be rejected or they perceived the processes as too complicated.[19] The cost of loans does not appear to be perceived as a significant barrier. BoA data shows average interest rates around 5 percent for euro loans and 5.5/6 percent for ALL loans, in 2017.[20]

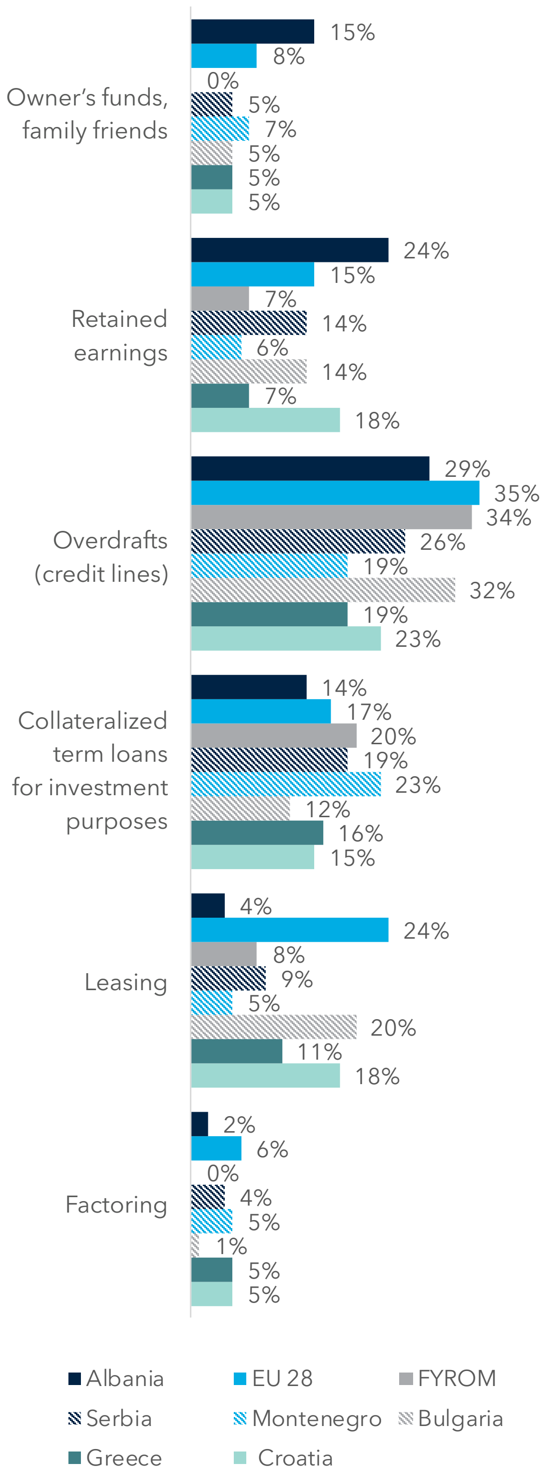
Figure 4. Enterprises relationship with banks and their expectations for the future



Source: Bank of Albania and INSTAT Survey of Agricultural and Micro Enterprises

[19] Elona Dushku and Kliti Ceca, *Agricultural Enterprises in Albania and their Financing*, Bank of Albania Research Department, 2017; and Elona Dushku and Kliti Ceca, *Use of external financing by micro enterprises (1-4 employees) in Albania*, Bank of Albania Research Department, 2017.
[20] Bank of Albania.

Figure 5. Types of credit products which MSMEs use



Source: European Commission, Survey on the Access to Finance of Enterprises - Analytical Report 2017

While the actual number of MSMEs using bank financing is very low compared to other countries in the region; MSMEs still represent a big part of banks' financing portfolios. In 2017, only 29 percent, 14 percent, and 4 percent of Albanian MSMEs respectively used an over-draft or revolving credit/loan facility, a loan from a bank for investment purposes, or leasing. These figures are not only behind the EU average of 35 percent, 17 percent, and 24 percent but Albania also lags behind countries in the region such as Serbia and the Former Yugoslav Republic of Macedonia (FYROM).[21] Based on BoA data, the MSME sector nevertheless represents a large part (over one third) of banks' lending portfolios.[22] This implies that banks are lending significant amounts to a small number of MSMEs, mainly a few larger MSMEs. This data is also in line with recent BoA research which showed that MSMEs who access formal financing generally show relatively high leverage.[23]

There is a lack of alternative credit products for MSMEs that could help overcome issues of limited access to immovable collateral or high levels of information asymmetry. The majority of loans are collateralized (land or real estate) and many MSMEs do not have such collateral available to offer as security for finance. Only 14 percent of MSMEs had a collateralized term loan for investment purposes. The uptake of alternative credit products is even lower. For example, leasing and investment finance have a similarly low uptake, as shown in Figure 5, and factoring is barely existent, with less than 2 percent of MSMEs using it.[24]

While use of formal financing is very low, many MSMEs rely on informal sources or retained earnings to finance their activities. 15 percent of Albanian MSMEs use informal third-party finance (family, friends, etc.), significantly more than MSMEs in Bulgaria (5 percent), Montenegro (7 percent), Serbia (5 percent), Croatia (5 percent) or FYROM (2 percent).[25] 24 percent of Albanian MSMEs finance their operations from retained earnings, much higher than for Bulgaria (14 percent), Montenegro (6 percent), Serbia (14 percent), Croatia (18 percent) or FYROM (7 percent).[26]

[21] European Commission, *Survey on the Access to Finance of Enterprises – Analytical Report 2017*.
[22] Bank of Albania.
[23] Elona Dushku and Kliti Ceca, *Agricultural Enterprises in Albania and their Financing*, Bank of Albania Research Department, 2017; and Elona Dushku and Kliti Ceca, *Use of external financing by micro enterprises (1-4 employees) in Albania*, Bank of Albania Research Department, 2017.
[24] European Commission, *Survey on the Access to Finance of Enterprises – Analytical Report 2017*.
[25] ibid
[26] ibid

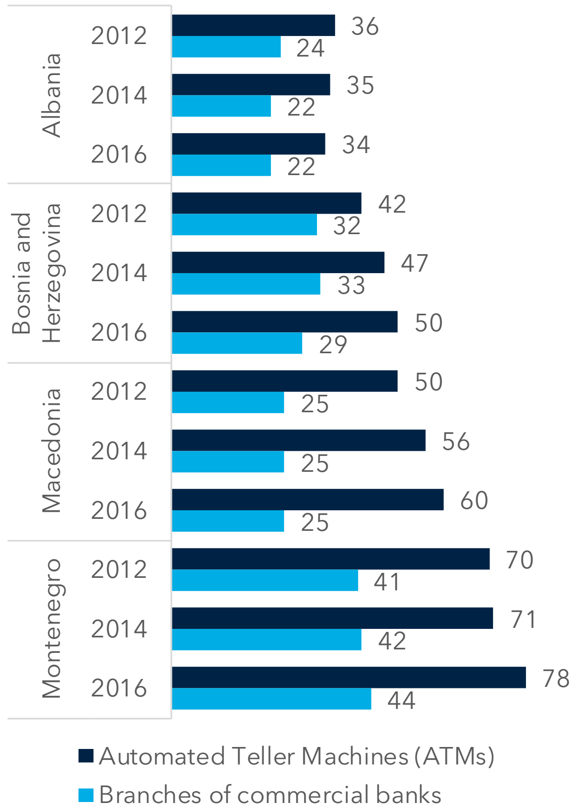
Access to Formal Accounts and Electronic Products

In terms of people having access to an account, Albania performs worse than any other regional economy, and below the regional average. According to 2017 Global Findex Data, only 40 percent of Albanian adults had an account at a formal financial institution, compared to 77 percent in FYROM, 68 percent in Montenegro, 59 percent in BIH, and 52 percent in Kosovo. 68 percent of small firms, 88.6 percent of medium firms, and over 96 percent of large firms have an account at a formal financial institution.[27] Use of accounts for payments for goods and services is very low.

There is a significant gap between urban and rural populations in accessing formal accounts. Significantly more adults in urban areas have access to an account; implying that those living in rural areas, including for example smallholder farmers, may have difficulties not only accessing credit but also in accessing formal financial services in general. Account ownership of the adult population living in rural areas in Albania did not grow between 2014 and 2017, standing still at 31 percent, while in comparable countries like Kosovo, BIH, and Montenegro it followed overall trends of account ownership growth.[28]

Beyond cultural barriers, insufficient access points may also contribute to the limited use of formal accounts. Albania has fewer bank outlets and automated teller machines (ATMs) per 100,000 than other comparable economies (see Figure 6) but, while the number of bank branches and ATMs have steadily declined, point of sale (POS) terminals and e-money agents have seen a slightly positive trend. According to a World Bank and BoA study "*The Retail Payment Costs In Albania*"[29] (cost study) the net growth rate of bank branches and ATMs per 100,000 adults during the period 2015-2016 was negative (-4.2 percent and -3.2 percent, respectively) while the net growth rate of e-money agents and POS terminals was positive (+25.7 percent and +6.3 percent, respectively).[30] While this is a positive outcome it is still not substantial enough to visibly influence uptake of electronic transactions in the country.

Figure 6. Number of access points in Albania and comparable economies (per 100,000 adults)



Source: IMF, Financial Access Survey 2016

Cash is predominant in all payment transactions of businesses, both received and initiated. Albanian businesses initiate approximately 18.2 million payments annually, or 792 payments per business annually, of which 66 percent in cash. Cash usage varies by business size. While micro businesses initiate 93 percent of their annual volume of payments in cash, this percentage falls to 47 percent for large businesses. Direct credit transfers (both paper-based and electronic) and direct debit transfers are the second and third most used instruments, respectively, regardless of business size. On the receiving side, 99 percent of all payments across businesses are received in cash. When breaking down volumes received by business size, it emerges that debit and

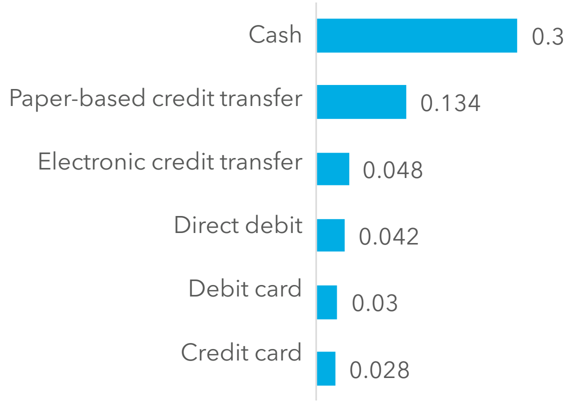
[27] The World Bank Enterprise Survey, 2013
[28] World Bank Global Findex Database.
[29] Bank of Albania and World Bank, *The Retail Payment Costs in Albania*, 2018.
[30] ibid

credit card payments are received by all types of businesses, but occupy a larger share among large businesses. Electronic credit transfers and direct debit transfers are not relevant among micro and small businesses, while they are more heavily used among medium and large businesses.[31]

The overall prevalence of cash adds a substantial cost for business. The recent cost study revealed that businesses in Albania incur annual costs equal to 0.6 percent of GDP in the context of receiving and initiating payments across all payment instruments, with cash representing half of total costs (0.3 percent of GDP). In comparison, the cost of paper-based credit transfers is estimated at 0.134 percent of GDP, electronic credit transfers at 0.048 percent, direct debits at 0.042 percent, debit cards at 0.03 percent, and credit cards at 0.028 percent.

Although banks recently started investing more in digital channels (on-line banking primarily), and POSs are becoming more and more accessible, the level of innovation and uptake of digital payments of enterprises is still very low. This is primarily due to the reported high costs of POS services, lack of disruptors pushing incumbent players to innovate, inaccessibility of access points in rural areas, and the prevalent cash-based culture in general. The lack of digitalization of MSMEs, especially in key sectors such as tourism and trade, undermines the potential to reduce information asymmetry by collecting and processing alternative (payments) data, decrease costs of transactions by lowering cash dependence, and ultimately increase tax revenues through more transparency.

Figure 7. Annual costs for businesses by payment instrument as % of 2014 GDP



Source: Bank of Albania and World Bank, The Retail Payment Costs in Albania, 2018.

Table 5. Selected access to finance indicators for MSMEs, by subtopic

Global indicators	Albania	Macedonia, FYR	Serbia
PRODUCT DIVERSITY AND APPROPRIATENESS FOR MSMES			
% of MSMEs which see no obstacles in obtaining financing from a financial institution (2017)	17	40	33
% of MSMEs with a line of credit at formal institution (2017)	29	34	26
% of MSMEs accessing investment loans (2017)	14	20	19
% of MSMEs using leasing or hire purchase (2017)	4	8	9
% of MSMEs using factoring for working capital finance (2017)	2	-	4
% of MSMEs using returns or profits to finance their activities (2017)	24	7	5
PROVIDER REACH, DIVERSITY, AND SUSTAINABILITY			
# of bank branches per 100,000 adults (2016)	22	25	30
# of accounts per 1,000 adults	1722	2232	N/A

Source: IMF Financial Access Survey, European Commission, Survey on the Access to Finance of Enterprises

[31] Bank of Albania and World Bank, *The Retail Payment Costs in Albania*, 2018.

2 OVERVIEW OF THE SUPPLY SIDE

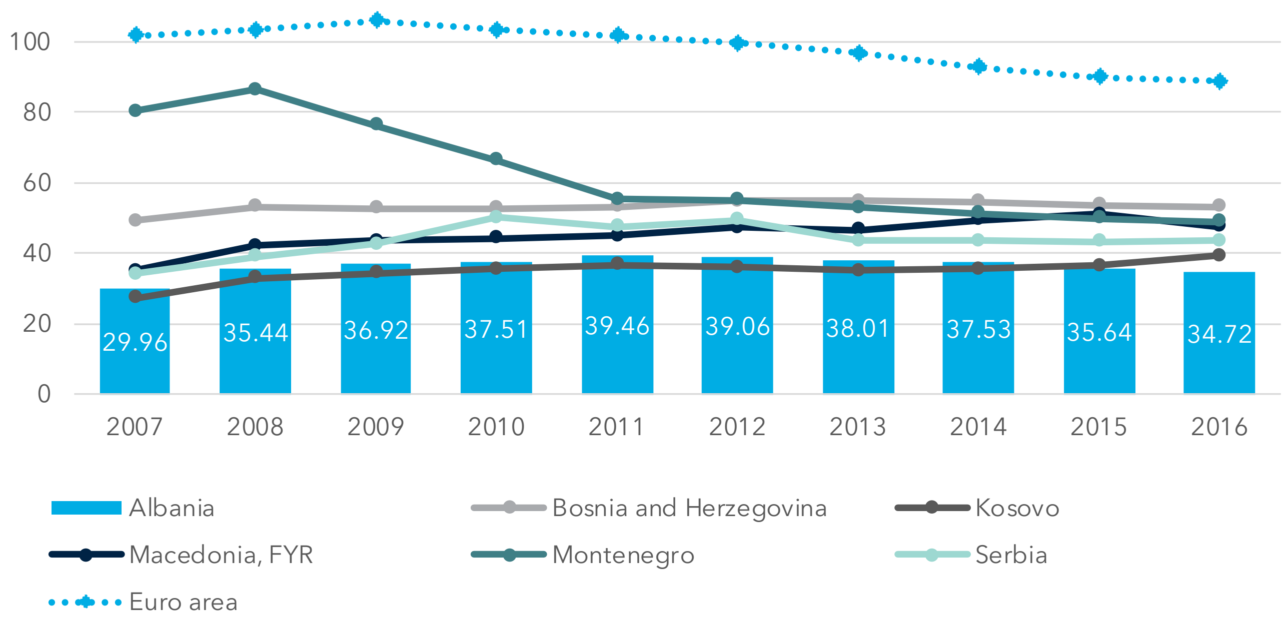
Overview of the Financial Sector

Albania's banking sector is small and dominated by foreign banks. 16 banks were operating in Albania as of December 2017. By mid-2018 this number is expected to decrease to 14 as two banks are in the process of acquisition by other banks in the system. Banks account for the bulk of financial sector assets and the majority are foreign owned. Concentration of the 3 largest banks, in terms of assets, stood at 55.8 percent, slightly below the regional median but higher than other economies in the region such as Bosnia and Herzegovina (BIH) (41.8 percent) and Serbia (44.9 percent). [33]

In terms of financial sector depth, domestic deposits and private credit to GDP are low in comparison to other countries in the region. At the end of 2016, domestic bank deposits to gross domestic product (GDP) stood at about 68.6 percent. At the same time bank credit to GDP stood at only 34.7 percent, far below that of comparable countries in the region and the EU (see Figure 8).

The banking sector dominates the market (banks' assets in 2017 stood at 92.5 percent of GDP) while non-bank financial institutions (NBFIs), namely microfinance institutions (MFIs), leasing, factoring companies, and savings and loan associations (SLAs) are small in terms of their assets. As of December 2017, there were 31 registered NBFIs in Albania: their total assets amounted to ALL 45 billion, accounting for 3.1 percent of total banking system assets. Recent consolidation of SLAs has reduced their number from over 120 down to 13. In December 2017, the total assets of all SLAs amounted to ALL 7.7 billion, accounting for only 0.5 percent of the banking system.

Figure 8. Financial depth in Albania and comparable economies (Private Credit/GDP, %)



Source: Finstats 2018

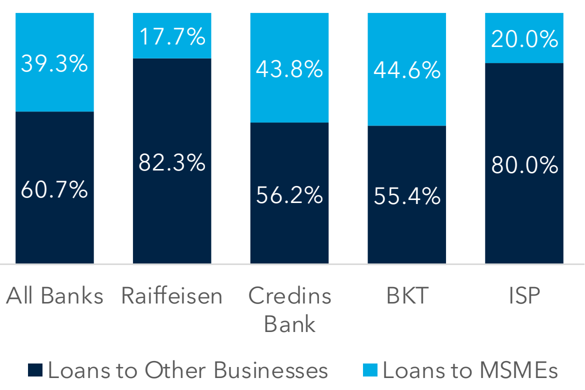
33 Finstats 2018.

Bank lending is mainly based on traditional plain vanilla products, with the majority of MSMEs using revolving facilities and overdrafts. Most of these facilities are secured and tend to be over-collateralized, with land and real-estate the dominant collateral type. High collateral demand and low value of collateral in general are seen as a considerable access to finance obstacle. This is especially true in the agriculture sector where agricultural land is partitioned into small unconnected plots, often with unclear ownership status due to unfinished land reform and ownership restitution process. High collateral requirements, caused by the perception of risk and shallow secondary market for collateral, makes it difficult for most MSMEs to qualify even for plain vanilla loan products.

Analysis of the Banking Sector

Albanian banks, despite a declared focus on MSMEs, have rather rigid lending and product innovation policies in place. Most banks have a dedicated MSMEs department, although they approach and define MSMEs in different ways. Some smaller banks focus exclusively on MSME and retail markets. Recently, due to adverse effects of the global financial crisis, even larger banks are declaratively shifting their focus towards MSMEs as this sector is perceived as less risky in comparison to larger corporations. Overall, as shown in Figure 9, over one third of the total banking portfolio is focused on MSME lending.

Figure 9. Overview of the bank lending portfolio for the four largest banks



Source: Bank of Albania

Despite having branches in all prefectures, banks' clients are mainly in urban areas, possibly because rural clients (including farmers) are perceived as riskier/less profitable clients as well as due to the lack of trust in the formal financial sector caused by lower levels of financial education. At the end of 2017, banks operated 488 branches / agencies across the country.[35] The geographical distribution of bank branches/ agencies covered the entire territory of Albania with a high concentration in Tirana (42 percent), where the population concentration is greater (29 percent). The focus on urban areas is partially a reflection of operational issues, including infrastructure development; but there appears to be a reluctance to expand into rural areas because the financing of agricultural activities is seen by some as high-risk. In addition, banks seem to perceive that the depositor base they could attain in rural areas may be less active due to less financial literacy and lower levels of disposable income. Hence, expanding in rural areas requires more investment per unit of return when compared to other types of businesses and clients.

[34] Microcredit institutions are non-bank financial institutions that meet all the following criteria at the same time: i. lending and advisory services on lending are the sole scope of its activity; ii. average value of a loan extended to a borrower is not higher than the value of the microcredit (up to ALL 600,000); iii. at least 50 per cent of the credit portfolio is composed of micro credits.

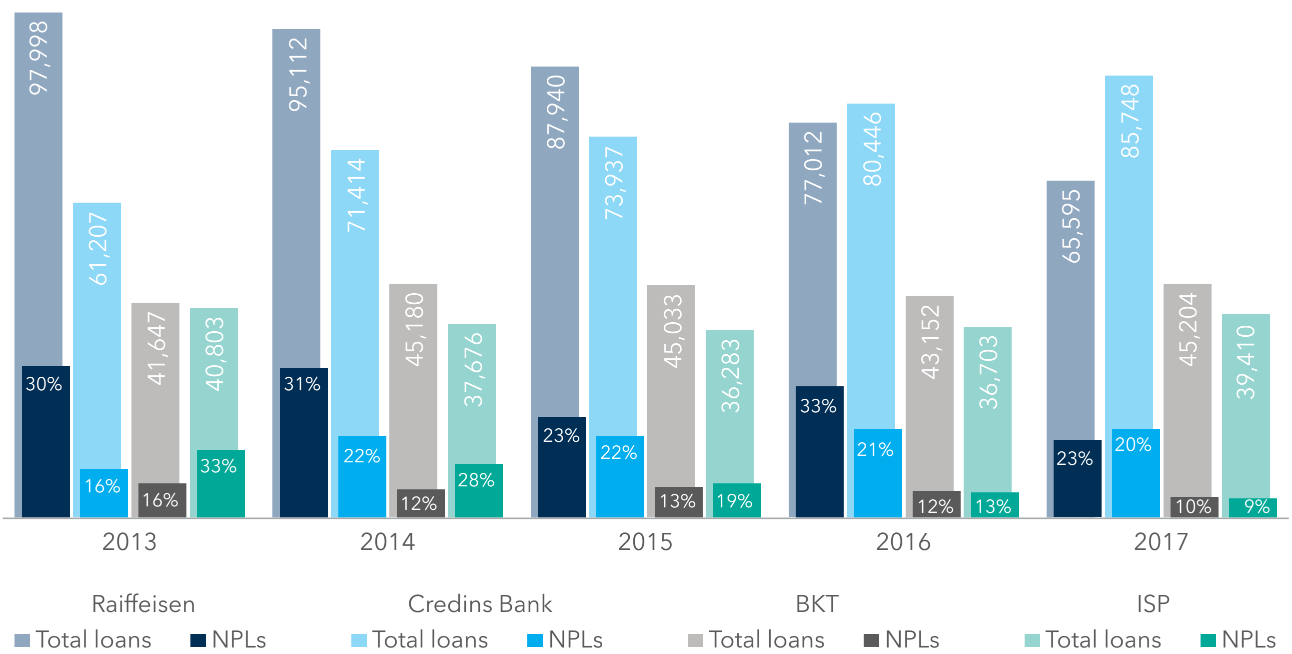
[35] Albanian Association of Banks Statistics, 2017.

High levels of NPLs in the aftermath of the global financial crisis have been reduced but bank lending has remained fairly stagnant in recent years (see Figure 10). Total credit grew by around 0.6 percent in 2017.[36] In the same period, bank assets increased by 2.8 percent; however, this increase was limited with regards to client activities. While treasury and interbank transactions increased by 4.5 percent, there was an increase of only 0.2 percent of client transactions. Security transactions with foreign institutions decreased by 3.1 percent.

As a response to the financial crisis, banks have adopted more conservative policies, seeking highly collateralized loans in particular by real estate. In 2016 the major share of the credit portfolio (71.2 percent) was collateralized.[37] By type of collateral, the largest share of loans in the system, around 49.4 percent were collateralized by real estate.[38] Loans to households had a higher rate of real estate collateralization (65.1 percent) compared to loans to enterprises (43.4 percent).[39]

Banks should explore alternative financial products and innovative business models to better serve MSMEs. Concentration in the banking sector, resulting in limited competition, the adoption of conservative lending policies post-financial crisis, and a lack of capacity and proper incentives have resulted in banks appearing not to be focused on developing new strategies to meet the specific financing needs of MSMEs. Anecdotal evidence suggests that banks mainly base their lending on availability of collateral. In addition, beyond online banking offered by the majority of banks, there seem to have been no serious attempts to explore partnerships with financial technology (Fintech) firms in order to offer alternative solutions that could help facilitate a shift from a cash-based economy to a more digital (electronic transactions) one.

Figure 10. Loan portfolio vs NPL for the four largest banks over a 5-year period (mln ALL)



Source: Bank of Albania

[36] Bank of Albania, *Financial Stability Report H2 2017*.

[37] Bank of Albania, Annual Supervision Report, 2016.

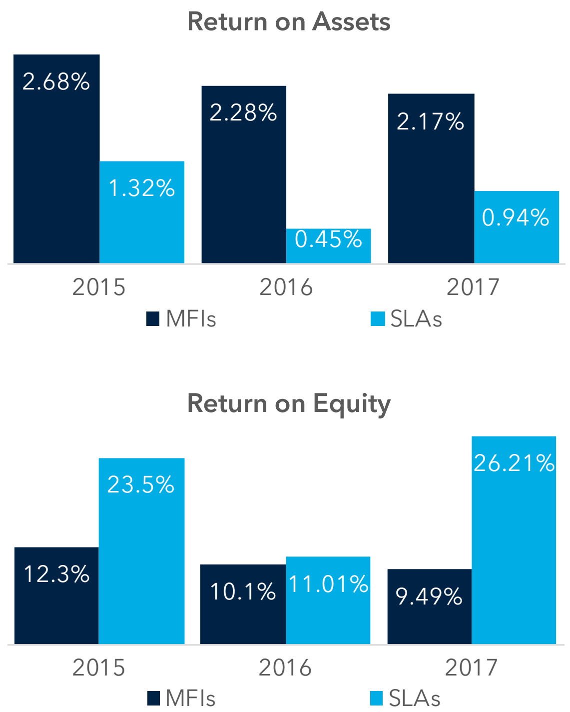
[38] ibid

[39] ibid

Analysis of the NBFI Sector

As of December 2017, 31 licensed NBFIs[40] operated in Albania, their size and role vary substantially.[41] Eight are registered to perform regular lending activities (solely or combined with other services),[42] five to conduct microcredit activities, 10 offer leasing products, six offer factoring services, and 10 are licensed to conduct payment services. Despite the relatively large number of NBFIs, their assets represent only 2.8 percent of the total financial sector assets (2.3 percent for MFIs and 0.5 percent for SLAs). The MFI sector is profitable, although profitability has been decreasing in recent years. SLAs, on the other hand, increased profitability in 2017.

Figure 11. Return on Assets and Return on Equity for MFIs[43] and SLAs



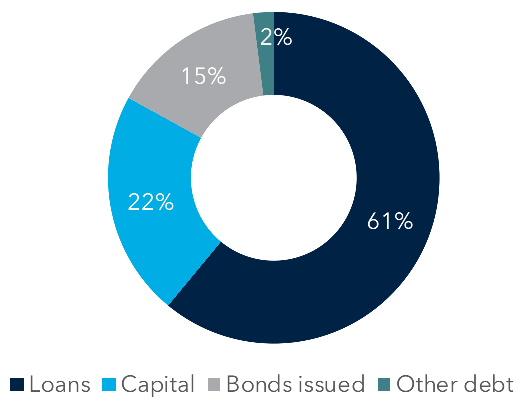
Source: Bank of Albania

Microfinance Institutions (MFIs)

MFIs are the largest and most prominent NBFIs, with a substantial presence in rural areas where they, jointly with SLAs, serve this segment of the market. While there are currently 8 licensed MFIs and 5 microcredit institutions, 2 of them dominate the sector. MFIs serve in particular smaller and micro enterprises as well as farmers. The quality of their portfolio demonstrates their ability to be able to lend to MSMEs while managing risks.

MFIs overall lending portfolio is stable and NPLs do not represent a major problem for the sector. The NPL ratio for MFIs in September 2017 was 12.5 percent, slightly higher than the 11.6 percent recorded at end 2016. The figures are influenced by a few smaller MFIs. The two largest lending MFIs have NPLs ratio below 7 percent.

Figure 12. Funding structure of the two largest MFIs



Source: Annual reports of 2 largest MFIs.

Difficulties accessing long term and low-cost funding is limiting MFIs sustainability in providing credit, including long term credit to MSMEs. The two largest MFIs have the potential and capacity to adequately serve the MSME market, including in rural areas, and have a business model oriented towards productive lending for small farmers and

[40] The term NBFI in this report refers only to those non-deposit taking institutions that provide mainly credit and payment services, and excludes insurance, pension funds, investment funds and other participants of capital markets (e.g. brokers).
[41] Bank of Albania, Register of Supervised Entities, December 2017.
[42] At present in Albania there is distinction between lending and micro-lending, based on the limits regarding the size of the loans they are allowed to provide. Lending institutions are non-deposit taking microfinance institutions which can provide larger loans than the one which can be offered by microlending institutions.
[43] Data are for the two largest lending MFIs dominating the sector.

enterprises, but they have limited funds. As outlined in Figure 12, MFIs cannot take deposits and they face difficulties in either accessing affordable wholesale funding or developing new services due to a shallow capital base which is based on some investors, donor interventions, and the issuance of small bonds.

Savings and Loans Associations

SLAs, following restructuring of the sector, have begun reviewing their business model seeking to better serve small and micro enterprises. The SLA sector had faced difficulties in the past, but has been completely revised as a result of a consolidation process and the entry into force of new legislation.[44] This restructuring has allowed SLAs to become more profitable and grow bigger; hence, the two major players are now seeking to "expand" towards the MSMEs sector. NPL levels for SLAs are low at around 4.8 percent in September 2017 down from 6.7 percent in 2016.

While they do not yet have enough capacity, SLAs could potentially be leveraged more to serve rural MSMEs given their presence in rural areas. SLAs have a strong presence in rural areas; in fact, the recent consolidation process avoided closing the smallest associations, transforming them instead into branches of larger associations. Although at present SLAs mainly offer loans to their members for consumption purposes, their deposit base is growing fast. Together with their strong rural presence and their knowledge of the agricultural sector, this could enable SLAs to increasingly serve MSMEs. SLAs have potential to provide more business advisory services to increase the bankability of MSME clients, especially in rural areas.

Financial Leasing and Factoring

In terms of other NBFIs, financial leasing and factoring companies play a small role in the market. The leasing portfolio is fairly small (about USD 8 million in 2017) and dominated by the financing of motor vehicles. Factoring barely exists. Factoring companies total assets were USD 1.3 million in 2017. The annual factoring portfolio turnover in 2016 amounted to ALL 6.63 billion with the number of invoices financed at 950 (see Table 6).[45]

Financial leasing activities are constrained by a weak secondary market for re-possessed assets, especially specialized equipment. Leasing is mainly limited to the financial lease of personal transport vehicles (54.8 percent in 2016) and work transport vehicles (24.1 percent in 2016). Weak secondary markets for repossessed equipment is a significant constraint to further development of leasing services, although at least one provider is solving this issue by selling repossessed assets through its international network of sister companies. While it should also be possible for financial leasing companies to offer operational lease products, there is a lack of clarity on this issue in the Financial Leasing Law.

Factoring and accounts receivable based finance in general is barely practiced in the market. There seem to be concerns that financial institutions do not fully understand the product, that courts lack capacity to understand the commercial construct of factoring transactions, and that limited trust exists in business partners and enforcement of creditors' rights.

Table 6. Factoring annual volumes and balance at December 2016

Factoring	Annual turnover		Portfolio balance
	No of Invoices	Value (ALL millions)	Value (ALL millions)
Total	950	6,639.71	566.19

Source: Bank of Albania

[44] Law No.52 dated 19.05.2016 On Savings and Loan Associations and their Unions.
[45] Bank of Albania, Annual Supervision Report, 2016.

Recommendation

Supporting the increased usage of e-invoicing linked to the tax administration (as enabled by the latest amendment of the VAT law), the development of platforms for reverse factoring or invoice discounting, as well as reforms to the moveable collateral registry (see financial infrastructure section) would increase trust and appetite for account receivable financing. This would ultimately provide an additional financing source for working capital to MSMEs and thereby enable them to more efficiently finance their business cycles.

Alternative Delivery Models and Financial Innovation

Supply Chain Finance (reverse factoring) is also not widely offered. Unlike traditional factoring, a reverse factoring product represents a buyer-centric model of accounts receivable finance.[46] This direct relationship helps to bridge some information asymmetries and other risks (e.g. invoice fraud) and is what makes this model especially well adaptable for MSME finance in developing markets.

Agricultural warehouse receipts financing is also missing from the market. As the country further develops infrastructure in the agricultural sector, a vision about the nature of warehousing capacity development in Albania will be needed.

Albania does not currently have the comprehensive and well-developed venture capital ecosystem required to support business innovation, productivity gains, and sustainable economic growth. This is the result of a combination of factors including: (i) lack of a legislative/regulatory environment conducive to the creation of private equity funds; (ii) low supply-side activity, which makes it difficult for entrepreneurs to find external sources of funding to support their businesses; and (iii) an underdeveloped high-quality pipeline of investable companies on the demand-side. With respect to potential institutional investors in the private equity/venture capital (PE/VC) industry the supply is almost inexistent. The domestic pension funds nor the insurance companies appear to be eligible to invest in alternate assets, nor do they seem to have the capacity to do so. According to the World Bank Albanian Venture Capital Ecosystem Diagnostic report (WB VC Report), the multilaterals appear to be have been the most active partners in Albania, albeit to a very small degree. The World Bank's Enterprise Development and Innovation Facility program, along with the European Bank for Reconstruction and Development (EBRD) and its subsidiary, the European Investment Fund, have co-invested in South Central Ventures, an early stage and growth VC fund focused on Albania and the

[46] In the case of reverse factoring, the lender purchases accounts receivables only from specific informationally transparent, high-quality buyers. The factor only needs to collect credit information and calculate the credit risk for selected buyers, such as large, internationally accredited firms. Like traditional factoring, which allows a supplier to transfer the credit risk of default from itself to its customers, the main advantage of reverse factoring is that the credit risk is equal to the default risk of the high-quality customer, and not the risky MSME. This arrangement allows creditors in developing countries to factor "without recourse" and provides low-risk financing to high-risk suppliers.

countries of the former Yugoslavia. Of its 40 million euros fund, which closed in late 2015, 1.5 million euros was earmarked for seed-investments in start-ups (up to 100,000 euros per investment) and shared within targeted markets.

Limitations also exist on the demand side for PE/VC investments. The small pipeline of potential investee companies is attributed to the lack of entrepreneurial attitudes that do not reward risk-taking behavior. These challenges are reflected in the fact that the tech startup sector in Albania is estimated to have a total of only 50-60 groups with innovative ideas, compared to other countries in the region that can offer a larger pipeline. Incubators and accelerators can play an important role in helping develop the entrepreneurial environment and provide support to inexperienced graduates who want to succeed in business. Albania has no accelerators as strictly defined, that is organizations that provide equity financing, co-location, intensive mentoring, and help with networking activity. Several operations do though act as incubators, providing office space and some training but little or no financing.[47]

Online banking and POS services are increasingly widely available, but penetration of digital credit and digital financial services in general is very low. Banks recently started investing more in digital channels (on-line banking primarily), and POS services are becoming more and more accessible. However, the level of innovation and uptake of digital payments is still very low which undermines the potential to reduce information asymmetry by collecting and processing alternative (payments) data, decrease costs of transactions by lowering cash dependence, and ultimately increase tax revenues through more transparency on the market. This is primarily due to the high costs of POS services, lack of disruptors pushing incumbent players to innovate, a lack of access points in rural areas, and the prevalent cash-based culture (e.g. unwillingness of many merchants to accept electronic payments).

Recommendation

Authorities should create a favorable framework for Fintech to stir competition and develop innovative products. Different types of frameworks and tools exist for authorities to stimulate Fintech and innovation in the market. In this respect, implementation of the EU PSD II Directive and establishment of a clear and transparent framework of licensing of innovative providers as well as their access to the financial sector infrastructure in general should be supported. A Fintech strategy should be developed and adopted focused on identifying barriers and opportunities to the development of financial innovations in Albania and proposing solutions and actions that will enable financial services to reach greater numbers of low-income individuals and small firms at lower cost and risk. See Box 2 for further detail on different types of approaches to promote Fintech and financial innovation.

Greater support should be available for innovative firms. Programs in the form of co-investment VC and seed funds should be developed. Mentoring-based "investment readiness" training for companies receiving financial support/grants should be established. This should focus on ensuring consistency in financial reporting and forecasting, developing a complete "pitch deck" with standard information required by investors, and improving presentation and negotiation skills. Development of accelerator programs linking innovative firms with potential investors, business skills trainers, and mentors should also be prioritized to support creation of sustainable demand of innovative start-ups.

[47] These examples based on the WB VC Report include Yunus Social Business, Talent Garden, Protik ICT Resource Center, Albanian Innovation Accelerator and Tirana Business Park

Box 2. Different approaches to promote Fintech and financial innovation

Policymakers in developed countries and increasingly in the developing world have adopted a wide variety of policies and tools to promote financial innovation:

- Innovation hubs: financial regulators offer assistance to firms not used to dealing with financial regulations and/or which have doubts as to whether certain regulation apply to their activities.
- Regulatory sandboxes: financial regulators offer a controlled environment for testing financial innovations that meet certain criteria. Sandboxes typically lower barriers to testing within the existing regulatory framework, while ensuring participating customers, institutions, and the broader financial system are appropriately protected. If, after sandbox testing, the firm wants to offer its services to the wider market, it shall comply with existing regulatory frameworks applicable to that type of activity. The regulatory sandbox approach also enables regulators to closely observe the innovations in a live environment and thereby have a better understanding of the risks and opportunities. This could also lead to fine-tuning regulatory frameworks.
- Public-private partnerships: public authorities support private entities and create a forum for incumbents and start-ups to exchange resources, know-how, and experiences and cooperate in the funding and development of innovative solutions.

An agricultural warehousing capacity strategy should be developed. Efforts to develop agricultural warehousing should be accelerated and a feasibility study for development of warehouse receipt financing[48], supporting agribusinesses in accessing post-harvest finance for working capital needs, should be considered. The strategy should focus on necessary credit infrastructure (electronic register of receipts), regulation, and supervision of warehouse receipt financing as well as establishment of a guarantee fund serving as a performance guarantee in case of fraud by the licensed warehouse operator.

The feasibility of regional e-platforms for the exchange/sale of repossessed collateral among lenders, with the aim to increase the efficiency of movable collateral execution and hence its perceived value, should be explored. The creation of regional e-platforms would improve the liquidity of movable assets and increase execution value. Financial services providers may then be more willing to use it as collateral or develop various leasing product lines for tourism, agriculture, and trade.

[48] Warehouse receipt financing is a collateralized commodity transaction where the goods themselves provide security for the loan. This type of financing allows lenders to immediately sell off a very liquid asset, namely the commodities they grow, if a farmer defaults on the loan. The underlying collateral is usually a soft commodity like grain.

3 GOVERNMENT POLICIES AND PROGRAMS IN SUPPORT OF MSME FINANCE

Government Strategies and Policies

The Government is committed to improve MSME access to finance and in general to enable economic development and MSMEs' contribution to economic growth. Albania has introduced many laws over the last decade, and as a result it has a fairly developed legal and regulatory framework to support the creation of various financial products suitable to finance the needs of MSMEs. Relevant examples include laws on secured transactions, financial leasing, factoring, and late payments. Additional effort now needs to be invested in effective implementation of the reforms.

The Government has developed and is approaching the implementation phase of several national strategies which are relevant for MSMEs. The *Business and Investment Development Strategy for the Period of 2014-2020* has a particular focus on MSMEs. It identifies the development of MSMEs as a key factor for the economic development of the country, including through the promotion of innovation in the MSMEs sector. Further, it underlines MSME financing as a constraint for the development of the sector and envisages the scaling up of existing government and donor funded programs to support MSMEs.

A coordination structure to facilitate implementation of initiatives and regulatory reforms is required. There is a piecemeal approach to MSME access to finance development and coordination of donor driven projects. Given limited resources and capacity scattered through various agencies and public institutions, an organized, transparent, and accountable public stakeholder coordination structure is important to ensure access to finance activities across all major sectors of the economy.

Implementation of initiatives and regulatory reforms needs further strengthening. Reforms can appear more focused on complying with international standards and guidelines rather than addressing an identified issue. Implementation of several crucial access to finance reforms seem to have been suboptimal. For example, the uptake of usage of factoring did not follow the enactment of the factoring law, payment practices have not yet reflected the late payment law, and movable collateral lending did not substantially develop following the implementation of a secured transaction system.

Public Sector Funding for MSMEs, Credit Guarantee Schemes, and Donor Interventions

While several government programs to support MSMEs finance are in place, these are relatively small with limited impact. The Government has set up and runs several financial programs (direct subsidies or other types of support) through various Governmental Agencies, such as the Agency for Research, Technology and Innovation and the Albanian Investment Development Agency. Limited funds, lack of visibility, and poor coordination of these programs has produced limited results. For example, the Albanian Investment Development Agency (AIDA) is an agency sub-ordinated to the Ministry of Finance and Economy to support MSMEs access to finance innovation. However, the grants it offers are of very small amounts (most of them are less than 10.000 Euros with the ones concerning start-ups/ innovation being less than 2000 Euros). AIDA, has very small programs, reaching between 60 to 90 SMEs per year (between 2014 and 2017). It manages several funds through which it disburses grants: (i) Competitiveness fund; (ii) Startup fund; (iii) Innovation fund; and (iv) Tourist entrepreneurship fund. The average disbursed grant goes from 9.500 USD in 2016 to 5100 USD in 2017. Less than 1

percent of Albanian MSMEs received a grant or a subsidized loan in 2017.[49] A number of donor-funded interventions also aim to support MSMEs access to finance, but they appear to lack coordination among donors and target different areas and sectors.[50] Funding and support for MSMEs varies widely in its amount and nature, with both gaps and overlaps and only very limited joint and coordinated focus on priority sectors.[51]

Some of the available programs also lack appropriate business advisory services to leverage the provided lending. Programs that target the development of particular sectors in parallel with supportive business advisory services would increase the bankability of MSMEs.

In addition to direct support through subsidies and grants, some donors have set up specific guarantee schemes to help support MSMEs finance in Albania. Briefly, these schemes cover the following:

- **Albanian Guarantee Fund (within the Italian-Albanian Program for SME Development since 2009):** This Guarantee Fund was set up under the Italian-Albanian Program for the Development of Albanian SMEs. It seeks to provide guarantees in the form of collateral to stimulate credit from financial institutions to MSMEs that face difficulties in accessing bank loans due to insufficient guarantees. This guarantee fund is connected to the subsidized loans given to MSMEs to buy Italian goods with a percentage of the proceeds. In terms of funding i) the credit line amounts to EUR 25 million; ii) the guarantee fund amounts to EUR 2.5 million; and iii) a grant of EUR 1.7 million for capacity development support to the MoE.
- **The Rural Credit Guarantee Fund (operational since late 2015):** This is a guarantee fund set up by the KfW to encourage banks and non-bank financial institutions to provide financial services to farmers and rural businesses in Albania. The fund also supports tailor-made technical assistance to the fund's partner financial institutions in order to increase their willingness and capability to provide financial services to rural MSMEs.
- **EBRD (operational since 2016):** This is a non-sector specific guarantee fund put in place by the EBRD to stimulate lending to MSMEs. It is unfunded and is rolled out in partnership with several financial institutions, including the biggest banks. In addition, EBRD has a framework operation of up to EUR 100 million for the implementation of the Albania Agribusiness Support Facility. This consists of a combination of credit lines for agribusiness lending and unfunded risk-sharing facilities for agribusiness loan portfolios of selected partner financial institutions in Albania. It also holds a senior unsecured loan of up to EUR 5 million to NOA, a non-bank microfinance lending institution, for on-lending to agribusinesses – the first project under the Albania Agribusiness Support Facility.

There is a strong demand and appetite for partial credit guarantee schemes and other types of credit enhancement funds in the market. While larger banks prefer unfunded guarantees, smaller ones and MFIs desire funded resources (wholesale credit lines). As mentioned previously, the Albanian financial sector is extremely liquid and interest rates are low; however, Albanian banks are reluctant to lend to MSMEs as they perceive the sector as risky and there is a limited secondary market for movable and immovable collateral. Considering liquidity issues are not a problem, unfunded guarantee schemes are preferred by the larger banks in Albania. For smaller institutions (smaller banks, SLAs and MFIs) funded credit lines should be encouraged.

While some interventions target the rural / agricultural sector, none of the reviewed financial support programs or guarantees currently support introduction of agricultural insurance. The lack of agricultural (yields or weather) insurance is limiting agricultural lending as banks are particularly reluctant to lend to farmers due to the high risks of unmitigated natural disasters or lack of skills negatively influencing yields. Despite this need, no government program nor donor funded intervention appears to focus on developing agricultural yield or weather insurance.

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[49] European Commission, *Survey on the access to finance of enterprises* – Analytical Report 2017.

[50] For example, EU has a program to promote and assist start-up business and promote innovation. The Italian Cooperation has partnered with several financial institutions to set up a set of subsidies to lower interest rates which does not target any particular sector but have a sole requirement to be using part of the proceeds of the loan to buy Italian products.

[51] An exception in size is the joint EU –GoA Instrument for Pre-Accession Assistance in Rural Development (IPARD) program. The program has approved a budget of EUR 71 million from EU and EUR 24 million grant from the GoA (75 percent EU and 25 percent GoA). The total EUR 94 million grant is available for investments in rural areas during the period 2014 – 2020. Utilization of this fund will require increased efforts both by the GoA as well as the financial services providers in order to find and train agribusiness to be able to extend funding under the program.

Recommendation

A dedicated unit within the MOFE should be created to promote MSMEs development. The unit should coordinate the development and implementation of MSME focused policies, consolidating as well as coordinating financial support funds, and integrating activities focusing on MSMEs across all public sector stakeholders. It could effectively coordinate and target donor activities towards agreed upon development goals. Working holistically with all relevant public and private sector stakeholders the unit would increase the efficiency of the available capacity and resources across various agencies and institutions.

Box 3. WB Principles for Public Credit Guarantee Schemes for MSMEs

Public credit guarantee schemes (CGSs) are a common form of government intervention to unlock finance for MSMEs. More than half of all countries in the world have a CGS for MSMEs and the number is growing.

CGSs can contribute to the expansion of MSME finance. They may also generate positive externalities by encouraging banks and non-bank financial institutions to get into the MSME market, thus improving institutions' lending technologies and risk management systems. However, CGSs may add limited value and may prove costly when they are not designed and implemented well.

In January 2015 the World Bank Group and the Financial Sector Reform and Strengthening Initiative, in coordination with the SME Finance Forum, convened a global task force to identify and draft principles for the design, implementation, and evaluation of public CGSs to improve access to finance for SMEs.

The 16 principles cover four key areas that are critical for the success of CGSs.

Legal and regulatory framework

1. Establish the CGS as an independent legal entity.
2. Provide adequate funding and keep sources transparent.
3. Promote mixed ownership and treat minority shareholders fairly.
4. Supervise the CGS independently and effectively.

Corporate governance and risk management

5. Clearly define the CGS mandate.
6. Set a sound corporate governance structure with an independent board of directors.
7. Design a sound internal control framework to safeguard the operational integrity.
8. Adopt an effective and comprehensive enterprise risk management framework.

Operational framework

9. Clearly define eligibility and qualification criteria for SMEs, lenders, and credit instruments.
10. Ensure the guarantee delivery approach balances outreach, additionality, and financial sustainability.
11. Issue partial guarantees that comply with prudential regulation and provide capital relief to lenders.
12. Set a transparent and consistent risk-based pricing policy.
13. Design an efficient, clearly documented, and transparent claim management process.

Monitoring and evaluation

14. Set rigorous financial reporting requirements and externally audit financial statements
15. Publicly disclose non-financial information periodically.
16. Systematically evaluate the CGS' performance and publicly disclose the findings.

Figure 13. Functions and roles of the MSME unit

MoFE - MSME Unit

Unit to coordinate, promote and drive all MSMEs access to finance related activities including funding activities.

CGS and other economic empowerment funds (public sector, donors, mixed)	MSME A2F development policies at various government agencies / donor initiatives - all sectors of economy	Public sector employees with training on MSME business capacity building skills	Angel investor / VC networks - linked to government/ donor supported Start-up innovation accelerators / mentoring programs	BoA data on lending to MSMEs
Existing credit guarantee schemes and funding programs to be coordinated and consolidated by the MSME Unit.	Existing policies to be streamlined and coordinated by the MSME Unit.	MSME Unit to take stock of existing human capital with knowledge on MSME finance.	MSME Unit to promote the creation of networks linking these types of interventions.	BoA and MSME Unit to work on a definition of MSMEs and streamline data collection and reporting to inform policies and reforms.

Improving coordination of existing public and donor-funded initiatives would be beneficial to increase economies of scale and promote linkages with business advisory initiatives. To further promote MSME finance, the GoA should rationalize the existing interventions based on a review of the efficiency and reach of the existing programs, to avoid overlaps and gaps, while at the same time ensuring that they cover all priority sectors. Linkages with business advisory initiatives should be strengthened.

Promoting further development of partial credit guarantee schemes based on international best practice to facilitate lending to MSMEs is recommended. This would help further address the perceived risks of lending to MSMEs. These programs should be accompanied with simultaneous business advisory and training activities. They should be established based on international best practices concerning governance, independence and sustainability, and any business capacity and financial capability programs should have clear success evaluation mechanisms built in (see Box 3).

Moreover, the development of agri-insurance products accompanied by business development activities for farmers should be supported. Apart from sporadic attempts by local insurance companies in the past, the agriculture sector does not have access to affordable agriculture insurance products (such as yield or weather). Development of those products can be supported through research / data collection, insurance model developing, increasing the network of agricultural extension officers supporting farmers with knowledge and skills, and potential financial support through premium subsidies. Business advisory services for farmers could be provided through the network of financial services providers (MFIs mainly) and non-financial conglomerates (such as agricultural cooperatives) and linked to lending combined with agri-insurance products.

Using G2B payments to unlock finance

Securing adequate cash flow to execute operations profitably is one of the most critical issues facing businesses across the world today, and Albania is no exception. Long payment terms and late payment (arrears) for products and services put a heavy burden on MSME working capital management. A major cause of liquidity problems are long payment terms and late payments of accounts receivable, i.e. delays in incoming cash flows after the sale of products and delivery of services. Based on discussions with local private stakeholders it appears that payments for products and services in Albania often have long and delayed payment terms.

The GoA has invested considerable efforts to tackle the problem of arrears in public sector payments. The late payment law[52], passed in 2014, follows other recent positive international examples (e.g. EU[53], India[54], Turkey[55]). In addition to the establishment of strict payment deadlines, the law provides the automatic application of statutorily set amounts of penalty interest in the supply of goods or services from commercial undertakings to other commercial undertakings and public authorities.[56] The law also specifies that the creditor is entitled to interest payment in case of delay in payment for a good or service without even the need to notify the debtor.[57] The payment and interest under the law are considered an enforceable title.[58]

Interviews with the local private sector reveal that the late payment law is not yet adequately enforced and enterprises rarely seek enforcement for delayed payments (usually finally paid without interest). There seems to be a lack of trust that a payee, particularly a public entity, would pay another creditor (with or without interest). Hence, making a cost-benefit analysis, many MSMEs accept late payments without the due interest. Creditors do not seek enforcement against public companies, fearing either that courts would not rule against the government or that they would not be awarded contracts in the future. This pervasive lack of trust affects the ability of MSMEs to trade with their invoices. Account receivables are difficult to be sold by MSMEs and there is no formal platform (market) where they could easily sell and buy electronic invoices.

Recommendation

Consider allowing public sector accounts payable to MSMEs to be offered for sale on web-based invoice discounting platforms to further support access to working capital finance and to improve payments liquidity in the country. This could have multiple positive effects. Payees accept having to pay interest in case of delayed invoice payments, allowing MSMEs to sell the invoices and receive relatively cheap working capital finance. The potential volume of finance on such a platform could attract Fintech companies to operate in Albania hence increasing competition and bringing innovations to the rather stiff market. Box 4 outlines examples of such reverse factoring and invoice discounting platforms in other countries.

[52] Law No. 48/2014, *On Late Payment in Contractual and Commercial Relations*.
[53] The Late Payment Directive, 2011/7/EU.
[54] Act on Payment Terms in Commercial Contracts (30/2013).
[55] Article 1530 of the Turkish Commercial Code, No. 6102.
[56] Law No. 48/2014, *On Late Payment in Contractual and Commercial Relations*, Article 1.
[57] Law No. 48/2014, *On Late Payment in Contractual and Commercial Relations*, Article 4.
[58] Law No. 48/2014, *On Late Payment in Contractual and Commercial Relations*, Article 16.

Adequate implementation and enforcement of the late payment law should be ensured. The Government should build public confidence by improving application of the terms of the law to public institutions, including paying interest when due. Stakeholder awareness of the scope and application of the law should be enhanced, and capacity should be built amongst the judiciary on how to apply and enforce the law. The strict implementation of automatically applied minimum penalty interest would also enable the financial sector to properly ascertain the risk of providing finance against accounts receivables and, hence, set realistic and more affordable pricing of such finance which is still perceived as too risky and too expensive in Albania.

Box 4. Reverse factoring and invoice discounting platforms

In addition to promoting a culture of prompt payment in private and public sector, local MSME suppliers should also be provided with viable and realistic financing options enabling them to bridge their existing needs for cash injections. This can effectively be done through promotion of financial instruments that are well designed to allow efficient and cheaper access to working capital finance leveraging MSME relationship with their large private and public sector customers, such as factoring, invoice discounting, and reverse factoring. A special type of receivables finance known as reverse factoring (or supply chain finance) is especially well placed to offer such access to working capital finance.

Development of platforms for reverse factoring or invoice discounting that attract substantial numbers of large buyers can open up access to working capital finance to a vast number of MSMEs located in remote areas of the country and reduce overall costs of financing transactions (due to the increased competition between available financiers).

In the case of reverse factoring, the financier purchases accounts receivables only from selected MSME customers of its large corporate or public sector client based on a pre-agreed financing program. Thereby the financier increases its risk exposure to one customer, but the costs of acquiring information and assessing credit risk are lower and typically only high-quality receivables are accepted. Reverse factoring is suitable for financing of receivables from accredited firms that are more creditworthy than the MSME seller, such as large firms. Public sector payables for goods and services (central government, local government, specialized agencies, as well as state owned enterprises) are also very suitable for this type of finance.

The most apparent benefit of reverse factoring for an MSME supplier is the access to immediate cash at lower rates (since the financier takes a risk position against a large buyer and not an MSME supplier). By selling the accounts receivable to a financier MSMEs are able to rapidly convert accounts receivable into another asset – cash. One of the benefits for the buyers is that in exchange for working capital financing, the MSME sellers may agree on more favourable sales terms.

Reverse factoring programs are made particularly efficient and accessible to many MSMEs when offered through an on-line platform interconnecting buyers, financiers, and MSME suppliers. These platforms could be owned and operated on a private basis or specifically developed for a national body supporting MSME access to finance such as a development bank.

The Government could support the creation of an initial reverse factoring market by allowing public sector payables to be listed and financed on such platforms. With enough potential business volume created, private start-up Fintech investments could become justifiable and attractive. This could in turn lead to further development of Fintech services providing the same type of finance in the private sector domain, as well as gradually developing other features and potential products for the Albanian market. These additional products and benefits could include processing and usage of alternative credit information (big data), increased formality in microbusiness (through use of transaction accounts as a condition to access finance), on-line invoice discounting (sale of receivables on a secondary market), and progressively to even equity crowdfunding and peer to peer lending.

Two examples of public initiatives to create platforms for nation-wide public use are Mexico's development bank NAFIN reverse factoring program, and a similar recently introduced Indian TreDS model. An interesting regional example is the Bulgarian model for factoring municipal payables to contractors under PPP projects by the Bulgarian Development Bank.

In response to lack of financing in the formal sector, NAFIN developed an electronic platform for reverse factoring through a program called Cadenas Productivas (productive chains). The productive chains program works by creating chains between large buyers and small suppliers. It started out as a public sector institution and after 8-10 years became a quasi-private sector entity.

The role of NAFIN is only to provide a platform (to coordinate the on-line factoring services) and not to purchase receivables directly. It maintains an internet site with a dedicated page for each large buyer. Suppliers are grouped in "chains" to their buyers. NAFIN also plays a critical role in handling the sale and delivery of electronic documents. The suppliers and NAFIN sign a pre-agreement allowing the electronic sale and transfer of receivables. Additional contracts between the financiers and buyers and NAFIN define their obligations, such as the requirement for buyers to pay sold receivables to the financiers directly.

Once a supplier delivers its goods and an invoice to the buyer, the buyer posts a negotiable document on its NAFIN webpage equal to the amount that should be factored. The supplier accesses the buyer's NAFIN webpage and clicks on its receivable. Any financier that has a relationship with the buyer and the supplier and is willing to factor the receivable will appear on the next screen, along with a quote for the interest rate at which it is willing to discount this specific receivable. To sell its receivable, the supplier clicks on a shown financier and the amount of its negotiable document less interest is transferred to its bank account. When the invoice is due, the buyer pays the financier directly. All factoring is also done without recourse, which lets small firms increase their cash holdings and improve their balance sheets. The sale of receivables from the supplier to the financier and the transfer of funds from the factor to the supplier take place electronically. The electronic platform allows all commercial banks and MSMEs to participate in the program and gives national reach to regional banks and access by rural firms to banks. In addition, it allows multiple financiers to electronically compete for a supplier's receivables.

The Reverse Bank of India has recently introduced a legal and regulatory framework that would allow the start-up of Fintech reverse factoring platforms on a national level. This followed the introduction of the Factoring Regulation Act of 2011 which addressed some major concerns of low penetration of factoring in India, caused among other things by high stamp duty on assignment, an inadequate legal framework, and a lack of clarity on the roles and responsibilities of parties to the transactions. The envisaged reverse factoring process is almost identical to NAFIN. The "Trade Receivables Discounting Systems" (TReDS) are electronic platforms, operated by an independent, registered / authorized entity. Receivables Exchange of India Ltd (RXIL) launched India's first TReDS on January 09, 2017. RXIL is a joint venture promoted by the Small Industries Development Bank of India and National Stock Exchange of India Limited. In June 2016 Axis Bank Ltd, India's third-largest private-sector lender, formed a joint venture with Mjunction Services Ltd to start up a TReDS operation in India. Several other companies have also started the process.

The Bulgarian Development Bank purchases receivables of construction companies which have concluded contracts with municipalities pursuant to the procedures of the Bulgarian Public Procurement Act. The projects should have been correctly completed and the relevant certificates and invoices proving the payments made should have been issued. This reverse factoring mechanism enables the companies to transfer the debts due by the municipalities in their capacity as contracting authorities to the Bulgarian Development Bank by signing a debt purchase agreement. The bank requires the construction companies to provide evidence that the debts exist and that they are payable and recognized by the municipality.

Many private invoice discounting platforms have also emerged in recent years across the world. These are online marketplaces for sale of receivables to interested investors (peer to peer or institutional investors). Receivable exchanges enable suppliers to individually sell (offer for auction) their receivables and gain quick access to working capital.

4 FINANCIAL INFRASTRUCTURE

Credit Infrastructure

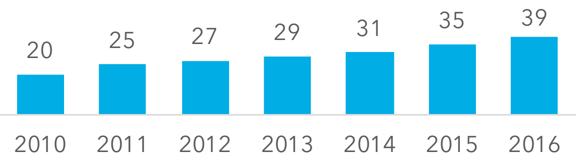
The existing credit infrastructure could be improved to better respond to the financing needs of MSMEs as well as the needs of financial institutions. While there have been ongoing reforms, the credit infrastructure in general could benefit from modernization. The current infrastructure has failed to take advantage of global technological advancements, such as the establishment of fully on-line accessible movable collateral registries, uptake of electronic invoicing, or harnessing alternative data for credit referencing purposes.[59]

The credit reporting system (CRS) has been significantly improved over recent years, but still lacks credit referencing properties and does not collect all potentially valuable credit data. The current CRS is based on a credit registry operated by BoA. Since April 2016, all banks and other financial institutions report loans, including loans subject to a judicial process, restructured loans, and sold loans, which are also identified in the borrower's report that is generated by the credit registry. Thanks to these reforms, Albania is performing relatively well in terms of getting credit according to the World Bank Doing Business Report 2018; in fact, it ranks better than countries like Croatia and Greece. While strength of legal rights (6) and credit registry coverage (at 51.6 percent of adults) are higher than the regional Europe and Central Asia average, the depth of credit information is slightly lower than the average (6 vs. 6.3).[60]

Despite recent positive developments, the BoA credit registry coverage remains limited to traditional data on borrowing, although a project to create a credit bureau is reported to be underway. Albania does not yet have private credit bureaus operating and the BoA credit registry collects information only from credit providers.[61] The potential of payment data and utility bills has not yet been explored, limiting the ability of financial institutions to conduct credit risk-assessments and develop credit scores for MSMEs who have been outside the formal credit market.

To address this issue the banking association is working with the EBRD to set up a credit bureau; but the timeline for implementation of the project is unclear and it is not known if non-bank payment service providers, mobile network operators, and utilities providers would be involved.

Figure 14. Overview of number of institutions reporting to the Credit Registry



Source: Bank of Albania.

There is no specific legal framework that would support development of privately-operated credit bureaus. At present the Banking Law[62] governs the operation of the credit registry within BoA. The regulation covers some important aspects such as data accuracy[63], access to information, and correction rights,[64] but due to the secondary nature of a regulation it does not create a framework that would be applicable to the operation of private credit bureaus. A credit reporting law would provide a comprehensive, transparent, and legally certain framework regulating the type of data which can be reported, collected, and analyzed, as well as obligations of financial institutions and rights of consumers, such as their right to access their data and request, rectification, cancellation and oppose any incorrect data for both public credit registry as well as for potential private sector entrants into the market (credit bureaus).

[59] For example, it is estimated that Total Transaction Value in the "Alternative Lending" segment amounts to US$6m in 2018 in Croatia and it is expected to grow to over US$11m by 2022; while in Serbia for 2018 it is estimated only at US$3m it is expected to increase to over US$18m by 2022.

[60] World Bank, *Doing Business Report,* 2018, available at http://www.doingbusiness.org/data/exploreeconomies/albania#getting-credit.

[61] The reporting entities as of mid-2017 were 16 banks and licensed NBFIs that are involved in lending and leasing

[62] Law, No. 9662, dated 18.12.2006, *On Banks in the Republic of Albania*, Article 127.

[63] Bank of Albania, Decision N. 67 dated 13.10.2010, *On the Information Content and Functioning of Credit Registry at the Bank of Albania*, Article 16.

[64] Bank of Albania, Decision N. 67 dated 13.10.2010, *On the Information Content and Functioning of Credit Registry at the Bank of Albania*, Article 10.

The level of satisfaction with the services provided by the moveable collateral registry (Registry of Securing Charges) is reported to vary amongst financial institutions. The Registry is online, but does not offer the ability to file notifications nor to consult the registry in real time. Only public notaries have real-time access to the registry. The fact that registration is not done in real time creates issues especially for accounts receivable finance since factoring (assignment) of accounts receivable needs to be registered in the registry to be valid. Delays between submission of notice and the actual registration add additional time and administrative burden on these types of transactions. Moreover, the notary fees and the number of procedural steps needed to create collateral when public notaries need to be involved present further hinderance.

The limited secondary market for movable collateral is an additional bottleneck for the development of lending against movable collateral. The shallow secondary market represents a serious constraint to the re-sale of repossessed collateral; in fact, beyond immovable property, financial institutions appear to be taking moveable collateral more as a moral pledge rather than for their economic value. The market for repossessed collaterals in Albania is very shallow and it is difficult to sell a repossessed asset. While the sub-regional market could provide an opportunity to deepen the re-sale market for repossessed collateral, there are no formal platforms to access it, and only large financial institutions with a strong presence in the entire sub-region have begun exploiting this option.

Payments Infrastructure

While BoA is actively working on improving the National Payment System, the retail payments infrastructure is still not developed to a satisfactory level. Although BoA operates a real time gross settlements system and automated clearinghouse, at present there is no local infrastructure in place for the exchange of payment card transactions. In most cases this is done via an international card network which increases the costs of these transactions.[65] For instance, according to anecdotal information received from the Albanian Tourism Association, in Albania a POS transaction cost is 2.5 percent to 4 percent, while in Montenegro it is 0.7 percent to 1.2 percent. In addition, there is no system of e-money issuer to e-money issuer interoperability, or interoperability between e-money accounts and bank accounts.

The uptake of electronic money is still very limited. Only one non-bank e-money issuer is operating in Albania. In fact, the uptake of e-money has not attained the results expected and providers which originally entered the market, such as M-Pesa, exited the market completely. In addition to remittance services, non-bank payment services providers currently operating in the market mainly offer bill payments, and peer to peer transactions are mainly done informally.

[65] It is possible to withdraw cash/pay with a Visa or MasterCard branded card issued by a local bank at the ATM/POS terminal of another local bank as most of these card acceptance devices in the country are "interconnected" via the Visa and MasterCard global processing networks.

Debtor's and creditor's rights

Albania performs above the regional average and more advanced economies such as Greece and Croatia when it comes to creditors' rights.[66] Although Albania had a reasonably modern insolvency framework on paper since 2002, it has been scarcely used by businesses. A new bankruptcy law was approved in 2016 with support from the World Bank Group. The law which is yet to be efficiently applied in practice, awaiting approval of accompanying bylaws, is expected to bring the following improvements: (a) strengthen creditors' rights, including to ensure further creditor participation in the process and an adequate regime of priorities, (b) bring an expedited reorganization mechanism that allows court confirmation of workouts ('pre-packaged plans' or 'pre-packs'), (c) allow for post-filing financing, (d) improve the company reorganization process, and (e) simplify and strengthen the system of avoidance actions against fraudulent transactions.

Immovable collateral is the preferred type of risk mitigation in the market, but the secondary market for on-sale, especially for agricultural land, is limited and there can be issues around multiple legitimate claims on the same land. For nearly all types of loans, financial institutions demand immovable collateral as guarantee; however, these are often undervalued as the secondary market is also shallow for immovable collateral. Following the "construction crisis" and spike in NPLs many financial institutions found themselves having to manage immovable properties due to a lack of buyers. Further, it is often very difficult for farmers to use land as a collateral as there can be issues with registration of property, or multiple claims on the same land lot.

Unpredictable and slow court decisions contribute to the perception of riskiness of lending and hinder MSME access to credit. There is a market perception that courts are slow, unpredictable, and subject to external influence. Moreover, it appears that there are issues with the enforcement of contracts and court orders. Recent reform to the Private Bailiffs Law[67], which would introduce success fees related to bailiffs' performance, is not yet implemented in practice, awaiting the amendments to the fees regulations issued jointly by the Ministry of Finance & Economy and Ministry of Justice. Private bailiffs are currently paid large remuneration upfront leaving them little incentive to enforce court orders.

The 2014 Value-Added Tax Law introduced electronic invoices as equivalent to paper invoices but the uptake is still very low. In order to issue electronic invoices and to ensure the authenticity of the origin and the integrity of the content of the electronic invoice, taxable persons must use an advanced electronic signature or electronic data interchange. However, uptake of e-invoicing seems to be very low. There is no efficient public register of electronic invoices available to be used for registering accounts receivable financing transactions. Possible use of the movable collateral registry for this purpose is hindered by it not allowing seamless real-time registration.

[66] World Bank, *Doing Business Report*, 2018, available at http://www.doingbusiness.org/data/exploreeconomies/albania#getting-credit.
[67] Law No 10 031, dated 11.12.2008, *For the Private Bailiff Office*.

Recommendation

The movable collateral registry should be improved to enable seamless real-time access and registration of notices of creation of security interests. Also, the need for participation of notary publics in movable collateral contract creation / registration process, and applicable fees charged should be reviewed to decrease administrative burden and costs of lending against movable collateral.

An enabling legal framework allowing for the development of private credit bureaus and alternative data processors (e.g. postpaid utility services, payments data, etc.) with appropriate data and consumer protection safeguards should be developed. With the progressive digitization of the economy, financial institutions should be able to adequately exploit digital transaction data as well as utility payments within a framework adequately guaranteeing the privacy and protection of consumers' data.

Payments system regulation and infrastructure should be introduced enabling interoperability on various levels and facilitating the development of alternative payments providers and/or products. This will incentivize use of electronic payments, facilitate development of innovative approaches to finance, reduce transaction costs for MSMEs, and increase e-commerce. Improvements in infrastructure should be accompanied by awareness raising campaigns and measures, especially in the trade and tourism sectors but also in other sectors of the economy with large volumes of payments. Enabling interoperability between e-money accounts, and e-money accounts with bank accounts would support innovation and the development of alternative payment products, such as for example white label POS[68] and Quick Resolution (QR) codes. This would in turn have potential to reduce transaction costs for MSMEs and increase the attractiveness of electronic payments for users, influencing more merchants to accept electronic payments.

Improvements in credit infrastructure and product innovation need to be accompanied by increased capacity of the judiciary to interpret and efficiently enforce creditors' rights. The ability to effectively execute collateral is of the utmost importance and efforts should be invested to explore possible solutions for the rather shallow secondary market. A feasibility study on the creation of regional e-platforms for exchange/sale of repossessed collateral among lenders could be explored to increase the efficiency of collateral execution and hence its perceived value.

[68] POSs not affiliated with any bank or any international card network.

Box 5. QR code payments

Over the past few years, technologies have been transforming the payments landscape, providing payers and payees with a wide variety of new methods through which e-payments can be made. Recognizing the fast-paced change, in 2017 the Committee on Payments and Market Infrastructures expanded its Red Book statistics to begin collecting information on online and contactless payments.[69] When revising the indicators, it took a broad interpretation of contactless payments and included QR codes as one type, showing that this payment method is becoming common.

What are QR codes and how do they work? QR codes are two-dimensional bar codes with data encoded within, which allow a mobile phone or tablet (with a camera able to read such codes) to access information about a product, service, or person by scanning it.

In the payments sphere, two types of codes have been adopted to facilitate merchant payments:

- Consumer-presented codes (linked to the customer's account): when paying the customer shows the QR code to the merchant who optically scans it; and
- Merchant-presented codes (linked to the merchant's account): the merchant displays the code and the customer must use his/her mobile device to read it.

Regardless of the type of code, several steps are required to effectuate a payment using a QR code: i) using an appropriate device with a relevant app the customer (or the merchant) scans the QR code. The app can be developed directly by a payment service provider (PSP) or another app connected to the customer's (or merchant's) account; ii) the option to make a payment using a QR code is selected in the app to open the camera; iii) the payment amount is entered; and iv) the authentication process is completed.

What are the benefits of using QR codes for merchant payments? More and more PSPs and regulators are advocating or encouraging for the use of QR codes to make payments as a practical and more convenient way to introduce e-payments in predominantly cash-based societies. These solutions, in comparison to card-based payments, are more infrastructure light, as POS machines are not needed, making them cheaper and easier to be adopted. Furthermore, merchant-presented codes can be safer for clients, as consumers do not share any details with the merchant, eliminating the risk of card details being copied when using POS.

What are the downsides of using QR codes for merchant payments? Although using QR codes does not require additional instruments like cards, the payment experience may not be seamless, as it involves prerequisites (having the app) and several steps at the moment of payment. Similarly, while QR codes eliminate the need for POS terminals, their bi-dimensional nature requires the usage of a smartphone camera which not all users or merchants necessarily have. Finally, while for merchant-presented codes the consumers do not share their information, when making payments they are redirected to a payment page, app, or internet browser, posing the risk that the code presented may have been replaced with a malicious code containing viruses or risks of fraud as the transaction may take place in an unsecured environment over the internet.

How are regulators and other entities responding? Regulators and other entities are responding in different ways to this phenomenon: some regulators have banned or partially banned the use of QR codes70 for electronic payments, others are working with other stakeholders on developing a common code and issuing standards to avoid fragmentation and to ensure simple, swift, and safe transactions for everyone.[71]

[69] Committee on Payments and Market Infrastructures , Methodology of the statistics on payments and financial market infrastructures in the CPMI countries (Red Book statistics), Bank for International Settlements, August 2017.

[70] Notably, the People's Bank of China temporarily banned QR code payments in 2014.

[71] The Monetary Authority of Singapore, through the Payment Council has set up a task-force to develop a Common QR code for Singapore. Similarly, NACHA in the United States and NPCI in India have issued guidelines on the process of a QR code transaction.

5 REGULATION AND SUPERVISION OF THE FINANCIAL SECTOR

BoA is the sole regulator and supervisor of banks, SLAs, MFIs, leasing, and factoring companies. The Banking Law[72] lays down the regulatory landscape for providing credit products and related financial services in the country. A separate law on SLAs[73] provides provisions for their creations, governance, risk management, supervision, and liquidation. There is no specific law for other MFIs, their licensing and prudential regulations and supervision is referenced under the Banking Law.

The Banking Law specifically regulates banks and banking activities. It defines banking business as any business which implies the receiving of funds from the public by accepting them as deposits, or by borrowing from the public or other banks and using these funds to grant loans, advances, and credit facilities, and by investing in other means. Further, it defines which institutions have the right to carry out banking activities. It provides minimum capital requirements and other prudential requirements. As provided in the Law, the BoA licenses and oversees banks.

SLAs legislation includes the calculation of risk-weighted assets which may affect their ability to lend. The regulation on the licensing of SLAs establishes licensing conditions, financial activities allowed by SLAs, and capital requirements. While the variation in capital requirements, as shown in Table 7 below, between MFIs, banks, and SLAs is justified by their activities there is some divergence in terms of calculating risk weighted assets between banks and SLAs. For instance, exposure to international organizations, including loan guarantees by guarantee schemes, does not affect the weighting coefficient for SLAs but does for banks. Similarly, mortgages on real estate are weighted differently; loans guaranteed by a real estate mortgage should have a risk co-efficient of 35 percent for banks and 50 percent for financial cooperatives.

While rules on risk management are present for all types of financial institutions; rules applicable to non-deposit taking institutions may be overly restrictive. NBFIs have initial capital requirements, to limit the number of players in the market, and BoA has additionally issued a comprehensive set of risk management rules for non-deposit taking institutions from maximum exposure rules[74] to overly prescriptive capital adequacy and provisioning requirements for lending institutions (MFIs)[75] and factoring companies.[76]

Financial institutions which should be suitable to develop various products targeting MSMEs, such as leasing, factoring, or supply chain finance, are also prudentially regulated despite the fact that they do not take deposits. Leasing companies have rather high capital and reporting requirements although they are not allowed to take deposits. These types of companies are not in a credit intermediation business (deposit taking and on-lending) and these requirements are a burden which act as a deterrent to both international and domestic investors in this usually lucrative and MSME supportive type of financial service.

Albania has a stricter approach to regulation of factoring activities than other countries in the region. Some even feel that factoring is over-regulated in Albania considering its risks. Albania is the only country in the region that has liquidity standards, classification rules and provisioning requirements applicable to factoring companies. However, there are no capital adequacy rules nor mandatory exposure limits, except for related persons exposure.[77]

Only banks and SLAs are allowed to take deposits; however, all credit institutions are prudentially regulated and supervised by BoA. SLAs are only allowed to receive deposits from and provide lending to their members. The legal framework for microfinance is established under the Banking Law and the Regulation on "Licensing and Activity of Non-Bank Financial Institutions". On top of restrictive prudential requirements, growth of MFIs have been hindered by limited options to raise funding. All institutions, including non-deposit taking ones, have initial capital requirements (shown in Table 7), specific capital adequacy ratios, and are prudentially supervised by BoA.

[72] Law, No. 9662, dated 18.12.2006, *On Banks in the Republic of Albania*.
[73] Law, No 52/2016, dated 19.05.2016, *On the Saving and Lending Associations and their Unions*
[74] Bank of Albania, Decision No. 02 dated 17. 01. 2013, *Approval of Regulation "On Risk Management in the Activity of Non-Bank Financial Institutions"*, Article 7.
[75] Bank of Albania, Decision No. 02 dated 17. 01. 2013, *Approval of Regulation "On Risk Management in the Activity of Non-Bank Financial Institutions"*, Article 11.
[76] Bank of Albania, Decision No. 02 dated 17. 01. 2013, *Approval of Regulation "On Risk Management in the Activity of Non-Bank Financial Institutions"*, Article 15.
[77] Bank of Albania, Decision No. 02 dated 17. 01. 2013, *Approval of Regulation "On Risk Management in the Activity of Non-Bank Financial Institutions"*.

Table 7. Initial capital requirements

Entity	Minimum initial capital
Bank	1 billion ALL
Non-bank financial institutions that may conduct one of the following financial activities:	
All lending types	*100 million ALL*
Factoring	*20 million ALL*
Leasing	*20 million ALL*
Payment services and money transfer	*20 million ALL*
Guarantees and commitment	*20 million ALL*
Foreign exchange	*1.5 million ALL*
Advisory, intermediation and other auxiliary financial services of all the above activities	*10 million ALL*
Microcredit financial institution	15 million ALL
Non-bank financial institutions that purchase non-performing loans	50 million ALL
Electronic money institutions	50 million ALL
Savings and loans associations:	
When conducting only the activity of accepting deposits and granting loans to the members of the association.	*5 million ALL*
When SLA also seeks to exercise at least one of these activities (all payment and money transfer services; foreign exchange; financial leasing)	*20 million ALL*
Unions of savings and loans associations	20 million ALL
Foreign exchange bureaus	1.5 million ALL

Source: Based on legislation and Bank of Albania data

Informal lending is widespread and common in Albania. Borrowing informally leaves MSMEs exposed to financiers without any systemic consumer protection. This is in turn then reflected in the lack of transparency of pricing, clarity of contract terms, and questionable collection practices. Borrowing informally also represents a lost opportunity for development of the MSME sector as formal providers of financial services such as banks or MFIs often offer various business support and training services that contribute to the improvement of productivity in other countries.

Lack of financial and business capacity further undermines access to finance, productivity, and potential for growth. Many MSMEs, especially in the agricultural sector, lack understanding of financial products and the potential benefits various solutions might have for their business. There is also a very weak demand for innovative IT solutions and e-commerce services in trade business and tourism which is partly linked to lack of proper products being offered but also to the prevalent cash based culture. A lack of comprehensive financial consumer protection regulation and its proper implementation contributes to the status quo of mistrust some MSMEs exhibit towards formal financial services.

Supervision and enforcement of financial consumer protection rules should be enhanced, and there is no measure in the legal framework directly limiting informal lending. The financial consumer protection framework is based on three regulations which focus almost solely on disclosure and transparency.[78] There is a lack of guidance to the supervised entities on how to set-up complaints handling systems, and a lack of clarity about potential alternative dispute resolution channels in case of unsatisfactory resolution of the consumer complaint. The financial consumer protection framework does not apply to MSMEs, or at least to micro enterprises which would face same issues with imbalance of power and lack of financial acumen as individual consumers. There is also a lack of rules and guidance on fair treatment of consumers that would encompass rules on, for example, sales tactics, affordability and suitability of products for consumers, and collection practices. Further, no rules prevent or limit the widespread practice of informal lending.

Recommendation

Prudential regulation requirements for non-deposit taking financial services providers should be relaxed, and the focus should shift instead to AML/CFT, fit and proper management, and financial consumer protection. It is important to regulate non-deposit taking institutions from a consumer protection, fit and proper management, and AML/CFT perspective, but as these institutions are not allowed to take deposits from the public their prudential regulation and supervision may be less justified. It is recommended that BoA reviews the necessity of regulating non-deposit taking institutions with strict capital adequacy requirements. Instead the maintenance of minimum capital necessary for sound operations should be emphasized and regular reporting required on exposures per sector and type of client to enable efficient monitoring. Further, the Authorities should try to identify solutions that provide opportunities for non-deposit taking credit institutions to secure funding and thereby expand their lending capacities.

MSME lenders should be supported to help improve MSMEs financial knowledge and capacity. The authorities will need to work with MSME lenders to provide them with adequate training and educational material which can be used to train their clients during so called teachable moments (for instance when clients approach them to ask for a financial service). Albanian MSME lenders understand the value of providing such support to their clients and many of them have, on an ad-hoc basis, invested some efforts into educating them. These private initiatives should be supported through an organized approach at the systemic level and leveraged by meaningful support.

The financial consumer protection framework should be enhanced and expanded to cover micro enterprises. The system already provides for rules on disclosure and transparency, but rules on fair treatment of consumers (including financial advice and product suitability) should also be adopted. Guidelines for financial institutions on how to set-up their complaints handling function should be developed. Finally, since unregulated informal lending is high and costly for MSMEs, a study on how to adequately prevent and regulate this sector from a consumer protection perspective should be conducted and a set of concrete measures developed and implemented.

[78] Bank of Albania, Decision No. 60, Dated 29.08.2008, *On the Approval of the Regulation For the Minimum Requirements of Disclosing Information from Banks and Foreign Bank Branches*; Bank of Albania, Decision No. 48, Dated 1.7.2015 *Approval of Regulation On Consumer Credit and Mortgage Credit*; and Bank of Albania, Decision No.59, Dated 29.08.2008 *Approval of Regulation On Transparency for Banking and Financial Products and Services*.