

# **Empirical Estimates of the Lack of Liquidity and the Use of Factoring by SME in Albania**

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## **Abstract**

A company may be profitable, but it may be classified as a failure if it fails to cash its money on time for its customers, necessary to pay off its suppliers and employees. For this reason, to make this company keep operating in the market, despite having a higher cost compared to other financial method, factoring is applied, a financial method that needs less time to have pay off but expensive for the business. For this reason, to analyze the lack of pay off as well as the readiness of the companies, using factoring as a short term financial source, we have done an empiric study of the Albanian Market, analyzing 110 SME (Small – Medium Businesses) which are active in different sectors of economy. But, do SMEs prefer the traditional ways of doing business? Do they appreciate that a third party be in between them and their supplier, being this a Factoring Company or a bank? In conclusion of this work, we have given in a form of recommendation the economic role of the factoring and the importance of its use during financial crises and post crises by the SMEs.

**Key words:** Supplier, Factor, Customer, Working capital.

## **1. Empirical analysis, case of Albanian firms that use factoring**

SMEs may face many problems and lots of challenges that bring the market in their efforts to grow and develop. one of the many problems is the financial burden... this is because as they are not powerful enough to list their shares on the capital market, but also can not have a positive relationship with the bank doing so lack liquidity for working capital becomes worrying and requires an immediate solution. Factoring as advanced financial instrument provides simple and efficient financing service and helps in the success of activities of local and foreign businesses. With the rapid growth of firms that expanded their operations, but who are not willing or are unable to get a loan from a bank is needed a service such as factoring.

For this reason, we take the study of 110 SMEs, which operate in different sectors of the industry in Albania and have special features between them. The aim of our study was to achieve some goals by giving you answers to the following questions, through empirical analysis.

- Do the companies have lack liquidity?
- Is factoring used as a source of financing for working capital?
- What kind of resources uses SMEs, in addition to self-financing loan?
- Are the suppliers and customers ready to use factoring?
- Are the suppliers and customers ready to provide information on the progress of payments between them?
- What percentage of their annual turnover they reach to collect within a year?
- What do SMEs predict invest for the next 5 years?

## Empirical Analysis of Results

to study the factors that influence the use of factoring and features that should have firms that use factoring as a source of short-term financing, we analyzed responses collected from surveys conducted, giving finally the relevant conclusions asked what is the actual duration of repayment of payments from your customers leading, respondents answered as follows:

Question 1. **What is the actual duration of repayment of payments from your main buyers?**

Table 1.1. Actual duration of repayment.

Alternative	Frequency	Percentage
0-30 days	22	20 %
30-90 days	55	50%
Morethan90 days	33	30%
Total	110	100%

Resource: Calculation of the Author

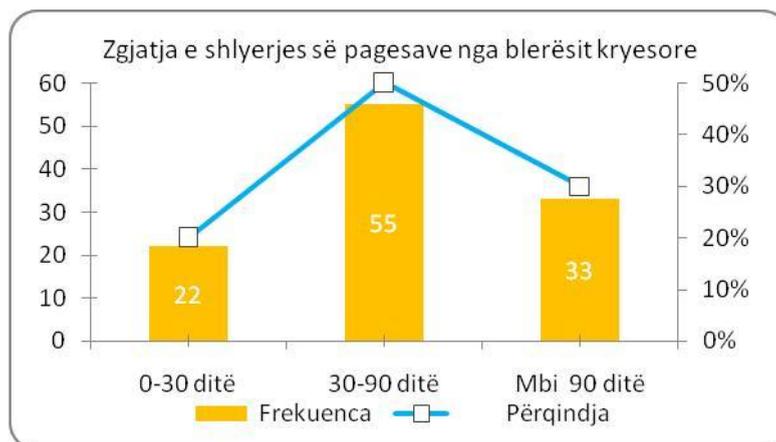


Figure 1.1. Duration of repayment (Percentage rate on the right).

As we see from the table and graph above, SMEs that are already consolidated in the market, feel the lack of liquidity because 30% of them fail to collect their accounts receivable after more than 90 days. An analysis by age of accounts receivable of enterprises included in the study, shows that this extension of the repayment term of these accounts it's because of the difficulties that costumers face during their operation in the market. We precede the study with the question of what percentage of turnover these SMEs collect within a period of 12 months and our respondents answered as follows:

- What percentage of turnover have you cashed within 12 months from your customers?

Table 1.2. Percentage of turnover received during the year.

Alternative	Frequency	Percentage
0-10%	3	3%
20-40%	90	82%
50-70%	12	11%
80-100%	5	4%
Total	110	100%

Resource: Calculation of the Author

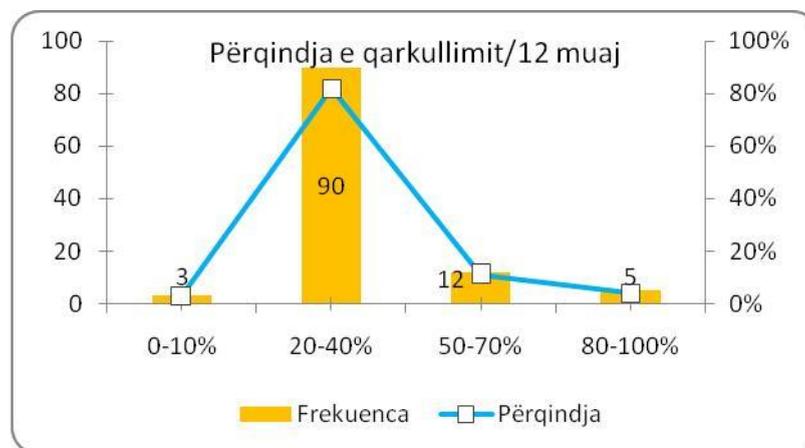


Figure 1.2. Percentage of turnover receivable within one year (Percentage rate on the right).

From the table 5.3 and graph 5.4 we see that 3% of them manage to collect 0-10% of their turnover within a year, 82% of them collect 20-40% of the turnover and only 11% of them manage to collect only 50-70 % of their turnover during the year. 80-100% of them fail to collect only 4% of the turnover. This shows once again the financial difficulty faced by SMEs in the study.

Question: **Do you get time to liquidate your suppliers?**

Table 1. Timely liquidation of suppliers

Alternative	Frequency	Percentage
Yes	30	27%
No	80	73%
Total	110	100%

Resource: Calculation of the Author

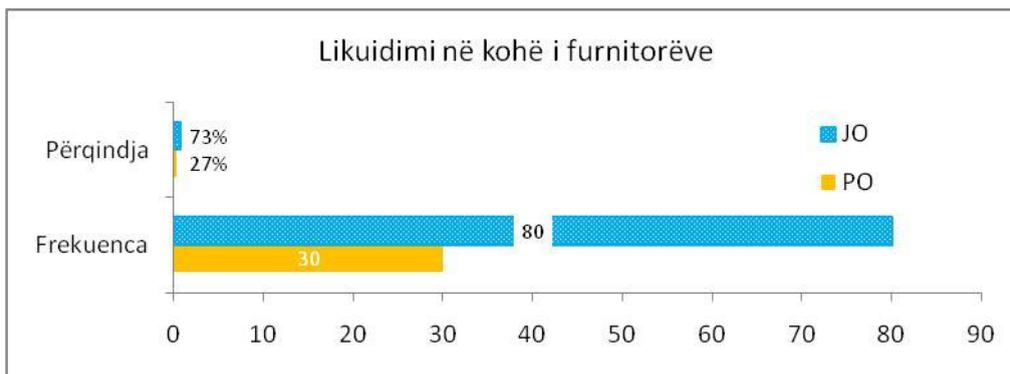


Figure 1. Alternative suppliers timely liquidation.

Respondents answered that only 27% of them arrive to liquidate suppliers, while 73% answered that fail to pay suppliers on time, becoming an obstacle for the successful continuation of their activities.

Asked how much difficulty you face from not paying on time from 0- 10? (Where 0 expresses not having difficulties and 10 expresses having difficulties on daily operation of the company).

Table 2. Degree of difficulty from not paying on time the suppliers.

Alternative	Frequency	Percentage
0-3	22	20%
4-7	55	50%
8-10	33	30%
Totali	110	100%

Resource: Calculation of the Author

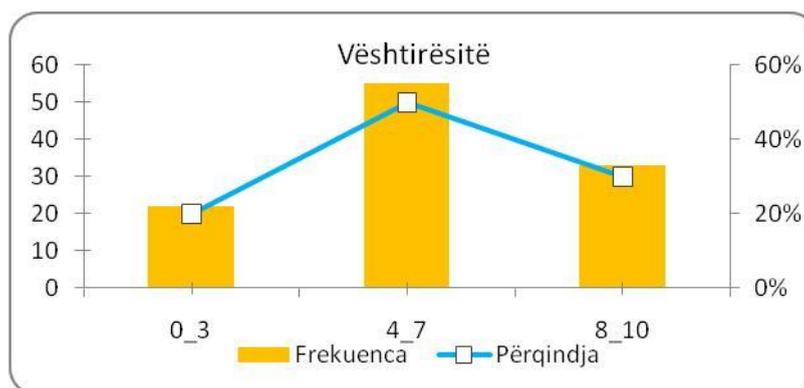


Figure 2. Degree of difficulty from not paying on time the suppliers. (Percentage rate on the right).

The respondents answered as follows: Only 20% of them have difficulties in scale 0-3. 50% of respondents claim to assess the difficulty in connection with the liquidation of their suppliers with a note 7 that is too high and 30% of them answered that they faced difficulties in 8-10 scale, which is the maximum difficulty for current businesses, because no liquidation of suppliers directly affects their supplies of raw materials necessary for their performance in the market.

It is known that one of the most important indicators of liquidity is working capital. It is calculated as the difference between short-term assets and short-term liabilities. When current assets exceed current liabilities, working capital is positive. A positive working capital expresses a good liquidity for the company. The higher this indicator, the more liquid it is the society or entity, and the more "security" express its financial statements for creditors who do not want a lack of cash. When short-term liabilities exceed current assets then we lack in working capital, a situation that indicates that the unit lacks liquidity. This financial situation is forcing firms to seek external funding.

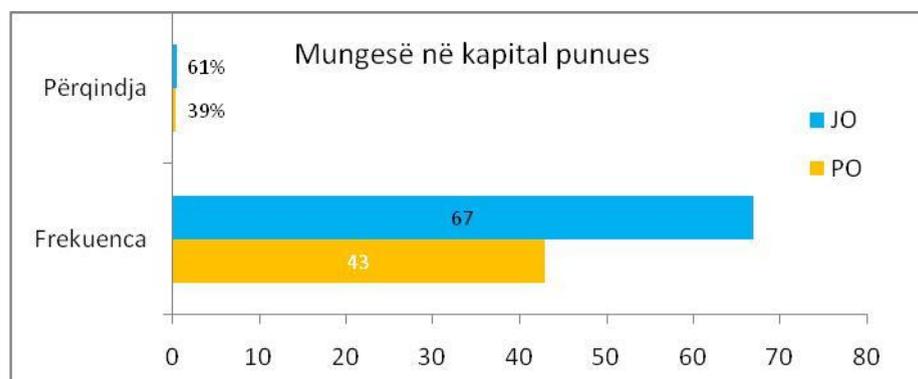
To see whether firms that have received a liquidity shortage in the study or not, we continued with the question:

Question: ***Have you been lacking in working capital during your activity?***

*Table 3. Lack of working capital for firms included in the study.*

Alternative	Frequency	Percentage
Yes	43	39%
No	67	61%
TOTAL	110	100%

Resource: Calculation of the Author



*Figure 3. Alternatives to the lack of working capital.*

From the responses we see that 61% of firms had no shortage in working capital, while 39% have been lacking in working capital. This figure is significant and once again expresses a clear lack of liquidity faced by Albanian firms that we've got to study.

Although clearly a need for funding, again companies operating in the Albanian market prefer or are forced to use more self-sustaining method and other financial instruments for short-term working capital. This table shows the chart below 5.7 and 5.8. Only 18% of these needs are financed with loans, 37% financed by self-financing, 24% financed by the partners and other members of the group and 21% other financial instruments. This is because the banks are meaner more about loans for working capital to these new companies, but also the ability to provide collateral for banks is very difficult for these companies.

Although over 60% of the companies interviewed recognize factoring as short-term funding so, again interpretation of how does a factoring company was different. In Albania SMEs have difficulties to provide the necessary funds for working capital.

Question: **Which financial resources are used for working capital?**

Table 4. Financial resources for working capital

Alternative	Frequency	Percentage
Self-financing	41	37%
Loan	20	18%
Partners and members of the group	26	24%
Other financial instruments	23	21%
Total	110	100%

Resource: Calculation of the Author

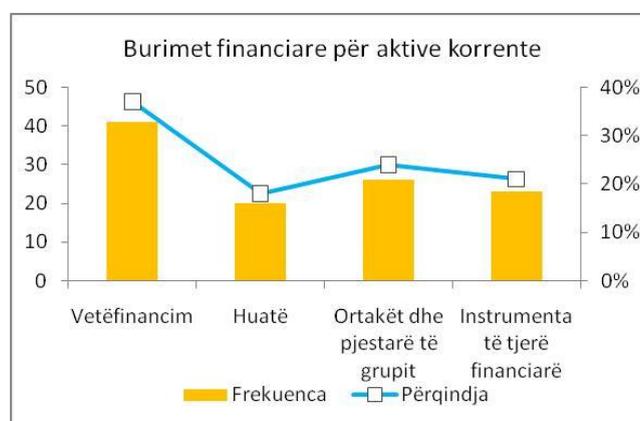


Figure 4. Financial resources for working capital (Percentage rate on the right).

We have continued our analysis answering the question: **What do you predict to invest in your business for the next 5 years?**

Table 5. Forecasting future investments by SMEs.

Alternative	Frequency	Percentage
Building, machinery equipment	20	18%
Material Circulating Active	56	51%
Financial Circulating Active	34	31%
Total	110	100%

Resource: Calculation of the Author

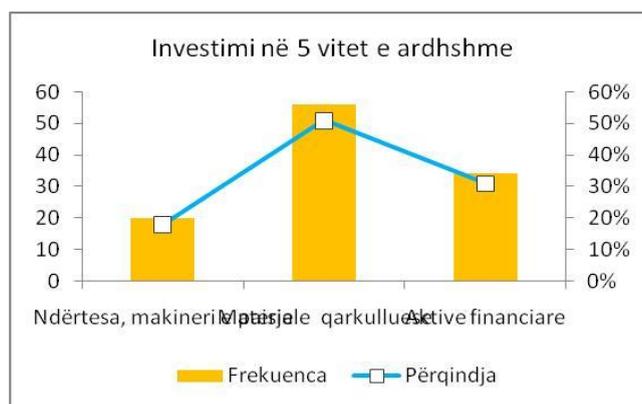


Figure 5. Forecasting future investments by SMEs in the study (Percentage rate on the right).

From Table 5.8 and Figure 5.9 we see that investment of the companies included in the study, for the next five years will go to 51% of circulating active material, 31% of circulating financial assets and only 18% for buildings, machinery and equipment. This shows that SMEs will be more focused on short-term management of their businesses, while continuing to be attracted to undertake projects and plans for long-term financing. As we see from the above indicators, the largest investment will go towards working capital, so that in turn will increase the need for short-term funding sources.

To test how ready are small and medium business to use factoring as a source of short-term financing in the questionnaire we prepared for them the following questions:

Question: **Are you glad as e economic entity to provide information about the payment performance of your clients?**

Table 6. Information for customer payment performance.

Alternative	Frequency	Percentage
Yes	43	39%
No	67	61%
Total	110	100%

Resource: Calculation of the Author

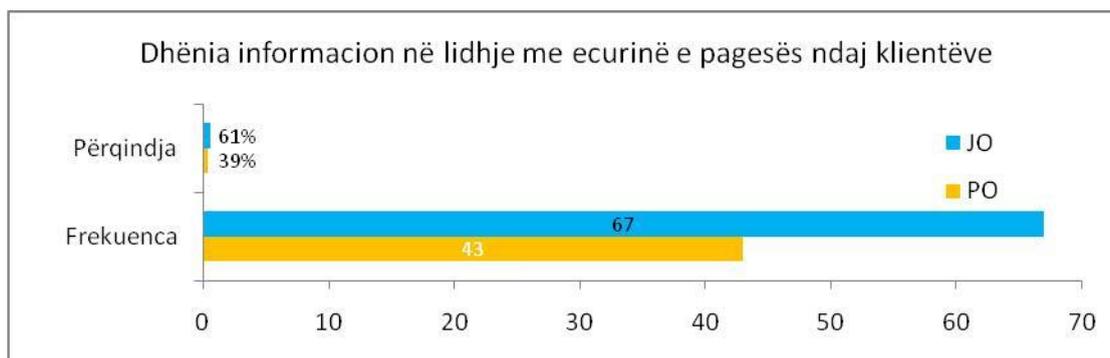


Figure 6. Information for customer payment performance

In the table 5.9 and graph 5.10 we see that 39% of respondents answered that they are willing to provide information about the payment performance of their customers, while 61% responded that they were not ready.

This is only a problem mentality that currently Albanian businesses, because they think that they are giving information about the company debit accounts. But again we can say that 39% is very promising for creating a good environment for business operations of factoring.

**The question of whether you are ready like an economic entity to provide information on the obligations that you have to suppliers?**

Table 7. Information on obligations to suppliers.

Alternative	Frequency	Percentage
Yes	40	36%
No	70	64%
Total	110	100%

Resource: Calculation of the Author

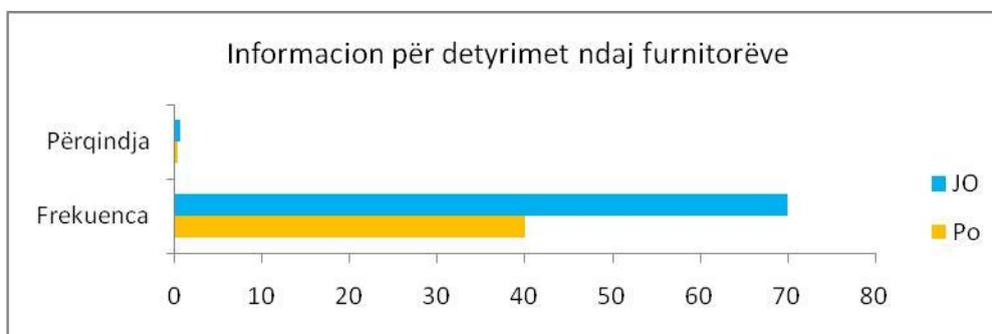


Figure 7. Information on obligations to suppliers.

So even in this case, we see that only 36% of respondents answered positively to the question, while 64% answered that they are not willing to provide information concerning their obligations to suppliers.

We continued our analysis with the following question. A do të pranoni që arkëtimin e klientit tuaj ta realizojë një kompani faktoringu apo një bankë?

Table 8. Alternatives about collection of clients by factoring company or bank.

Alternative	Frequency	Percentage
Yes	44	40%
No	66	60%
Total	110	100%

Resource: Calculation of the Author

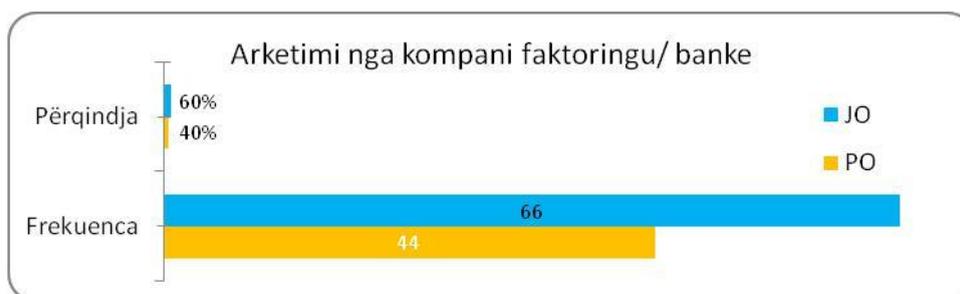


Figure 8. Alternatives about collection of clients by factoring company or bank.

We see that 40% responded positively to the question, while 60% responded negatively, thinking that perhaps the collection of accounts receivable by a factoring company will lead to an irritation of their client.

Question: **Do you agree to pay your obligation to the supplier through a bank?**

Table 9. The repayment of the obligation of the supplier through a bank.

Alternative	Frequency	Percentage
Yes	77	70%
no	33	30%
Total	110	100%

Resource: Calculation of the Author

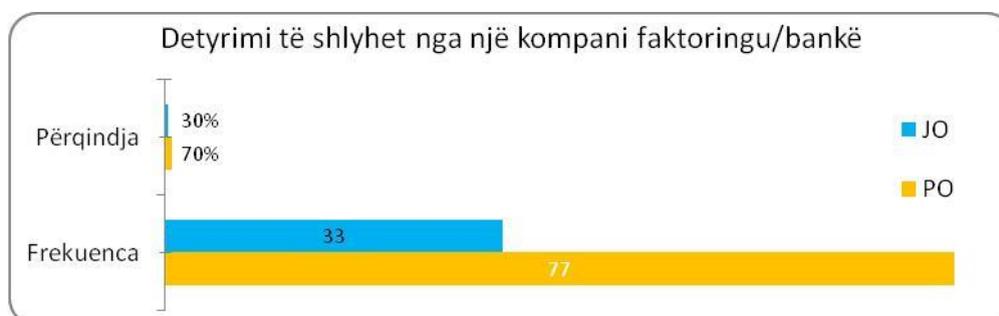


Figure 9. The repayment of the obligation of the supplier through a bank.

To this question, 70% of respondents answered yes. So they can pay their supplier through a commercial bank, after they had explained that he would pay the bill with those conditions that were agreed with the supplier. This result, as we all have encountered in world literature, gives priority to the development of factoring offered by the banks. This way is a very popular form of factoring in Italy, where the factors that are part of banking groups, are key market players. While 30% of respondents gave a negative answer to this question, so they prefer that in relations between them and the supplier not to enter a third company or bank. They prefer the traditional relations of doing business. Thus we see that the obstacle in the use of factoring as a source of short-term financing to meet working capital needs, are even firms which have difficulty to change the mentality of doing business.

## **Conclusions of the survey results**

Most of the surveyed companies, which operate in the Albanian market, with various services and facilities, of their activity, feel the lack of liquidity. This is because 30% of them fail to collect their accounts receivable after more than 90 days, 11% of them manage to collect only 50-70% of their turnover within a year and 39% of them result in negative working capital.

Lack of liquidity does not feel only on the companies over 5 years of experience, but almost on all businesses, as 73% of them report that fail to liquidate their suppliers on time, becoming an obstacle to the successful continuation of their activities. This results from the fact that 50% of respondents claim, by evaluating with a grade 7, the difficulty in connection with the liquidation of their suppliers, which is too high for current businesses, because no liquidation of the suppliers, directly affects their supplies with raw materials, necessary for their performance in the market.

In the coming years, according to the survey results, there will be more investment in working capital and financial assets than in long-term investments. Investments in working capital will occupy 51% of investment of the firms in the study.

These investments will be financed with short-term resources, as demand for loans from SMEs, to fund working capital, in 2013 fell by 0.4% compared with 2012 (according to the Bank of Albania). The development of factoring, as a genuine industry, will take its time, because in Albania there is the mentality of not giving the information as to the performance of customer payments and for the settlement of liabilities to suppliers. About more than 60% of the firms in the study, answered that are not ready to cooperate. So private factoring companies will have difficulties in finding information for their customers and suppliers. But, on the other hand, according to survey results, we can say that 70% of firms responded that they can make bill payments to their suppliers to a second tier bank. For this reason, we think that there will be more development in factoring, offered by second tier banks, as happens in Italy, where the main actors on delivering factoring are departments of banks and not the no-banking financial companies.

Factoring in Albania is a new business that has only 3-4 years which is functioning as such, despite the law on factoring has been developed since 2006. So, just as noted in world literature we can say that, 'are indicators of financial constraints of firms', those who play a determining role in the use of factoring. From what we saw above, we can say that in Albania, though there are limitations due to inherited mentality of doing business, there is also place for use and development of factoring business, as new option of short term financing, because the firms that we have taken in the study resulted in a lack of liquidity.

## **2. Economic role of Factoring**

The use of factoring as a source of short-term financing for SMEs in cases where they result in liquidity crisis has several advantages because it provides:

- Less time in the realization of factoring - the application process and ensuring funds through factoring is many times faster than the time required to provide a short term bank loan;
- The company's growth is not financed with a new debt - and the company has no monthly payments or a specific date of maturity of the loan such as occur when taking credit from banks;
- No need for an evaluation of credibility of the supplier, after factoring analyzes the solvency of the customer;
- "Fresh working capital" which means that suppliers of raw materials can be prepaid by benefiting an additional discount;
- The best financial position, positive remarks for loans and solvency;
- A company that just has started, can provide immediate funds.

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