Final Report:

Fostering Private Sector Development:

Assessing Business Constrains and

The Impact of Informal Activity

To Service Sector

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This study is based on the hypothesis that private sector development is a prerequisite for creating conditions that lead to poverty reduction and conflict prevention. In this ground, good interventions are required to create sound macro-economic conditions, as well as institutional and legal framework capable to support economic development. But effective policies can be designed only if a thorough knowledge about present business situation, constrains and other general factors limiting particularly small businesses to grow exist. The best way to achieve such an objective is through a process of monitoring and surveying businesses in the field.

This study aims to fill the gap of information regarding present development in the service sector, particularly in the retail and wholesale trade sectors, as well as in the financial sector. In doing that, it utilized all available information published by Institute of Statistics and business surveys conducted by CRD in the frame of this project.

The analysis of various factors that limit businesses in trade and financial services is based on direct interviews conducted in the main urban centres in Albania, including Tirana, Durrës, Vlorë, Shkodër, Elbasan and Fieri. Both, statistical and business survey information is presented within a set of indicators, which are estimated on a methodology developed by OECD and European Commission in the frame of EU harmonised programme.

The outcome of this study will be of significant use, not only for information provided on development within service sector, but also as a methodological tool for further research in other sectors of economy. We hope that the study will serve the needs of public institutions, especially Bank of Albania, Ministry of Finance, Ministry of Economy, other research centres and universities, as well as business associations.

The main conclusions drawn during the analysis of individual and composite indicators are as follows:

Ø After a substantial increase of turnover in 1998, retail trade has been gradually decreasing during the 1999-2000 period. Kosovo crisis in 1999 has contributed in increasing wholesale trade activity.

Ø Over the period 1998-2000, number of people employed in wholesale trade companies, as well as number of enterprises in this sector, has been gradually decreasing, indicating that in the wholesale trade sector there are signs of concentration of this activity in fewer firms.

Ø Analysis of investments for the period 1997-2000 indicates two characteristics of the trade sector: large fluctuation and secondly, a relatively small level of investment in trade sector. Moreover, the decreasing investment over year 2000 indicates that entrepreneurs in trade sector lack confidence in the future of their business activity.

Ø Indicators of labour productivity and share of labour force in value added indicate that during in the period 1997-2000 labour has been more effectively used in the retail trade sector. For the wholesale sector, the reduction of employment has been the main factor that contributed to the increase of labour productivity.

Ø By the end of year 2000, firms in retail trade are becoming almost unprofitable, while in the wholesale trade sector they are still profitable mainly because of employees becoming redundant.

Ø For the first 6-months of 2003, business confidence in trade sector is pessimistic. Much more difficult is the situation in the retail trade sector where, for three consecutive quarters, business surveys reveal negative business confidence indicators, decreasing sales & order books and slightly increasing stocks. Some hope for recovery is seen in the wholesale trade activity, where expectation for sales and order books are increasing.

Ø Survey results reveal that there exist no signs of increase in consumer prices. On the contrary, there are signs of deflation.

Ø Financial situation in the trade sector reflects the general business conditions. It is deteriorating as regards the retail trade firms and improving for the wholesale ones.

Ø Competition among licensed trade agents is very high, especially in the wholesale trade. On the contrary, competition faced by unlicensed agents does not have any significant impact on trade activity. This is more evident in the wholesale trade sector.

Ø Low costumer demand is the new obstacle for the retail trade to grow. The wholesale sector is searching ways to reduce financial costs due to high credit interest rate, whereas labour cost is the most important problem in the retail trade.

Ø In 2003, business situation in the financial sector seems to be very positive. This situation is mainly attributed to the increasing demand for financial services. Employment in the financial sector is thought to have decreased due to the restructuring measures taken by The Savings Bank.

Ø Prices of banking services are thought to have been decreased. This is attributed to competition among various commercial banks. Results of the survey conducted in April indicate that increasing competition has also narrowed the gap between deposits and credit interest rates, which is a indicator of increasing efficiency on behalf of the banking industry in Albania.

Ø Survey results show that the pressure by unlicensed financial agents is reduced.

Ø Non-performing loans are likely to have been diminished in the recent past, which indicates further strengthening of banking sector.

Ø Operating in a very good business climate, commercial banks are increasing their investment for modernizing their services and providing their clients with better services. Investments are mainly on IT and expanding office space.

Ø The most important factor that limits credit activity is inability of private firms to present feasible requests for credit. The second limiting factor seems to be credit rationing imposed by Central Bank.

Ø Banks have to modernise their business activity to meet the increasing demand for financial services, especially for payment transactions, which along with unfair competition by unlicensed agents, comprise the most important factors that limit payment transaction to grow.

Ø Banks have very few constrains on investments.

Recommendations are:

v Stimulate consumer demand.

v Reduce credit costs to businesses by:

- o further diminishing interest rates
- o narrowing the interest rates range

v Stimulate competition, especially in the wholesale trade sector.

v Find ways to fight informal activities, especially in payment services (including foreign exchange).

v Train entrepreneurs in presentation of good business plans that stimulate credit activity.

Chapter I

THE OBJECTIVES AND METHODOLOGY

1.1 Scope of Study

This study is carried out according to the project-proposal on "Fostering Private Sector Development: Assessing Business Constrains and Impact of Informal Activity to Service Sector". The study was designed to assess business development and constrains facing firms in service sector and particularly those which exercise trade (both retail and wholesale) and financial service activities.

Trade and financial services are very important activities within the service sector. Trade service links consumers and producers and transmits important signals to all actors of economy. Contribution of financial services to GDP is relatively small. However, this is a very important sector for the economy for promoting the best businesses to grow and facilitating business transactions between firms by increasing security and reducing transaction costs. Nevertheless, firms operating in both activities face a broad range of constrains, which could be grouped into two main categories:

a) Administrative barriers (or external);

b) Market type barriers (internal), including shortages in raw materials, labour force (skilled ones) and unfair competition by subjects operating in the informal markets.

Assessment of business development in the service sector and the analysis of limiting factors are made through the following different steps:

1) Identification of business indicators that will help to evaluate business development in trade and financial services.
2) Drafting of questionnaires for collecting the managers/owners' opinion on their business situation and future expectations.
3) Processing and analysis of statistical and business survey data.
4) Preparation of conclusions and recommendations based on the assessment of data and preparation of final report.

1.2 Methodology and Definitions

1.2.1 Statistical Indicators

Preparation of this report is based on two types of indicators, i.e. statistical data provided by INSTAT and business survey data provided by CRD. Statistical data are published in the frame of "General Results on the Annual Structural Survey of Economic Enterprises, Years 1997-2000". Results for the year 2001 were not available at the time this study was accomplished.

A number of statistical indicators are available for assessing trade business development. For trade activity, this report makes use of the yearly change of following indicators:

1. ***Turnover*** includes the amounts invoiced by enterprises during the study period and corresponds to the market sales of benefits and services offered by third parties. This indicator shows overall enterprise activity.

2. ***Value Added*** is the contribution of a producer to GNP and is defined as the difference between sales and purchases of goods from other producers. This indicator is similar to turnover, but differs in its exclusion of indirect taxation and the price of materials used. Value Added is an important indicator in evaluating business performance or enterprise productivity.

3. ***Number of Enterprises*** represents the number of retail and wholesale trade firms on the basis of which the value of the other indicators is estimated.

4. ***Annual Average Number of Employees*** represents the annual average number of occupied persons employed by the total number of retail and wholesale trade enterprises.

5. ***Investment*** represents the value of long-term goods purchased or produced by an enterprise for use in the production process within a period of not less than one year, including the land. This is an indicator of business stability and future prosperity, as investments are made if managers feel that the business will be expanded.

6. ***Labour Productivity*** is measured as Value Added per employed person.

7. ***Share of Labour Cost to Value Added*** is measured for retail and wholesale trade firms as a percentage of labour cost estimated by CRD per value added.

8. ***Enterprise Profitability*** is defined here in terms of difference between Value Added and Labour Costs, adjusted for the wage of the self-employed, as a percentage of Value Added.

1.2.2 Business Survey Indicators

Business survey indicators are qualitative indicators which are generated by means of a standard business survey. These indicators are used for: (1) complementing statistical information at a time when statistical data is not available (for instance, at present and during the last three months of development); (2) short-term economic forecasting analysis (3 to 6 months); (3) identification of major constraints and the impact of various policies on businesses; and (4) cyclical business analysis.

Business surveys are a method of gathering information from a number of units or individuals that form a sample, in order to draw meaningful conclusions about the groups from which samples have been drawn. They differ from statistical surveys in one important aspect, namely the nature of the information gathered. More precisely, a business survey is designed to deal with judgments, estimates and expectations of economic agents, i.e. managers of firms. Surveyors (original participants) also provide information, not only about their intentions, but also about their perception of factors affecting those intentions. Government agencies, research organizations, international bodies, universities and the general public make use of the results.

Each survey consists of a series of multiple-choice questions, usually: increased, unchanged, and decreased. Questions are either put through a written questionnaire or orally.

Subsequently, 'balances' are calculated, i.e. the differences between the percentages of positive and negative answers.

The results are very important and can be used either as indicators of business short-term economic development, or in forecasting in conjunction with quantitative statistics.

In establishing a business tendency survey, the core element is the question-programme. All questions collect information regarding the situation of the respondent's enterprise and not the situation of the branch or the whole economy. The questions differ considerably from questions of a quantitative survey.

§ <u>Past development</u>: These questions focus on the development of the recent past and do not have to give information about the level of a variable activity, but only the direction of change.

§ <u>Judgment</u>: This information is subjective, taking into consideration the past and expected future development. Judgments have the character of level of information and give information regarding the current situation on the topic asked. These questions go in the business cycle.

§ <u>Expectation and plans</u>: Expectations are prediction by firms on the development of economic indicator asked. The evolution is determined by external factors. Plans are based on internal information, being thus more reliable than expectations.

Indicators for Retail and Wholesale Trade

Retail and wholesale trade business situation is surveyed by questionnaires that are designed with three groups of questions:

1. <u>Business situation compared to present</u>
   a) Assessment of the *business (sales) situation* is defined as the arithmetic mean of the answers given to questions in this area;
   b) Assessment of the *present volume of stock* is defined as the Balance of the answers given to questions in this area;
   c) Evolution of *orders placed with suppliers* expected in the coming three months is defined as the Balance of the answers given to questions in this area;
   d) Evolution of *business activity (sales) expected* in the next three months is defined as the Balance of the answers given to questions in this area;
   e) Evolution of *total employment expected* in the coming three months is defined as the Balance of the answers given to questions in this area;
   f) Assessment of the *selling prices situation* is defined as the Balance of the answers given to questions in this area;
2. <u>Actual level of endogenous variables in relation to what is considered normal.</u>
   a) Evolution of *selling prices expected* in the coming three months is defined as the Balance of the answers given to questions in this area;
   b) Evolution of *financial situation* compared to last quarter is defined as the Balance of the answers given to questions in this area;
   c) Evolution of *sales compared to same period of the previous year* is defined as the Balance of the answers given to questions in this area;
   d) Evolution of *sales compared to last quarter* is defined as the Balance of the answers given to questions in this area;
   e) Evolution of *stock compared to last quarter* is defined as the Balance of the answers given to questions in this area;

f) Evolution of *storage free space* compared to last quarter is defined as the Balance of the answers given to questions in this area.

3. <u>Actual level of exogenous variables in relation to what is considered normal.</u>
   a) Evolution of *competition compared to the last quarter is* defined as the Balance of the answers given to questions in this area for licensed and unlicensed activities;
   b) *Limiting factors to improve the present business (sales) situation* is calculated as percentage of the answers to questions related to 10 factors limiting the activity of enterprises in the business environment.

Financial Market Indicators

   Financial services are surveyed by a questionnaire that contains four groups of questions. These questions are different from retail and wholesale questionnaires, because businesses are also quite different:

1. <u>Business situation compared to present</u>
   a) Assessment of the *business situation* is defined as the Balance of the answers given to questions in this area;
   b) Evolution of *demand (turnover) for services in recent* three months is defined as the Balance of the answers given to questions in this area;
   c) Evolution of *demand for services (turnover) expected* in the coming three months is defined as the Balance of the answers given to questions in this area;
   d) Evolution of *total employment in recent* three months is defined as the Balance of the answers given to questions in this area;
   e) Evolution of *total employment expected* in the coming three months is defined as the Balance of the answers given to questions in this area.

2. <u>Actual level of endogenous variables in relation to what is considered normal</u>.
   a) Evolution of *service price expected* in the coming three months is defined as the Balance of the answers given to questions in this area;
   b) Evolution of *differences on average rates between lending and borrowing in the recent* three months is defined as the Balance of the answers given to questions in this area;
   c) Evolution of *differences on average rates between lending and borrowing expected* in the coming three months is defined as the Balance of the answers given to questions in this area;
   d) Evolution on *average commissions / fees / premiums in the recent* three months is defined as the Balance of the answers given to questions in this area;
   e) Evolution on *average commissions / fees / premiums expected* in the coming three months is defined as the Balance of the answers given to questions in this area;
   f) Evolution of *non-performing loans in the recent* three months is defined as the arithmetic mean of the answers given to questions in this area;
   g) Evolution of *non-performing loans expected* in the coming three months is defined as the Balance of the answers given to questions in this area.

3. <u>Business constraints.</u>
   a) Evolution of *competition by licensed and unlicensed agents* is defined as the Balance of the answers given to questions in this area;
   b) *Limiting factors to credit production sector expected* in the next three months is calculated as percentage of the answers to questions related to 14 factors limiting the activity of enterprises in the business environment.
   c) *Limiting factors to payment services expected* in the next three months is calculated as percentage of the answers to questions related to 10 factors limiting the activity of enterprises in the business environment.

4. <u>The capital investment planed for this year</u>.
   a) Evolution of *increase of capital investment compared to last year* is defined as Balance of answers given to questions in three areas: (a) Buildings, (b) Vehicles, Plants & Machinery, (c) Computer Technology;
   b) *Limiting factors to capital investment this year* is defined as the arithmetic mean of the answers to questions related to 6 factors limiting the activity of enterprises in the business environment.

CHAPTER II

DEVELOPMENT IN TRADE SECTOR

2.1 Retail and Wholesale Trade Development during 1997-2000

The analysis of trade development in the period1997-2000 will be based on a set of indicators estimated on the basis of statistical information provided by INSTAT. First, changes of trade volume will be assessed and then the analysis will continue with other indicators, such as number of employees and that of enterprises. The analysis will continue with estimated indicators such as labour productivity and profitability, which will give an indication of efficient changes within trade sector.

2.1.1 Turnover

Turnover is one of the main indicators that show total volume of retail and wholesale trade sales. Figure 1 shows the percentage of turnover yearly changes from 1997 to 2000. As it can be distinguished, in 1998 turnover indicator shows that both retail and wholesale trade has emerged from the very low levels of trade activity in 1997. The bigger impact can be distinguished on retail trade. Contrasted with 1997, in 1998 the turnover is increased by 102%, while the wholesale trade is by 38%.

Figure 1: Turnover; Yearly change (1997-2000)
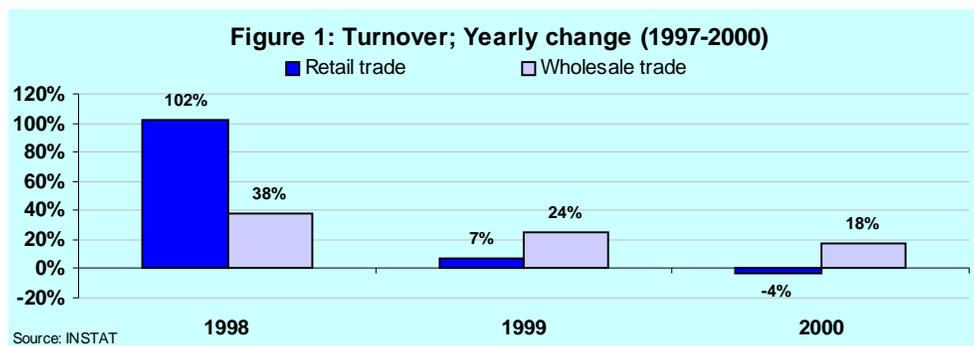
In 1999, turnover in the retail trade sector is increased by only 7%, while the other trade activity (wholesale) maintains its levels and the increase is much higher or 24%. The same situation is noticed in 2000, when turnover in wholesale trade is increase by another 18%. Contrary to that, in 2000 the retail trade has diminished and that is indicated by a 4% negative turnover indicator.

2.1.2 Value Added

Value added is another indicator that shows changes in volume of trade sector. It changes from turnover due to certain different qualities. Value added represents not the total value of sales, but only the additional value of goods, which have been added in this sector (mainly cost of labour and profit), so it excludes the effects of taxes and the cost of inputs.

Figure 2: Value Added; Yearly change (1997-2000)

■ Retail trade □ Wholesale trade

Source: INSTAT
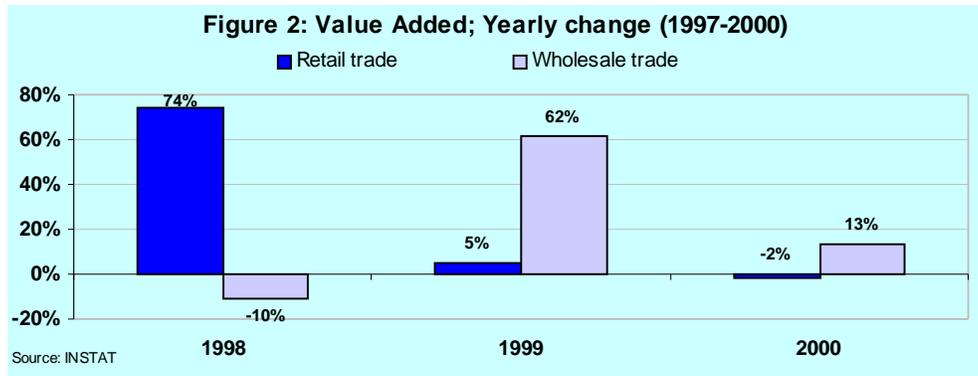
Figure 2 shows that, over the period 1998-2000, value added in retail trade activity has the same growth rate pattern as turnover (see Figure 1). It grew by 74% in 1998, 5% in 1999 and decreased by 2% in 2000. Instead, value added indicator for the wholesale sector has a different growth path in comparison with turnover. As contrasted to 1997, in 1998, value added in wholesale sector has decreased by 10%, while in 1999 increased by 62%, which is about 3 times higher than turnover indicator, which increased by 13% in 2000.

Such figures indicate that in 1998 business in wholesale sector continued to face difficulties and have produced negative value added, which in 1999 has increased quite substantially. Such differences could be attributed to the situation in 1999 (Kosovo crisis), which has stimulated growth of wholesale sector much more than retail trade and increased the revenue.

Conclusion: Turnover and value added indicators show that over the years 1997-2000 retail trade, but for a substantial increase in 1998 (due to very low levels of trade in 1997), shows decreasing signs in 2000. Wholesale trade activity has particularly increased in 1999.

2.1.3 Number of Employees

Figure 3 shows that, in the period 1998 – 1999, number of employment in both trade activities has increased respectively by 22 or 14% in retail trade and by 17 or 12% in wholesale trade sector. In 2000, labour force in both sectors has decreased respectively by 8% in retail trade and 18% in the wholesale trade sector.

Figure 3: Number of Employees; Yearly change (1997-2000)

■ Retail trade □ Wholesale trade

Source: INSTAT

2.1.4 Number of Enterprises

Change in number of enterprises (together with number of employees) in trade sector indicates the initial response of supply side (producers) to demand side of economy (consumer side). Hence, basic development in trade sector is mainly caused by changes in consumer behaviour. They tend to spend more on consumable goods.

Figure 4 shows that in 1998 and especially in 1999 the number of firms in retail trade sector has constantly increased, respectively by 11 and 22%. Companies in wholesale sector, after experiencing an initial increase by about 30% in 1998, have moderately increased by 2% in 1999. In 2000, the number of enterprises in both sectors of trade has decreased, but decrease is much more obvious in wholesale sector: 10% as compared to 7% in retail sector.

Figure 4: Number of Enterprises; Yearly change (1997-2000)

Conclusion: Indicators of number of employees and number of enterprises confirm that in 2000 we have a decrease in trade activity, which can be attributed to the diminishing demand for consumer goods. Moreover, it is indicated that during this same year, the number of people employed in wholesale companies and the number of enterprises in this sector have decreased much more than in the retail trade sector. This indicates that the wholesale trade sector bears signs of concentration of activity in fewer firms.

2.1.5 Investment

Investment is an important indicator of the wealth of business activity and especially its sustainability for future growth.

Figure 5: Investment; Yearly change (1997-2000)

Figure 5 indicates yearly changes of investment over the period 1997-2000. Relative figures indicated also in the Figure show large fluctuation in investment levels, as well as tremendous ups and downs (this is shown in 1999, where investments in whole trade sector have been

increased by 638% in comparison with 1998). Both these indications show that the level of investments in both trade activities is relatively small in absolute figures.

Figure 5 also indicates that in 2000 firms in trade sectors have spent less money on investments; they diminished investment respectively by 49% in retail trade and 87% in wholesale trade sector.

Conclusion: Changes in investments show large fluctuation of investment during the period 1997-2000, as well as the fact that level of investment in trade sector is relatively small. The decreasing investment over year 2000 indicates that business in trade sector is not confident for the future, as demand for consumable goods is expected to be reduced in the coming years.

2.1.6 Labour Productivity

Labour productivity is estimated as value added per occupied persons and shows contribution of labour force in creation of value added.

Figure 6: Labour Productivity; Yearly change (1997-2000)

Figure 6 indicates that in 1998 labour productivity for retail trade firms grew by 43%, For the same period, labour productivity for wholesale firms diminished by 23%, because the increasing figure of employment was not followed by increase of value added (see Figures 2 and 3). In 1999, labour productivity of retail trade firms has been decreased by 8%, while for the wholesale firms this figure is increased by 45%. This is consistent with other indicators, which have shown that value added in the wholesale sector has increased. Labour productivity has also increased in 2000, respectively by 6% and 39%, which can be attributed mainly to the reduction of labour force in the wholesale trade sector.

2.1.7 Share of Labour Cost to Value Added

Share of labour cost to value added is an indicator, which together with labour productivity, indicates enterprise efficiency.

Figure 7 shows that in 1998, the share of labour cost to value added has decreased by 43%, indicating that increase of labour productivity has been the main factor that has contributed to increase of value added in retail trade sector during this year. Instead, in wholesale sector, the share of labour cost to value added has increased by 19%, which indicates decreasing efficiency in the use of labour force by this sector. In 1999, the increasing number of employees in the retail sector has not been followed by increase of value added, which has influenced in the increase of share of labour cost to value added by about

7%. In 2000, this indicator shows a decrease by 22%, which is explained by decrease in number of employees in this sector and increase of labour productivity in retail trade sector.

Figure 7: Share of Labour Cost to Value Added; Yearly change (1997-2000)

In 1999 and 2000, the share of labour cost to value added in wholesale trade sector has decreased by 13 and 29%, which could be explained by decrease of employment in the sector, especially during 2000.

Conclusion: Indicators of labour productivity and share of labour force to value added denote that in the period 1997-2000, labour has been more effectively used in retail trade sector. In the wholesale sector, reduction of employment has been the main factor of increase in labour productivity.

2.1.8 Profitability

In 1998, as contrasted to 1997, firms in the retail trade sector have increased their profitability by 86%. Instead, the wholesale firms show a negative growth in profitability by –13% (see Figure 8). In 1999 and 2000, profitability of retail trade firms has been almost unchanged, while the profitability of wholesale trade firms has increased by 66% and 19%. Such development could be explained by the fact that in 1999 firms in the wholesale sector have largely profited by Kosovo crisis and they manage to increase profitability in year 2000 also because of cut of costs especially in labour force.

Figure 8: Profiatability; Yearly change (1997-2000)
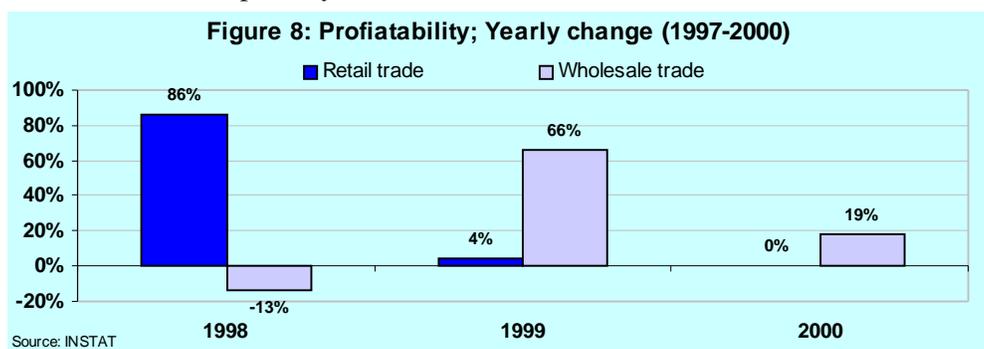
*Conclusion***:** By the end of 2000, firms in retail trade are almost unprofitable, while in the wholesale trade sector firm are still profitable because of reduction of number of employees. These firms have large profited by Kosovo crisis.

CHAPTER III
## RECENT DEVELOPMENT IN TRADE SECTOR

3.1 Business Climate in Trade Sector

Business climate is a composite indicator which shows the confidence of the entrepreneurs for business in the near future (normally, next 3-6 months). If this indicator is positive, it indicates that in overall business activity in the future will most likely be increased. On the contrary, if negative, it indicates that business is slowing down.

Figure 9 indicates values of business confidence indicator for retail trade in three consecutive surveys conducted by CRD. During all three periods, December 2002, March 2003 and June 2003, business confidence is negative respectively 29, 29 and 16%. Such figures indicate that entrepreneurs in retail trade are pessimistic about their business activity, which proves that retail trade in the first 6 months of the 2003 have been going down.

Figure 9: **Confidence Indicator for Retail Trade**

Source: CRD

Figure 10: **Confidence Indicator for Wholesale Trade**

Source: CRD
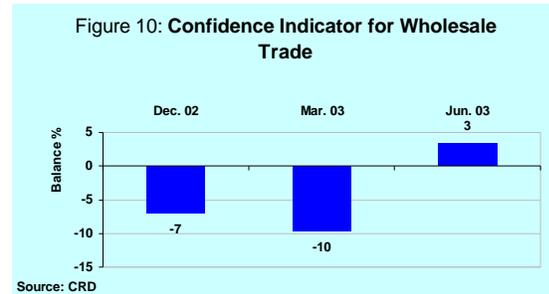
Business climate is rather different for the wholesale sector. In June 2003, results of the survey reveal that we might have a turning point in business for this sector. Figure 10 shows that business confidence is positive for 3 points, which comprises an improvement of 13 points compared with three months ago. Nevertheless, these results do not provide a strong evidence of improvement of business climate in the wholesale sector, because a lot of entrepreneurs think that their business situation is either unchanged or going down.

***Conclusion*:** Business climate in trade sector is not good. Much more difficult is the situation for retail trade sector, where for three consecutive quarter we have a negative business confidence indicator. Some hope for improvement can be seen in the wholesale trade activity.

3.2 Sales

Figure 11 shows the assessment of sales in the last three months for both retail and wholesale trade activity. As it can be distinguished, the balance of answers in percentage for both activities is negative in both sectors. The most difficult period seems to be the first quarter of 2003, because more than 79% of retail trade managers and more than 50% of managers of wholesale trade firms have declared that they have decreasing sales in the first quarter of the year.

Figure 11: Assessment of Sales for Retail Sale and Wholesale Trade

■ Retail Trade □ Wholesale Trade

Balance in %

	Dec. 02	Mar. 03	Jun. 03
Retail Trade	-46	-79	-44,9
Wholesale Trade	-18	-50	2,2

Source: CRD

Figure 11 shows also that situation is improved only for the wholesale sector, when in June 2003 the balance of answers is only negative by 2% (an improvement by 48 points in comparison with the results of the survey conducted in March 2003).

Figure 12 shows the balance of answers regarding sales expectation for the next 3 months in both retail and wholesale sector. In general, managers and owners of firms have been optimistic about increase of sales in the coming 3 months. This is more evident for the wholesale sector, where we have always positive balance of answers, respectively 11 points in December 2002, 43 points in March 2003 and 30 points in June 2003. For retail trade, the balance of answers is positive by 4 points in June 2003.

Figure 12: Expectation of Sales for Retail and Wholesale Trade

■ Retail Trade □ Wholesale Trade

Balance in %

	Dec. 02	Mar. 03	Jun. 03
Retail Trade	-33	-4	4
Wholesale Trade	11	43	30

Source: CRD

3.3 Stocks

Figure 13 shows the balance of answers regarding changes in stocks for the last quarter. From the Figure, it can be distinguished that stocks are increasing both in retail and wholesale trade sectors. However, the balance of answers for the wholesale sector is much higher than in retail, meaning the stocks are increasing much faster in this sector. In June 2003, the balance of answers for stock is 8% in retail and 18 % in wholesale trade sector.

Figure 13: Assessment of Stocks for Retail and Wholesale Trade

■ Retail Trade □ Wholesale Trade

Balance in %

	Dec. 02	Mar. 03	Jun. 03
Retail Trade	9	5	8,1
Wholesale Trade	14	22	18

Source: CRD

3.4 Order books expectations

Respondents in retail trade sector think that they will make fewer orders in the coming three months (Figure 14). The balance of answers for this question has been negative for 17 points in December 2002, 12 points in March 2003 and about 22 points in June 2003. Respondents belonging to the wholesale sector in general think that they will increase order books for the coming three months. In June 2003 the balance of answers was positive for 11 points.

Figure 14: Order-books Expectations for Retail and Wholesale trade

■ Retail Trade □ Wholesale Trade

Balance in %

Dec. 02: -17, 2
Mar. 03: -12, 22
Jun. 03: -22,3, 11

Source: CRD
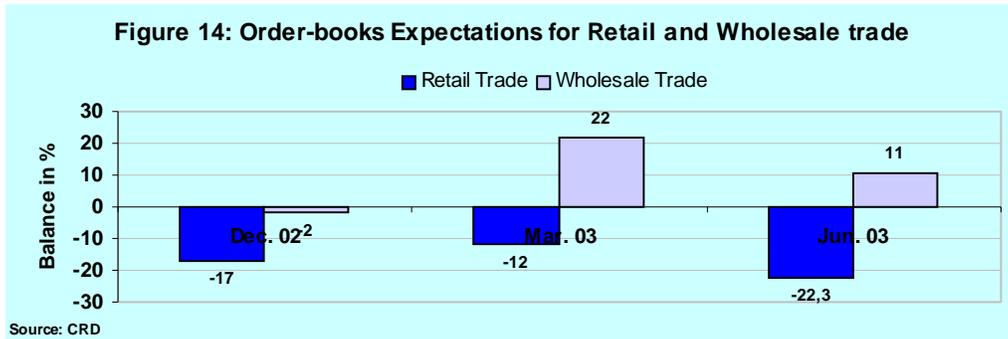
Conclusion: All indicators show that during the first 6-months of 2003, retail trade has diminished. This is reflected by decrease of sales, order books and slight increase of stocks. It seems that situation is much better in the whole trade sector since the majority of respondents expect sales and order books to increase.

3.5 Employment Expectations

The majority of respondents in both sectors think that employment will be unchanged. This is more evident in the wholesale sector where even balance of answers for the last two surveys is almost zero. Figure 15 shows also that in the last six months most probably employment in retail trade has been decreasing since the balance of answers is negative all three surveys (respectively 14 points in December 2002, 13 points in March 2003 and 11.5 points in June 2003).

Figure 15: Employment Expectations for Retail and Wholesale Trade

■ Retail Trade □ Wholesale Trade

Balance in %

Dec. 02: -14, 11
Mar. 03: -13, 2
Jun. 03: -11,5, 0

Source: CRD

3.6 Prices

Figure 16 provides important information with regard to prices. This Figure shows that the biggest pressure on consumer prices is experienced in the first quarter of 2003, as the balance of answers for both sectors is positive (respectively 9 points for retail trade and 27 points for wholesale trade sectors). In March 2003, the majority of respondents in the wholesale trade sector thought that they would decrease prices (the balance of answers is negative for 13 points, i.e. a change of 40 points compared with December 2002). It seems that this situation is reflected by the retail trade sector, because the June survey indicates a negative balance of answers by 4,4 points.

Figure 16: Selling Prices Expectations for Retail and Wholesale Trade

Source: CRD

Conclusion: Recent survey results reveal that there exist no incentives to increase consumer prices. Employment is expected to be slightly decreased in the retail trade sector.

3.7 Financial Situation

Figure 17 indicates the results of June survey for the question regarding assessment of financial situation. As expected, in the overall, the financial situation for retail trade firms is thought to have been deteriorated. This is because 47 % of responses indicate deterioration of their financial situation for the last three months, against 20% who think that their financial situation is improved (31 % think they have unchanged financial situation).

Figure 17: Assessment of Financial Situation for Retail and Wholesale Trade

Source: CRD

For the wholesale trade firms, financial situation seems to have improved in the last three months. The balance of answers is positive for 10 points.

Conclusion: Financial situation in trade sector reflects the general business conditions. It has deteriorated for retail trade firms and it is improving for wholesale trade firms.

3.8 Competition

Retail trade is based on micro and small business environment. Consequently, competition in trade is high. In the case when demand for consumer goods is diminishing, consumer prices are expected to fall. However, trade activity might face also the consequences of unfair competition, due to certain oligopoly position (especially in the wholesale trade) or by one part of the market working underground or in informality. For this reason, it is important to assess such impact on retail and wholesale trade activity.

Figure 18 shows changes of competitive situation within official market or among licensed business trade agents. Survey results reveal that 52% of respondents think that competition among licensed trade agents has increased and only 5% think that competition has decreased. Only 10 % of respondents didn't answer to this question. For the wholesale activity survey results reveal that most of the respondents (84%) think that competition in the wholesale trade sector has increased.

Figure 18: **Assessment of Competition by Licesing Trade Agents**

Source: CRD

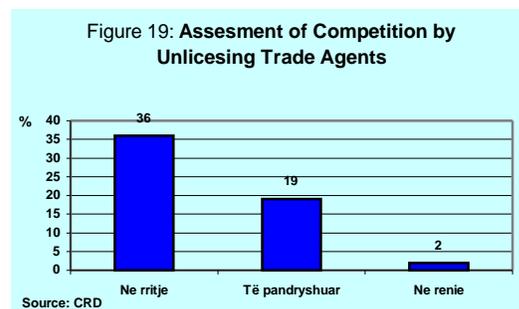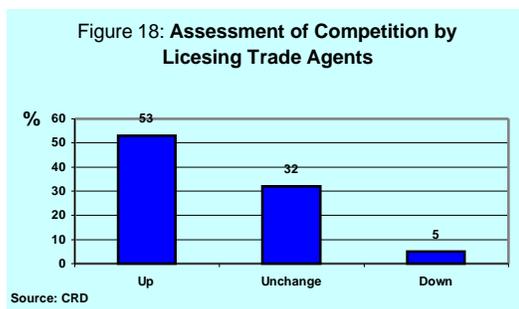Figure 19: **Assesment of Competition by Unlicesing Trade Agents**

Source: CRD

Figure 19 indicates responses to the questions regarding competition by unlicensed trade agents. 57% of respondents within the group of retail trade agents have answered to this question. Out of them, 36% think that competition has increased, 19% that it has not changed and only 2% that it has decreased.

For this question, the respondent rate regarding wholesale trade is very low. Only 36% answered to this question, out of them 25% think that competition is unchanged. The balance of answers has increased/decreased by only 3 points.

s

Conclusion: Competition among licensed trade agents is very high, especially in the wholesale trade. On the contrary, competition faced by unlicensed agents does not have any great impact on trade activity. This is more evident in the wholesale trade sector. From this point of view, we can conclude that the weak demand for consumer goods could be the major obstacle that retail trade us actually facing.

3.9 Factors Limiting Business Activity in Trade Sector

In June 2003, survey results indicated that about **98% of respondents** declared that they **face** various **obstacles in their business activity**. Figure 20 ranks main factors limiting business activity in retail trade. On the top of constrains is **weak consumer demand** mentioned by about 84% of respondents. The second obstacle mentioned by 57% is **competition within the sector**. **High labour cost** is ranked third by 29%.

Figure 20: Factors limiting the improvement of present business situation for Retail Trade
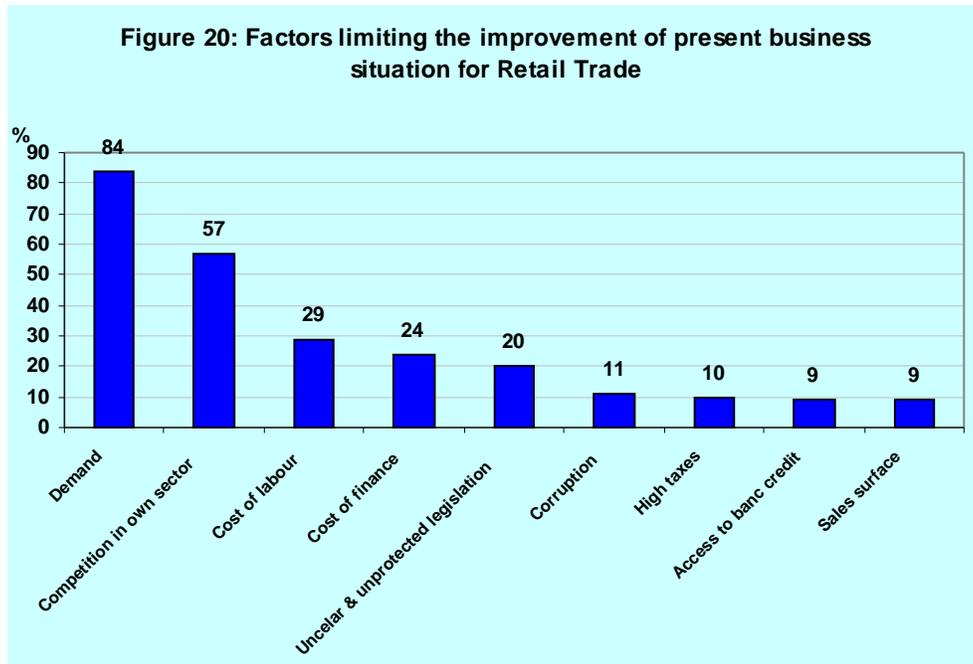
In Figure 20, we can also distinguish that factors such as lack of credit, high taxes or the size of the shop are considered as obstacles to their business activity by about 10% of respondents.

Figure 21 shows factors limiting business activity in wholesale trade. As it can be distinguished, the range of factors is different from retail trade. The main obstacle mentioned by 70% of respondents is **competition within the sector**. The second but very close obstacle (69%) is *very high financial cost* of business activity (from interest rate and so on). **Demand** is mentioned by 41% and **legislation** by 31%.s

Figure 21: Factors limiting the improvement of present business situation for Wholesale Trade
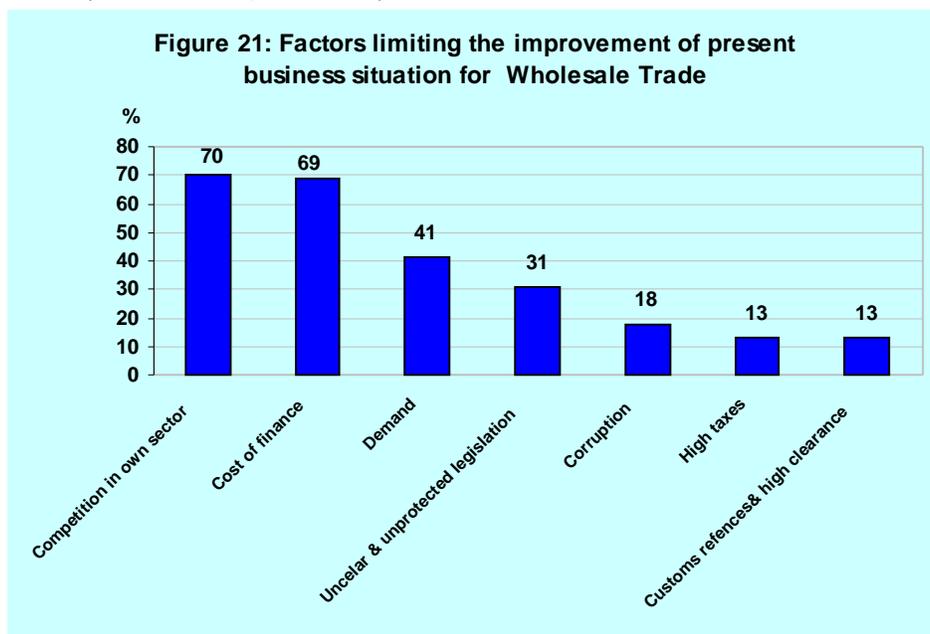
Conclusion: Weak costumer demand is the new obstacle for retail trade to grow. This factor is so significant for wholesale trade, which looks to competition within the sector as the main obstacle to their business activity. The wholesale sector is looking for a way to reduce financial costs due to high credit interest rate, while in retail trade the labour cost is the most crucial element for their business activity.

CHAPTER IV

DEVELOPMENT IN FINANCIAL SECTOR

4.1 Business climate

After a successful testing business survey for financial services on March 2003, another one was conducted in April 2003. The second survey was much more complex and included more questions regarding investments and factors limiting business activity in financial sector. In this chapter, whenever it will be possible, the results of two surveys will be presented together.

The first indicator that assesses business climate is the confidence indicator. Figure 22 shows that, also in April 2003, bank managers are very optimistic about their business activity as composite confidence indicator is 83 %.

Figure 22: **Confidence Indicator for Finacial Services**

Source: CRD

Figure 23: **Employment in the last 3-months in Financial Services**

Source: CRD

4.2 Employment

In the last month, employment in the banking sector seems to have decreased. This can be distinguished in Figure 23, where the balance of answers regarding this question has dropped by 60 points (in March 2003 the balance was positive for 47 points and in April negative for 13 points).

Such changes in employment can be explained by restructuring measures taken by The Savings Bank before it restarts negotiations about transfer of ownership right to a foreign bank. Assessment of employment expectation for next 3 months shows that managers in financial sector will not change their employment.

Conclusion: In general, business situation in the financial sector continues to be very positive. This situation is mainly attributed to the increasing demand for financial services. Employment in financial sector is believed to have decreased due to restructuring measures taken by The Savings Bank.

4.3 Prices

Prices for services provided by commercial banks seem to be under the pressure. This can be distinguished in Figure 24, where the balance of answers for price expectation in the next 3 months is negative. In April, the balance was negative for 25 points; a decrease by 9 points compares with the March survey results.

Figure 24: **Price Expectations for Financial Services**

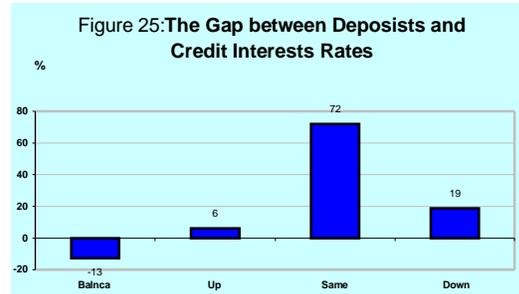Figure 25:**The Gap between Deposists and Credit Interests Rates**

Figure 24 provides information about another important indicator, which is the gap between deposits interest rate and interests charged for commercial credit given to the third parties. This information is important, not only because it informs you about future prices, but it indicates also the banking efficiency. The higher is the gap between two types of interest rates the low is bank efficiency.

Figure 25 indicates that the majority of bankers think (72%) that the spread between deposits and credit interest rates will remain the same. However, by comparing it to other replies (increasing and decreasing) we find that in percentage the balance of these two answers is negative by 13 points, which mean that in the last three months the gap between deposits and interests rate is likely to have been narrowed.

4.4 Competition

Like in other sectors of economy ensuring of competition among different actors is an important condition for future development, because it allows efficient use of resources, promotes innovations, stimulates improvement in the market and keeps long term prices stable.

Figure 26 shows how managers of commercial banks (the survey conducted in April 2003) responded to the question about competition. It reveals that 73% of bankers think that competition between financial institutions has increased and no one thinks that it went down. The respondent rate to this question was very high (96%).

Figure 26: **Competion in Financial Sector**
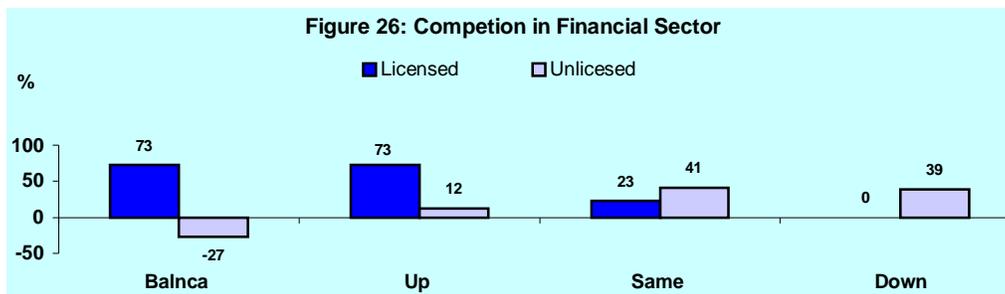
The same question posted for un-licensed financial agents shows a different picture. From Figure 26, it can be distinguished that 39% of bankers think that competition by unlicensed agents went down in the last 3 months, 41 % think that it is the same and only 12% think that it increased. The balance of answers (by – 12%) indicates that pressure of informal market to the financial one has reduced.

Conclusion: Taking into consideration that demand for financial services has increased, we can conclude that increasing competition among commercial bank is one of the factors that is pushing down prices for banking services. Results of April survey indicate that increasing competition has led also to the narrowing of the gap between deposits and credit interest rate,

which is a indicator of increasing efficiency on part of banking industry in Albania. Survey results also show that recently the pressure by un-licensed financial agents has reduced.

4.5 Non-performing Loans

Crediting is one of the most important activities of commercial banks. The success in credit allocation guarantees the wealth of financial system, which is the key to long-term development. Figure 27 indicates responses of bank managers regarding the changes in the portfolio of non-performing loans. The figure indicates that none of the managers think that non-performing loans will be increased, while 42% think that non-performing loans have been diminished in the past three months.

Figure 27: **Non-perfoming Loans**
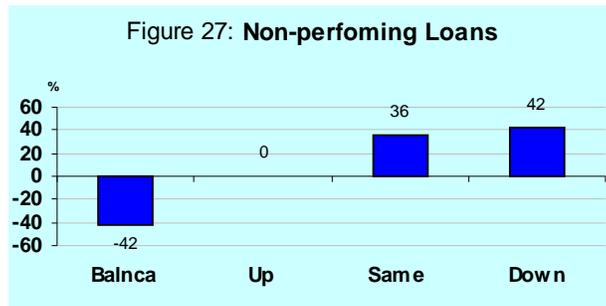
Conclusion: Survey results indicate that non-performing loans has most probably diminished in the recent past, which indicates further strengthening of banking sector.
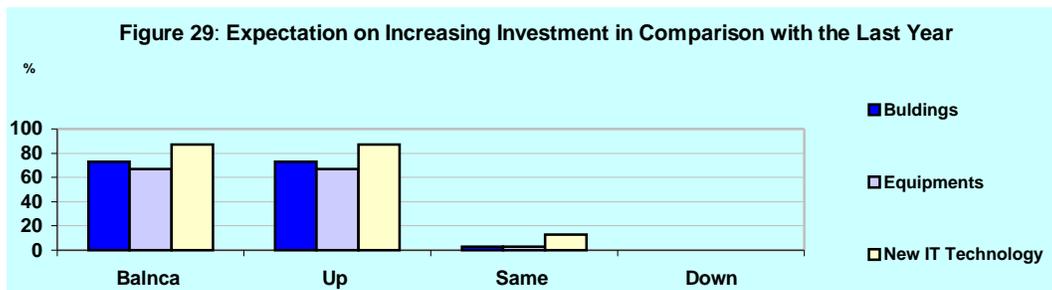
4.6 Investments

Survey results indicate that in the current year (2003), compared with the previous one, **the volume of investment by commercial banks will be increased by about 33 %**. This is an indication that banks are looking forward that demand for financial services will be increased and secondly the appropriate environment for enhancement of their business activity already exists.

Figure 28 provides information for the justification of investments conducted by commercial banks. Figure 28 shows that among 5 directions of investment, 3 are very close to each other, such as increase of capacities mentioned by 50,8 of respondents, increase of new services (49,4%) and finally banks are investing more for increasing efficiency and speed (49,2). From this figure, it can also be distinguished that banks are spending less money for replacement (24,7%) and are increasing the number of clients (22,9%)

Figure 28: Investment Justification
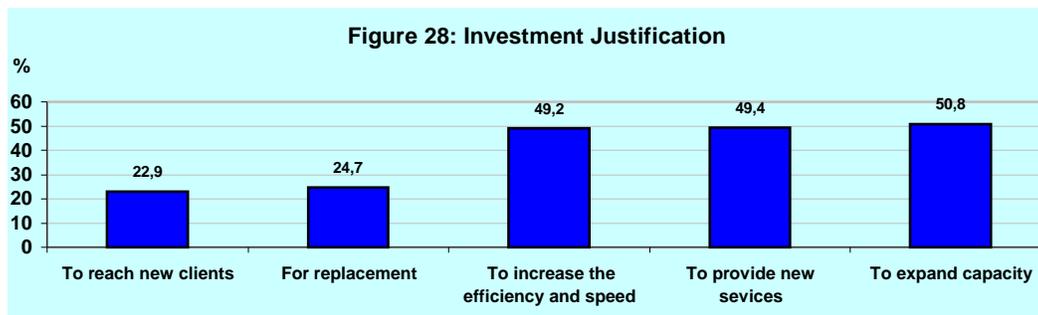
To achieve these objectives, banks are investing mainly on new IT and increase of office space (buildings) and less on equipment (see Figure 29).

Figure 29: Expectation on Increasing Investment in Comparison with the Last Year


Conclusion: Operating in a very good business climate, commercial banks are increasing their investment to modernize their services and provide their clients with better services. Investments are mainly on IT and expansion of office space.

4.7 Constrains

Banks like other businesses might face several constrains, which could harm their prospect for growth and support of the production sectors. For this reason, it is important to assess all factors that might disrupt business activity in financial sector, in order to take the necessary steps for avoiding or/and improving financial services. Constrains will be assessed for the two basic services that are delivered by commercial banks, credits and payments. We will also assess factors limiting future investment by banks.

4.7.1 Constrains on Credits

Figure 30 ranks factors that limit credit activity. As it can be distinguished by this figure, the most significant factor that limits credit activity is application for new credits, which are not financially visible (mentioned by 58% of interviewed bankers). Other less important factors are macroeconomic uncertainties (23%), as well as internal regulation and legislation.

Figure 30: Factors Limting Credit Activity
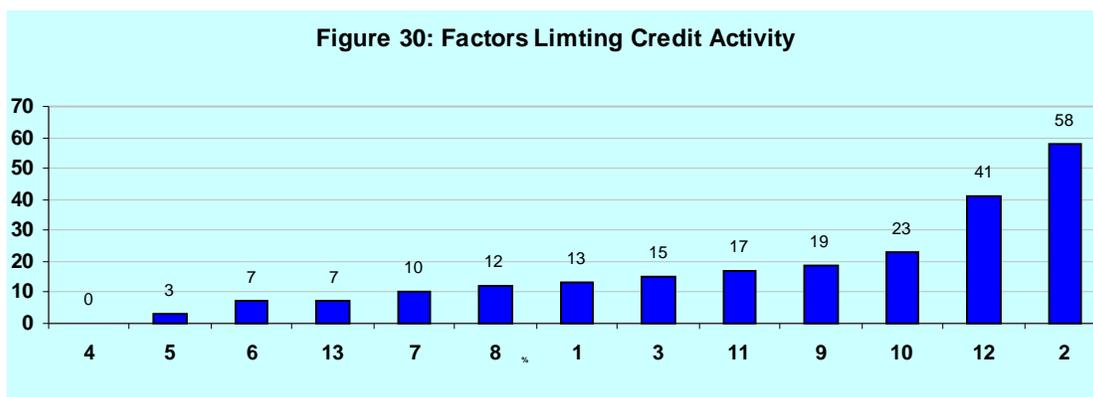
Legend

1. Level of demand for credit
2. No financial visibility for credit applications
3. No sufficient information for the client
4. Lack of financial resources (ability to rise funds)
5. Price of loans
6. Lack of professional staff
7. Unfair competition from the other commercial banks
8. Unfair competition from informal activities
9. Internal regulations
10. Uncertainty of macroeconomic environment
11. Unclear legislation
12. Credit rationing (from Central Bank)
13. Too high cost for credit settlements (non performing loans)

It is important to mention also that factors such as banks liquidity, high credit interest rate, and lack of skilled labour are not considered by interviewed bankers as very important factors that limit expending credit activity in the future.

4.7.2 Limits on Payment Transactions

Figure 31 ranks factors that limit expanding payment transactions in the near future. Survey results reveal that the most important factor limiting payment transaction is lack of inadequate technology to respond to the clients' needs. This factor is mentioned by 41% of respondents. The second important factor that limits payment transactions is the unfair competition by informal activities, which is mentioned by 34% of bankers. Legislation and demand are other less important factors mentioned by bankers.
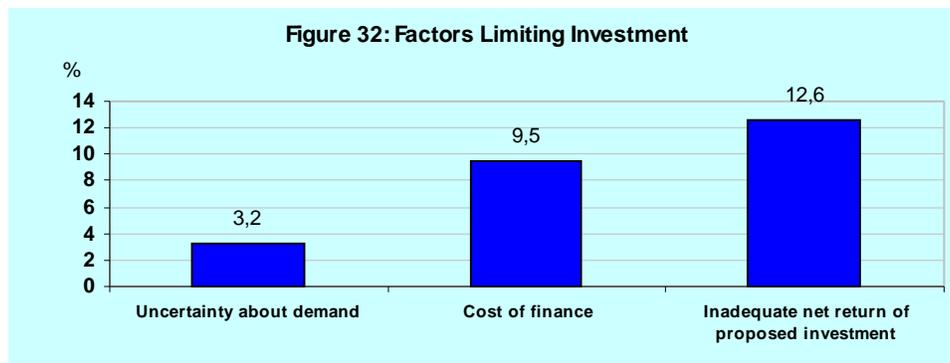
Figure 31: Factors Limiting Payment Transactions

%

0	0	0	6,5	10,1	13	13,4	15,8	33,8	41,5
3	5	8	2	7	1	9	10	6	4
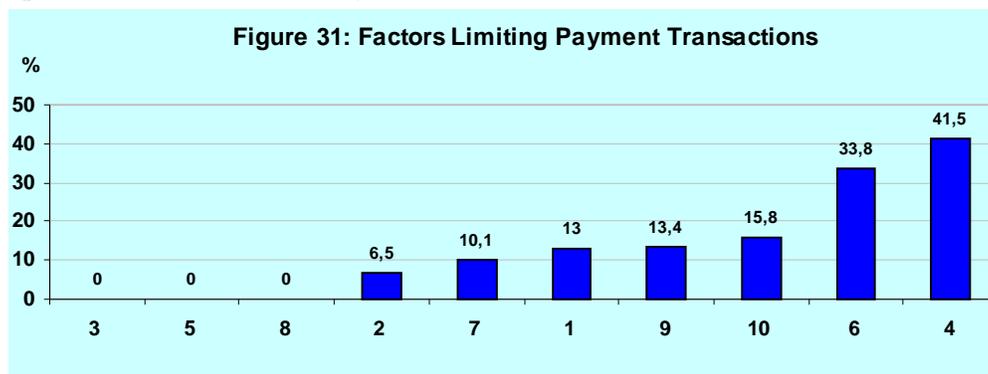
Legend:

1. *Level of demand*
2. *Too high cost for payment transactions*
3. *Lack of professional staff*
4. *Lack of adequate technology for providing required services*
5. *Unfair competition from the other commercial banks*

6. *Unfair competition from informal activities*
7. *Insufficient marketing*
8. *Unclear legislation*
9. *Lack of legislative procedures for banking transactions*
10. *Others, please specify*

4.7.3 Limits on Future Investments

Figure 32 indicates factors that limit investment by commercial banks. It is important to mention that this question has very low respondent rate, meaning that few or no constrains are facing bank regarding investments. Survey results indicate that some influence on investment might be exerted by factors such as low return on proposed investment plans and high cost of investments.

Figure 32: Factors Limiting Investment

%

Uncertainty about demand	Cost of finance	Inadequate net return of proposed investment
3,2	9,5	12,6

Conclusion: Assessment of factors limiting credit activity shows that the most important ones are: inability of private firms to argue on their request for credit and the administrative barrier imposed by Central Bank, such as credit rationing. Banks also need to modernize their business activity to meet the demand of clients for payment transactions, which along with unfair competition by unlicensed agents are the most important factors that limit payment transactions to grow. There are few constrains on investments.

CHPATER V

CONCLUSIONS AND RECOMMENDATIONS

The analysis of statistical data provide by INSTAT, as well as business survey results of CRD, enabled us draw the following conclusions regarding development in service sector and, particularly, in trade and financial services:

A. Trade Sector in the Period 1997-2000

Ø After a substantial increase of turnover in 1998, retail trade has been gradually decreasing in the period 1999-2000. Kosovo crisis in 1999 has contributed to the increase of wholesale trade activity.

Ø Over the period 1998-2000, the number of people employed in wholesale trade companies, as well as number of enterprises in this sector, has been gradually decreasing, indicating that the wholesale trade sector bears signs of concentration of this activity in the hands of fewer firms.

Ø Analysis of investments for the period 1997-2000 indicates two characteristics in trade sector: large fluctuation and, secondly, a relatively small the level of investment in trade sector. Moreover, the decrease in investment over the year 2000 indicates that entrepreneurs in the trade sector seem not confident for the future of their business activity.

Ø Indicators of labour productivity and share of labour force to value added show that in the period 1997-2000, labour is more effectively used in retail trade sector. For the wholesale sector, reduction of employment has been the main factor that contributed to the increasing of labour productivity.

Ø By the end of 2000, firms in retail trade are becoming almost unprofitable, while in the wholesale trade sector, firms are still profitable mainly because of the cut in the number of employees.

B. Trade in the Last 9-months

Ø In the first 6 months of 2003, there is a pessimistic business confidence in trade sector. Much more difficult is the situation in the retail trade sector, where, for three consecutive quarters, business surveys reveal negative business confidence indicator, as well as decreasing sales and order books and slightly increasing stocks. Some hope for recovery is obvious in the wholesale trade activity, as expectation for sales and order books are increasing.

Ø Survey results reveal that there exist no signs of increasing consumer prices. Instead there are sign of deflation.

Ø Financial situation in the trade sector reflects the general business conditions. It is deteriorated for retail trade firms and it is improving for wholesale trade firms.

Ø Competition among licensed trade agents is very high, especially in the wholesale trade. On the contrary, competition faced by unlicensed agents does not have any significant impact on trade activity. This is more evident for the wholesale trade sector.

Ø Weak demand by costumers is the new obstacle for retail trade to grow. The wholesale sector is looking for ways to reduce financial costs due to high credit interest rate, while in retail trade the labour cost is the most important concern.

C. Financial Sector

Ø In 2003, business situation in the financial sector looks very positive. This situation is mainly attributed to the increasing demand for financial services. Employment in the financial sector is thought to have decreased due to the restructuring measures that are taken by The Savings Bank.

Ø Prices of banking services are thought to have decreased. This is attributed to competition among various commercial banks. Results of April survey indicate that increasing competition has lead also to the narrowing of the gap between deposits and credit interest rates, which indicates the increasing efficiency of banking industry in Albania.

Ø Survey results show that the pressure by un-licensed financial agents is reduced.

Ø Non-performing loans tended to diminish in the recent past, which indicate further strengthening of banking sector.

Ø Operating in the very good business climate, commercial banks are increasing their investment for modernization of their services and provision of their clients with better services. Investments are mainly on IT and expansion of office space.

Ø The most important factor that limits credit activity is inability of private firms to present feasible requests for credit. The second limiting factor seems to be credit rationing imposed by Central Bank.

Ø Banks have to modernize their business activity to meet the increasing demand for financial services, especially for payment transactions, which along with unfair competition by unlicensed agents are the most important factors that limit payment transactions to grow.

Ø Banks have very few constrains on investments.

Recommendations:

- ∨ Stimulate consumer demand.

- ∨ Reduce credit costs to businesses by:

   - o further diminishing interests rate
   - o narrowing the interest rates spread

- ∨ Stimulate competition, especially in the wholesale trade sector.

- ∨ Find ways to fight informal activities, especially on payment services (including foreign exchange).

- ∨ Train entrepreneurs in presenting good business plans that stimulate credit activity