

Business environment, competitiveness and innovation among SMEs in Albania

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Abstract: Micro and small and medium enterprises make an important contribution to the economic development of Albania. Due to globalization and EU integration process, business environment in our country is becoming more and more complex and SMEs have to undertake proper actions in order to compete at national and international markets. Under these circumstances, more attention should be paid to innovation as the main tool to remain competitive in a globalized world. This paper aims to provide a descriptive analysis of SMEs sector in Albania focusing on their contribution to the national economy as well as at the status of Albania and its SMEs with regard to competitiveness and innovation. The data used were mostly retrieved from Doing Business, Global Competitiveness Indexes (GCI) & Global Innovation Indexes (GII) and Albanian Institute of Statistics (INSTAT). Over the last years significant progress is made toward the establishment of the proper business environment for SMEs. Government policies and initiatives seem to have produced concrete results with regard to some specific indicators of Doing Business such as paying taxes, while in terms of innovation more efforts need to be put either by the government or by the same SMEs in the country in order to improve innovative capabilities. Despite some initiatives towards the establishment of proper infrastructure to enterprise innovation, this latter remains weak and Albanian SMEs still lack funds for innovation, and skilled workers.

Keywords: SMEs, competitiveness, innovation, business environment.

1 Role of SMEs in economic development

1.1 Definitions of SMEs

There are several definitions on SMEs from International Institutions based on the economic size of countries. Thus, SMEs phrase have economical meaning rather than legal meaning. Number of employees and turnover seems to be main factors determining SMEs. Different countries define SMEs differently. Small and medium-sized enterprises (SMEs) are as well defined in the European Union (EU) recommendation 2003/361. The main factors determining whether a company is an SME are: i) number of employees and ii) turnover or balance sheet total. According to the European Union the category of micro, small and medium-sized enterprises 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 euro¹. Small and medium enterprises are thus defined as firms with 10 to 250 employees and, more than 10 million euro turnover or annual balance sheet total

Albania is an EU candidate country from 2014. In its way to EU integration Albania revised the Law on SMEs, in order to bring the SME definition closer to EU standards. According to this law (article 4): “Micro, small and medium enterprises (SMEs) includes those entities which employ fewer than 250 people and have an annual turnover that does not exceed 250 million Albanian Lek (ALL) (approx. 2,000,000 Euro). Small enterprises are those entities which employ less than 50 persons and have an annual turnover that does not exceed 50 million ALL (approx. 50,000 Euro). Micro enterprises are entities which employ less than 10 persons and have an annual turnover that does not exceed 10 million ALL (approx. 75,000 Euro). At the end as all these definitions exist, the important thing is that every definition is related to the size of each economy, and micro, small or medium is a relative concept in different countries. (Table 1).

Table 1. SMEs definition in EU and Albania,
from authors

Company category	EU		Albania	
	Employees	Turnover	Employees	Turnover *
Medium sized	< 250	≤ € 50 m	< 250	≤ 250 ALL m
Small	< 50	≤ € 10 m	< 50	≤ 50 ALL m
Micro	< 10	≤ € 2 m	< 10	≤ 10 ALL m

*1 Euro approximately 134 ALL

1.2 SMEs vs. large scale enterprise

There have been many debates about the role of the size of enterprises in the efficiency and effectiveness of the production. SMEs, observing the market closely, understanding the requirements of customers better and having intimate relations with its employee, have more elasticity than the large ones in terms of manufacturing, marketing and service. This means that SMEs overpass troubles lightly with less damage [1]. A comparative analysis between small firms and large firm is presented in Table 2. As it is shown by the table, there is significant difference related to marketing, management and communication and so on. Among advantages we can emphasize: i) opportunity to fast reaction to changes, because of single structure, ii) SMEs are the manufacturer of intermediate goods and inputs of large industrial enterprises iii) SMEs reflect small savings and family savings directly to the investments. In this regard the small firms are too important, have a significant impact on creating the future business generation. However, SMEs have also some disadvantages. These are lack of general administration, especially the lack of total participation of low level workers to the decisions taken by the owners or partners, lack of capital and financial planning, not taking enough support from the banks and other financial corporations, lack of product development, lack of coordination between production and sale, not showing the activities of modern marketing, risk of bankruptcy and losing its independency, etc.

Table 2.
Comparisons between small and large firms, from ISB, 2006 (2)

	Small Firms	Large Firms
Marketing	<ul style="list-style-type: none"> • Ability to react quickly to keep abreast of fast-changing market requirements 	<ul style="list-style-type: none"> • Comprehensive distribution and servicing facilities. • High degree of market power with existing products.
Management	<ul style="list-style-type: none"> • Lack of bureaucracy. • Dynamic, entrepreneurial managers react quickly to take advantage of new opportunities and are more willing to accept risk. 	<ul style="list-style-type: none"> • Professional managers able to control complex organizations and to establish corporate strategies.
Internal Communication	<ul style="list-style-type: none"> • Efficient and informal internal communication network. • Affords a fast response to internal problem-solving. • Provides ability to recognize rapidly to adapt to change in the external environment. 	<ul style="list-style-type: none"> • Internal communications often cumbersome: this can lead to slow reaction to external threats and opportunities.

Qualified technical manpower	<ul style="list-style-type: none"> • Frequent lack of suitably qualified technical specialists. • Often unable to support a formal R&D effort on an appreciable scale. 	<ul style="list-style-type: none"> • Ability to attract highly-skilled technical specialists. • Can support the establishment of a large R&D laboratory.
Finance	<ul style="list-style-type: none"> • Great difficulty in attracting capital, especially risk capital • Innovation can represent a disproportionately large financial risk. 	<ul style="list-style-type: none"> • Ability to borrow on capital market. • Ability to spread risk over a portfolio of projects. • Better able to fund diversification into new technologies and new markets.
Economies of scale and system approach	<ul style="list-style-type: none"> • In some areas scale economies of form substantial entry barriers to small firms. • Inability to offer integrated product lines or systems. 	<ul style="list-style-type: none"> • Ability to gain scale economies in R&D, production and marketing. • Ability to offer a range of complementary products.
Growth	<ul style="list-style-type: none"> • Can experience difficulty in acquiring external capital necessary for rapid growth. 	<ul style="list-style-type: none"> • Ability to finance expansion of production base. • Ability to fund growth via diversification and acquisition.
Patents	<ul style="list-style-type: none"> • Can experience problems in coping with the patent system. • Cannot afford time and costs involved in patent litigation. 	<ul style="list-style-type: none"> • Ability to employ patent specialists. • Can afford to litigate to defend patents against infringement.
Government regulations	<ul style="list-style-type: none"> • Often cannot cope with complex regulations. • Unit costs of compliance for small firms often high. 	<ul style="list-style-type: none"> • Ability to fund legal services to cope with complex regulatory requirements. • Can spread regulatory costs. • Able to fund R&D necessary for compliance.

1.3 The importance of SME in Albanian economy

During the years of transition, SMEs have played a significant role in the economy. SMEs contribute around 75% to the GDP of the country, while its contribution to exports is around 50% [3]. SMEs constitute the vast majority of businesses in Albania. SMEs generate over two thirds of value added and 81.6 % of employment, compared to the EU value added average of 56.8 % and employment average of two thirds. Micro-firms are the backbone of the Albanian economy, providing 40 % of employment, but they are providing only 20% of value added. As for small and medium sized enterprises, contributions to employment and value added are at comparable levels with EU average (Table 3).

Table 3
SMEs related to added value, employment and number (Albania vs. EU), from SBA Fact Sheet
Albania, 2017 (4)

Class size	Number of enterprises			Number of persons employed			Value added		
	Albania		EU	Albania		EU	Albania		EU
	No.	%	%	No.	%	%	Million Euro	%	%
Micro	87,854	94.5	93.0	162,261	40.8	29.8	95,250	21.9	20.9
Small	4,105	4.4	5.8	79,713	20.0	20.0	105,294	24.2	17.8
Medium	833	0.9	0.9	82,650	20.7	16.7	89,397	20.5	18.2
SMEs	97,792	99.9	99.8	324,984	81.6	66.6	289,940	66.6	56.8
Total	92,920	100	100	398,507	100	100	435,419	100	100

The number of SMEs has increased continuously during last years. In 2016, the number of SME registered was about 30 % higher compared to 2012, while employment increased by nearly 20 % during the same period. However, despite this increase, value added rise by only 3 %, and overall value added as a share of the economy still remains below its 2012 level [3]. The most significant improvements took place in 2015, with SME employment increasing by 18.7 % and value added by 6.5 %. This was mainly due to a significant increase in the number of SMEs. The major part (90%) of the enterprises are those with 1-4 employed and then 5% and 4% are enterprises with 5-9 and 10-49 employed respectively. Those enterprises that have over 50 employed consists only the 1% of the total [5].

The Albanian economy is dominated by services, but agriculture still retains an important role. Enterprises with main activity “Trade” and “Accommodation and food service activities” dominate with 46% of total active enterprises (Figure 1). The manufacturing sector is relatively small (7% of the total) and mainly produces low value added and labor-intensive products such as textiles and footwear. Construction's share of the economy greatly diminished over recent years as private credit and investment weakened. Another growth driver in the manufacturing sector was exports, which reached an all-time high in 2014. From 30% in 2012, in 2015, 37 % of total exports consisted of textiles and footwear, followed by exports of minerals, fuel and electricity [4].

SMEs realize 66.3 % of value added. Trade sector occupies the highest percentage of value added realized by small and medium enterprises with 22.2 %, followed by other services with 11.5 %, construction with 10.1 % and manufacturing industry with 10.0 %. Electricity, water & waste management and mining & quarrying sector have the lowest percentage of value added respectively by 2.2 % and 2.5 % [3].

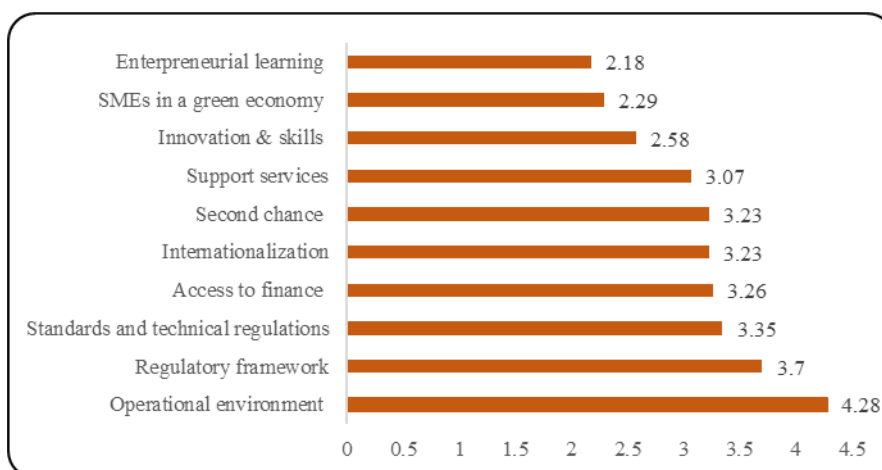
Small and medium sized enterprises play an important role in terms of employment. Accommodation and food services sector has the highest percentage of employment in micro enterprises by 78.9 %. Construction sector has the highest percentage of employment in small sized enterprises with 39.0 %. Manufacturing sector has the highest percentage of employment in medium sized enterprises by 36.4 % [5].

1.4 Business environment and public private dialogue

The Albanian government has always paid attention to SMEs development a catalyst for rapid increases in domestic production and employment. Strong and dynamic development of private sector is considered a priority of the government since the beginning of economic reforms. The creation of a suitable business environment and the support of the sustainable development of SMEs, are basic conditions for the economic development and the increase of social welfare as an employment source, innovation and productivity. For this reason Business and Investment promotion strategy for 2014-2020 is approved by Albanian Government. This is the main document for the identification and implementation of the national policies for the promotion of business investments for the period 2014-2020. The Business and Investment Strategy is part of the National Development and Integration Strategy. The Strategy is in line with the principles of the Stabilization and Association Agreement linked also with principles of the Small Business Act/ SBA. The primary objective of this strategy is to transform Albania to a country that has developed and improved the business climate, an open competitive market, development of industrial SMEs and an attractive investment destination and an inclusive and sustainable growth [6].

Albania continued to implement the 2014-2020 business and investment development strategy in order to facilitate the business environment. According to the 2016 Small Business Act policy findings, since 2012 Albania has made progress on several parameters, such as standardization, technical regulation and simplifying business procedures. Procedures for market entry were further streamlined and business registrations soared. Efforts were made to facilitate doing business and improve government communication with enterprises, but they have yet to produce tangible results on the ground [7]. The National Business Centre became operational in April 2016, providing a single business registration and licensing window and offering online registration services. Secondary legislation on strategic investment and economic development zones was adopted identifying priority sectors of investment, projects of strategic potential and strategic investment evaluation procedures.

According to the SME Policy Index, SMEs development in Albania is rated 3.12 out of a maximum of 5 points. This is a slight improvement from 2012 when Albania fared only slightly less than the regional average at 3.17 points. The report was based on ten dimensions derived from the ten principles of the EU Small Business Act. Detailed information about dimensions for policy on SMEs is provided by Graph 1 below.



Graph 1

Assessment of SME policy in Albania adapted from EBRD, ETF, SEECEL, EU, OECD 2016 (8)

Despite the progress made, a number of key components of a SME-friendly business environment are missing, such as fostering the entrepreneurship in the school curriculum, setting up regulatory impact assessment procedures, developing alternative sources of finance besides traditional bank lending, and setting up fast-track and specific bankruptcy procedures for SMEs, especially with regard to the issue of non-performing loans [4].

Albanian Government has undertaken significant steps to further increase the dialogue with the business community for economic and development policies. Important structures are in place to formalize this dialogue such as:

- **National Economic Council (NEC).** NEC is set up by law in 2014 to guarantee institutional cooperation and public-private partnership, ensuring **dialogue and consultation** between the government and the private sector. The National Economic Council is a forum of consultation between the business community and the government (with comments, observations and suggestions coming from the business community to the government). The Council has also an advisory function to the Government with recommendations for economic policy decisions and practices.
- With the support of the European Bank for Reconstruction and Development, the Albanian Government has established the **Investment Council**. Investment Council is a platform set up by the Albanian authorities to intensify the dialogue between the government and the private sector, improve the business climate and promote good governance.
- In 2017, in the new structure of Government is established a new position, **Minister of State for Entrepreneurship Protection**. The mission of the Minister is to assist and protect the entrepreneurs as well as to promote inter-institutional cooperation aiming at improvement of the public services to private business.

2 Competitiveness and innovation among SMEs in Albania

2.1 Albania's Competitiveness

The performance of SMEs is strongly influenced by the business conditions and factors which define the competitiveness of an economy. Nowadays several instruments are established to measure either business conditions or competitiveness of a given country. Going through these indicators, analyses and comparisons can be performed in order to get a clear picture of the situation. Actually, different studies have considered data of Doing Business and Global Competitiveness Index (GCI) provided respectively by World Bank and World Economic Forum in order to analyze and compare business environment and competitiveness in Albania. GCI measures national competitiveness defined as a set of institutions, policies and factors that determine the level of productivity. According to the latest report of GCI, Albania has made progress on the overall ranking. For 2017 – 2018, our country is listed 75th among 137 nations and it is considered as an efficiency driven economy. Being at this stage of development, Albania has to develop more efficient production processes and increase product quality. Hence, further improvements and further developments need to take place with regard to specific pillars of competitiveness such as education, goods and labor market efficiency, financial markets as well as technological readiness (Figure 1).

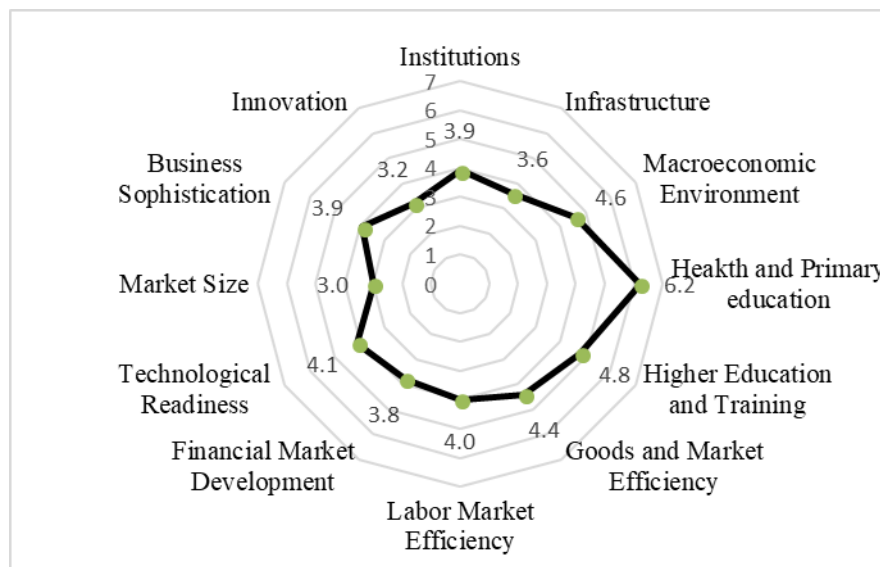


Figure 1

Competitiveness Indexes 2017 – 2018 from The Global Competitiveness report 2017 – 2018 (9)

The World Bank 2017 Doing Business Report placed Albania at the 58th position up 32 places from the 2016 assessment [10]. The score improvement was mostly due to reforms undertaken in dealing with construction permits, paying taxes and getting electricity. Regarding the construction permits, the 2017 Doing Business placed Albania at the 106th position up 83 places from the 189th position of 2016 Doing Business [11]. For the indicator of paying taxes and getting electricity, the 2017 Doing Business Report puts Albania respectively up 12 and eight places. Reforms undertaken with regard to these indicators consisted in:

- ✓ Reintroducing the issuance of building permits and streamlining the process of receiving the final inspection and compliance certificate.
- ✓ Speeding up the process for obtaining a new electricity connection.
- ✓ Introducing an online system for filing and paying taxes.

One of the indicators in which Albania has made steps back forward is trading across borders. Data of 2018 shows that trading across borders has become more difficult due to the introduction of mandatory scanning inspections for exports and imports which increased the time and cost for border compliance. Currently, Doing Business report provides the following data with regard to this indicator [12] (Table 4).

Table 4
Trading across borders indexes for Albania from Doing Business 2018 (12)

	Exports		Imports	
	<i>Documentary Compliance</i>	<i>Border Compliance</i>	<i>Documentary Compliance</i>	<i>Border Compliance</i>
Time (hrs.)	6	9	8	10
Costs (USD)	10	55	10	77

2.2 Innovation in Albania - An analysis at macro and micro level

Innovation is one of the contributors to the sustainable national economic growth. In 2017, Albania was ranked 93 out of 127 countries in the Global Innovation Index (GII). Actually, there is no significant change on the ranking of Albania compared to 2016 in none of the indicators listed in the table below. Innovation Input Indexes (III) involve 5 pillars (institutions, human capital and research, infrastructure, market and business sophistication) of the national economy which enables innovative activities while Innovation Output Indexes (IOI) involve 2 pillars (knowledge & technology outputs and creative outputs) and represent the results of innovative activities. The figures for 2017 indicate a better ranking of

Albania in innovation input sub – indexes (rank 70) rather than in innovation output sub – indexes (rank 115). As it is shown in GII report, ease of starting a business, resolving the insolvency and protecting the minority investors are among the strength for enabling innovative activities. Data from the same report also show that innovative activities results are reflected at the level of ICT services export and the number of ISO certificates issued [13] [14].

Table 5
Albania's ranking at Global Innovation from Global Innovation Index 2016 & 2017(13) (14)

	Score 0 - 100		Rank	
	<u>2016</u>	<u>2017</u>	<u>2016</u>	<u>2017</u>
Global Innovation Index	28.4	28.9	92	93
Innovation Output sub-index	16.2	15.7	115	115
Innovation Input sub-index	40.5	42.0	71	70
Innovation Efficiency Ratio	0.4	0.4	121	122

GII also consider Intellectual Property to contribute in the knowledge creation, impact and diffusion. Laws and institutions managing Intellectual Property Rights are among the most important instruments to encourage innovation. Actually, IP legislation in Albania is fully in compliance with the TRIPs Agreement and also with the EU Directives on IP matters. The most recent development in this field is the adoption of the new law on Copyright and Related Rights on March 2016 as well as of the national strategy on intellectual and industrial property. Albania has also ratified the most important treaties and conventions with regard to IPRs under WIPO and WTO organization. The main institutions engaged in IPRs matters are the Albanian Copyright Office (ACO) and the General Directorate of Patents and Trademarks (GDPT). The following table provides some valuable information with regard to the number of granted and registered patents and trademarks & industrial designs in Albania by the end of 2016.

Table 6
Intellectual Property grants and registration status by 2016 adapted from
http://www.wipo.int/directory/en/details.jsp?country_code=AL (15)

	Patents grants		Trademark registrations			Industrial Design registrations		
	<i>Residents</i>	<i>Abroad</i>	<i>Resident</i>	<i>Non-resident</i>	<i>Abroad</i>	<i>Resident</i>	<i>Non-residents</i>	<i>Abroad</i>
Number	5	1	526	2891	357	3	238	38

Innovation is crucial to SMEs since it can lead to increased market share and revenues, greater production efficiency and productivity growth [16]. Innovation can also serve as an instrument / tool SMEs can use in order to gain competitive advantage. It helps companies to offer a wider range of

differentiated products improving their financial performance [17]. Many times SMEs are seen as a source of innovation at the aggregate level because they are flexible, dynamic and sensitive to changes in demand in comparison to larger companies.

Despite improvements in the business environment for SMEs in Albania, innovation of this category of businesses still remains a challenge ahead. Albania's capacity for technological absorption and research, development and innovation (RDI) is low. Key obstacles include low expenditure on research and development (about 0.4 % of GDP); weak links between the scientific and private sectors; as well as fragmentation of the national research and innovation system. As a result of this weak innovation policy infrastructure, almost all sectors of the economy mainly provide low-technology, labor-intensive and low-cost products and services [7]. Increased funding and a more focused RDI strategy, would support the country's capacity to attract investment in RDI. Actually, innovation fund managed by AIDA, provided in 2016, in total 2,223,350 ALL (approx.. 17,000 Euro) only to five companies, while some funding was provided to SMEs by several national funds, the Italian Cooperation SME credit line program and the European Fund for Southeast Europe (EFSE). Since the beginning of its implementation, EFSE has provided loans to 525 clients disbursing about 35,000,000 euro. In 2016, around 5,000,000 euro was disbursed to 125 contracts. As part of Europe and since granted the "candidate" status, Albania is also involved in several EU programs targeting research & development and innovation in SMEs such as COSME and Horizon 2020. Currently, efforts to involve Albanian enterprises at COSME program are still at the preparatory phase and are focused more at raising awareness of business community while the participation of private sector at Horizon 2020 remains very low.

Albania still has considerable gaps to close between education outcomes and labor market. According to Global Competitiveness Report (GCI) a large share of enterprises report lack of appropriately skilled workers. Businesses in agriculture and agro-processing, textile and foot wear, tourism, construction, transport and communication, energy, information communication technology lack specialists and technicians. The relations between the vocational education and training system and industry are weak and most curricula offer little scope for practicing the skills learnt. Vocational education is perceived as a second best path to tertiary education, rather than a route to labor market entry. On the other hand, few companies provide formal training for their employees [9].

SMEs not only constitute an important segment of the Albanian economy, but they also have the ability to be a dynamic force in the country's economic development. SMEs specifically contribute as an integral part of economic structure as they are suppliers of the major enterprises and contribute to foreign competition of these firms. Hence, it is crucial that SMEs in Albania remain competitive. In order to comply with this, they continually monitor changes in the market and in the activities of the competitors. They also try to be innovative. Types of innovation used by SMEs in Albania are those related to marketing, product and organizational innovation. Hence, SMEs improve their products before competitors, introduce changes in the products' design & packaging and in distribution or sales practices (online sales, franchising, direct sales or distribution licenses). They also try to create alliances, partnerships or outsourcing with other firms and public institutions. Most of Albania SMEs spend 1 – 5% of the total capital for innovation. Among barriers Albanian SMEs face to adopt innovation are high innovation costs and instability in the markets [18]. Even though studies performed show that Albanian SMEs are innovative considering all the above mentioned activities, such a finding should always be taken with a "grain of salt". In most of the cases what SMEs representatives consider

as innovation include simple changes performed in production lines or machineries and management practice [19].

Conclusions

Today, economic development is at the heart of many economic scholars' debates, and the role of small and medium enterprises in this context, is a very important one, based on the contribution it makes to the economy of a country.

SMEs play an important role in Albania – fuelling the economic growth, providing flexibility, engaging in bridge-building between Albania and the European Union, and promoting employment. The reforms of the government has aimed promoting a friendly business climate, and to provide assistance and incentives for SMEs. Strategies for the business development are based on European Union directives, and are some of the priority obligations that Albania has to fulfill towards European integration. Significant progress has been made in improving the strategic framework for SMEs development and promoting the dialogue between Government and business community.

During the last decade, efforts of the government and policy makers in Albania were focused on the establishment of the proper and sustainable business environment to encourage private initiatives and promote Albanian enterprises to be competitive and further expand their activity domestically and internationally. These efforts are reflected to the improvement of Albania's position in the overall ranking of Doing Business and Global Competitiveness Indexes. However, as an efficiency driven economy, Albania still has to put more efforts on some specific directions such as education, business crediting and trading across borders. On the other hand, much more need to be done in order to improve R&D and innovative capabilities of private companies operating in our country since their efforts with these regards still remain "infantile". Establishment and promotion of proper infrastructure and increased budget and funding possibilities for innovation would definitively support Albanian enterprises to be competitive in a global environment.

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