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CONTENTS

Sr. No.	TITLE & NAME OF THE AUTHOR (S)	Page No.
1.	MARRIED WOMEN WORKING IN NIGHT SHIFT AND ITS IMPACT ON FAMILY RELATIONSHIP <i>DR. MUNIVENKATAPPA, DR. LAKHSMIPATHI. C.G, DR. SHOBHA. C & T. NARASIMHAIAH</i>	1
2.	BANKS IN BRAZIL: CHALLENGES AFTER THE GLOBAL CRISIS <i>MARIA ALEJANDRA CAPOALE MADI & JOSÉ RICARDO BARBOSA GONÇALVES</i>	6
3.	A STUDY ON POTENTIALITY OF SILVER AS AN INVESTMENT ASSET <i>CHANDRA SHEKAR BM, DR. NIRMALA K REDDY & MUNILAKSHMI R</i>	11
4.	ECONOMIC DEVELOPMENT AND TOURISM IN SIKKIM: A CRITICAL REVIEW <i>ANJAN CHAKRABARTI</i>	16
5.	AN ANALYSIS OF DETERMINANTS THAT INFLUENCE THE GOLD PRICE MOVEMENTS IN INDIA <i>SHEETAL DUBEY & ANAMIKA HARDIA</i>	22
6.	RISING FOOD PRICES AS THE BASE OF INFLATION IN INDIAN ECONOMY <i>CHITRA BHATIA ARORA</i>	26
7.	ADULT EDUCATION: A KEY ELEMENT FOR THE TRIBAL WOMEN'S EMPOWERMENT <i>DR. TADEPALLI DORA BABU</i>	32
8.	EFFECTIVENESS OF NREGA'S IMPLEMENTATION IN INDIA <i>PRIYANKA PANDEY</i>	36
9.	BUILDING BRAND LOYALTY THROUGH SOCIAL MEDIA <i>ROBIN INDERPAL SINGH</i>	41
10.	IFRS: AN IMPLEMENTATION <i>PAYAL CHATLY</i>	44
11.	CONTRIBUTION OF IMPROVED AGRICULTURAL INPUTS USE ON VEGETABLE PRODUCTION: IMPACT ANALYSIS ON VEGETABLE PRODUCERS IN ALMATA, TIGRAY, ETHIOPIA <i>GEBREMESKEL BERHANE TESFAY</i>	48
12.	IMPORTANCE OF INNOVATION FOR SME GROWTH: EVIDENCE FROM ALBANIA <i>DORJANA FEIMI & DR. VASILIKA KUME</i>	54
13.	ROLE OF MAHARATNA COMPANIES IN INDIAN ECONOMY <i>NIRANJAN KUMAR SINGH & NITA CHOUDHARY</i>	59
14.	DEVELOPING COMPETENCY BY STRATEGISING AN AGILE SUPPLY CHAIN <i>VIMALNATH VENKATASUBRAMANIAN & R BASKARAN</i>	66
15.	EURO ZONE CRISIS: IMPACT AND IMPLICATION FOR INDIA <i>NEHA ARORA</i>	71
	REQUEST FOR FEEDBACK & DISCLAIMER	76

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IMPORTANCE OF INNOVATION FOR SME GROWTH: EVIDENCE FROM ALBANIA

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ABSTRACT

History has amply demonstrated that innovation in the public and private sectors is the most important key to long-term prosperity and economic competitiveness. A recent OECD study using innovation surveys for 21 countries showed that firms receiving public support for innovation, invest 40% to 70% more than those that do not. Also, higher levels of firms' investment in innovation lead to higher innovation sales and productivity. Especially in countries in transition, they face a number of obstacles: administrative barriers, limited access to finance, lack of technology, entrepreneurial skills. Yet, these days Albania represents a deficit in innovation, with a poor performance, which becomes a handicap for the competitiveness of its enterprises. It ranks 123 out of 142 in Global Competitiveness Report 2011-2012. This puts in risk the competitiveness (ranked 78th out of 142 countries) and sustainability of economic growth and employment. However, Albania is ranked 62nd in terms of technological capacity. The purpose of this paper is to serve as a basis for discussion about the reasons why Albanians SME need to invest in innovation and on the key priorities for action to support innovation in Albania and to identify initiatives where these organizations can help catalyze change to go forward.

KEYWORDS

innovation, Albanian SMEs, development of SMEs, growth.

1. INTRODUCTION

I history has amply demonstrated that innovation in the public and private sectors is the most important key to long-term prosperity and economic competitiveness. A recent OECD study using innovation surveys for 21 countries showed that firms receiving public support for innovation, invest 40% to 70% more than those that do not. Innovation is important on different levels and is also important for different reasons. For nations, (and regions) innovation is an important driver of economic growth and improvement. For firms, there are a number of reasons, including survival, growth and shareholder return. A major topic in the innovation literature is the importance of SMEs for innovation. Studies have shown that SMEs contributed to the main innovations of the twentieth century (Oakey, et al., 1988; Rothwell, 1994). SMEs have some advantages because of their size. Many are flexible and have strong relationships with customers, enabling rapid response to technical and market shifts. Small and medium-sized enterprises (SMEs) dominate Albania's economy, representing 99.6% of all registered businesses. The share of the SME sector in GDP is about 73% and the sector covers approximately 71% of all employees. SMEs in Albania concentrate on the local market and lack export competitiveness.

This article starts by explaining the importance of innovation and the definition of it. Then, the article discusses about the innovation development within SMEs, the problem and needs. In the following part, we will discuss more briefly about some areas that have a specific relevance to the small and medium enterprises (SMEs) in Albania, which are known as the best way to lead an economy by using innovation as their primary tool to challenge the changing environment. The last section the article presents the performance of innovation in Albania.

2. IMPORTANCE OF INNOVATION

Innovation is important on different levels and is also important for different reasons. For nations, (and regions) innovation is an important driver of economic growth and improvement. For firms, there are a number of reasons, including survival, growth and shareholder return.

According to Baumol (2002) virtually all of the economic growth that has occurred since the eighteenth century is ultimately attributable to innovation. Long-run economic growth depends on the creation and fostering of an environment that encourages innovation. Also according to Economist Intelligence Unit 2007 "Innovation is considered an important driver of long-term productivity and Economic growth. It is argued that countries that generate innovation, create new technologies and encourage adoption of these new technologies grow faster than those that do not".

Why do we say that innovation is important? There are a number of surveys that have recently been published which confirm this. For example, respondents to The Boston Consulting Group for their report "Innovation 2010. A Return to Prominence – and the Emergence of a New World Order" ranked innovation as a strategic priority with 26% citing it as a top priority and a further 45% ranking it as a top three priority. Research undertaken by McKinsey during 2010 supports this with their survey reporting that "84 percent of executives say innovation is extremely or very important to their companies growth strategy."

3. DEFINITION OF INNOVATION

Innovation is considered as an essential component of the enterprise (Covin and Miles) and a key element of business success (Nonaka and Takeuchi, 1995). In simple terms, innovation involves the exploitation of new ideas. Innovation is often confused with invention. Freeman (1982), however, makes clear the distinction, when he notes: "an invention is an idea, a sketch or model for a new or improved device, product, process or system", whereas "an innovation in the economic sense is accomplished only with the first commercial transaction involving the new product, process, system or device". The OECD (1981) expand this assertion, by proposing that "innovation consists of all those scientific, technical, commercial and financial steps necessary for the successful development and marketing of new or improved manufactured products, the commercial use of new or improved processes or equipment or the introduction of a new approach to a social service. Research and Development is only one of these steps" (Nelly, 2009). According to Schumpeter (1934), pioneer in innovation research, has identified various forms of innovation, including products, processes, market and organizational innovation. He includes five manifestations of innovation in its definition:

1. Creation of new products or qualitative improvements in existing products

2. Use of a new industrial processes
3. New market openings
4. Developing of new raw-material sources or other new inputs
5. New forms of industrial organisations

The influence of the Schumpeterian vision of innovation persists to this day and can be seen in the European Commission’s Green Paper (1995) on innovation that defines it as “...renewal and enlargement of a range of products and services and the associated markets, the establishment of new methods of production, supply and distribution, the introduction of changes in management, work organisation and the working conditions and skills of the workforce” and in Edquist’s (2001) summary description of innovations as new creations of economic significance normally carried out by firms (or sometimes by individuals). In the following part, we will discuss more briefly about problems and needs for development of innovation in SMEs.

4. INNOVATION DEVELOPMENT WITHIN SMEs

A major topic in the innovation literature is the importance of SMEs for innovation. Studies have shown that SMEs contributed to the main innovations of the twentieth century (Oakey, et al., 1988; Rothwell, 1994). SMEs have some advantages because of their size. Many are flexible and have strong relationships with customers, enabling rapid response to technical and market shifts. Small firms usually have good internal communications and many have a dynamic and entrepreneurial management style (Rothwell, 1994). As well, some studies suggest that the average capability of technical people is higher in small firms and that innovations in these firms can be less expensive (Cooper, 1964). SMEs usually explore new technical spaces. In summary, innovation in small firms can be (more) efficient and effective (Vossen, 1998). On the other hand, many SMEs are not innovative at all. Researchers have stressed the differences between a limited number of very innovative small firms and a large number of non-innovative firms (Acs and Yeung, 1999; Hadjimanolis and Dickson, 2000) Many obstacles to innovation in SMEs are also stressed in the literature. The lack of financial resources, inadequacy of management and marketing, lack of skilled workers, weakness in external information and linkages, and difficulty in coping with government regulations are factors that limit their competitiveness (Buijs, 1987; Freel, 2000; Rothwell, 1994). SMEs may be unable to exploit new products because of the limited organizational and marketing capabilities. Other studies discuss cultural barriers to innovation, such as reluctance to change, tendency to ignore procedure, focus on short-term requirements, lack of strategic vision and the diffusion of a blame culture (Filson and Lewis, 2000; Freel, 2000). SMEs’ main problems are due particularly to the scarce attention devoted to organizational and managerial problems especially in the field of innovation (Cobbenhagen, 1999). In the following part, we will discuss more briefly about some areas that have a specific relevance to the small and medium enterprises (SMEs), which are known as the best way to lead an economy by using innovation as their primary tool to challenge the changing environment.

5. CHARACTERISTICS OF SMES IN ALBANIA

Small and medium enterprises are the engine of the economy. They are an essential source for the creation of new jobs; entrepreneur and innovation spirit, and have a crucial importance for increasing competitiveness. Small and medium-sized enterprises (SMEs) dominate Albania’s economy, representing 99.6% of all registered businesses. The share of the SME sector in GDP is about 73%and the sector covers approximately 71% of all employees. SMEs in Albania concentrate on the local market and lack export competitiveness. Less than 1.3% of the small and less than 5.3% of the medium companies in Albania have undertaken joint ventures with foreign partners over the last three years. SME development in Albania is below regional average. The main challenge remains the relatively poor investment climate. Poor law enforcement, very weak corporate governance (both at the macro and at the enterprise levels), lack of management skills and poor infrastructure constitute the major impediments to SME development. SMEs in Albania are classified according to the number of their employees and turnover and/or balance sheet in compliance with the law nr. 1042 (22/12/2008) on small and medium-sized enterprises:

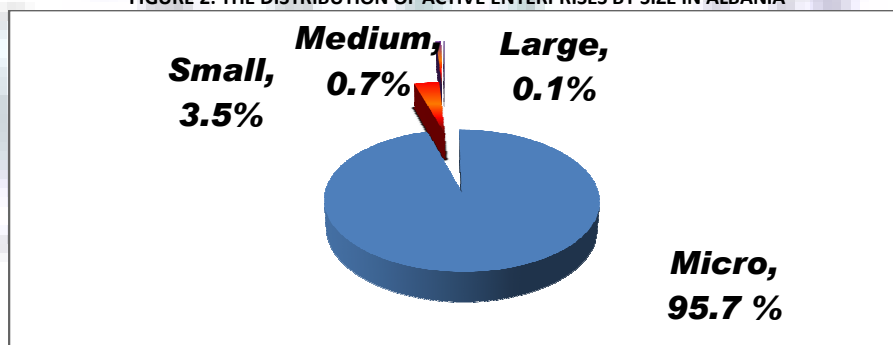
FIGURE 1: SMES DEFINITION IN ALBANIA

Micro and Small Enterprises	Medium Enterprises
By number of employees Micro enterprises: 1-9 employees. Small enterprises: 10-49 employees. - By annual turnover Micro enterprises: Annual turnover can’t exceed the sum 10 mil leke. Small enterprises: Annual turnover can’t exceed the sum 50 mil. lekë - By form of ownership 100% of capital must be owned by individuals	- By number of employees Medium enterprises : 50-249 employees; - By annual turnover Annual turnover can’t exceed the sum 250 million leke. - By form of ownership Less then 25 % of capital can be owned by enterprises which are not classified as SME.

The EU definition of small and medium-sized enterprises consists of firms that employ fewer than 250 people, and have an annual turnover not exceeding EUR 50million and/or a balance sheet total not exceeding EUR 43 million. The Albanian definition is not perfectly consistent with the EU one.

According to data from INSTAT (2010:1), the share of SMEs is 99,9% of the total number of companies in 2009. SME contribution to exports in the year 2009 was approximately 69%. (33% from medium enterprises, 22% from small enterprises, and only 14% from micro enterprises). Referring to their structure, active enterprises for 2010 are as follows: micro enterprises with 1 to 9 employees make up 95.7% of the total active enterprises, small enterprises with 10 to 49 employees cover 3.5%, and medium enterprises with 50 to 249 employees 0.7% and only 0.1% of the total number are large enterprises with more than 250 employees.

FIGURE 2: THE DISTRIBUTION OF ACTIVE ENTERPRISES BY SIZE IN ALBANIA



Source: INSTAT 2011

Total number of active enterprises: 100,687

- Micro (1-9) – 95.7 %
- Small (10-49) – 3,5%
- Medium (50-249) – 0.7 %
- Large (+250) – 0.1 %

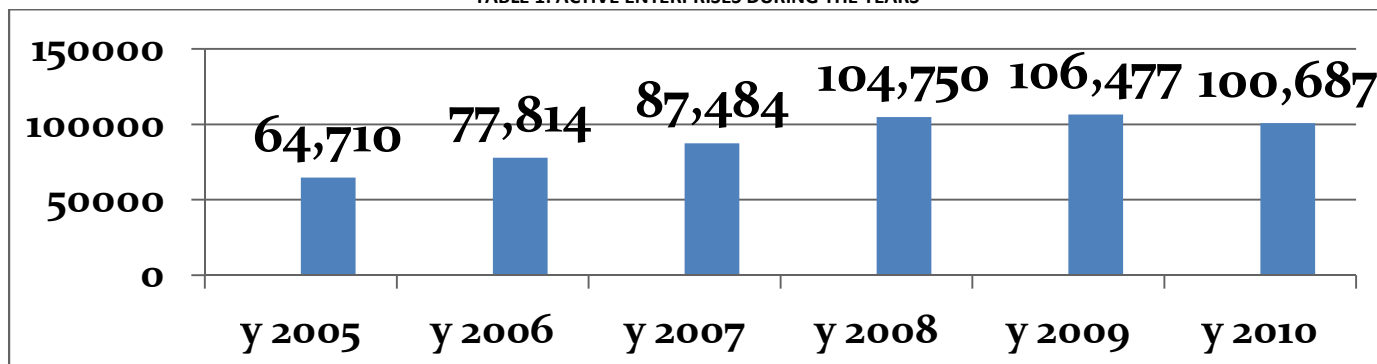
62% are self-employed

New enterprises 2011 12,706

- 5% less active companies compare 2009
- 3,1% increased the number of employee compare 2009

Referring to the INSTAT data (INSTAT, 2011:3), the number of active enterprises 13 till the end of 2010 reached 100,687; which indicated a very slight increase by 1% compared to 2008. The new enterprises created during 2010 are 16,443 (NRC, 2011). The number of employees in non agriculture private sector during 2009 decreased by 0.9% compared to the previous year, while the number of employees during 2010 increased by 3.1%. Birth rate of new enterprises for 2010 is 16% higher compared to 2009. In the following table are shown active enterprises by their year of creation. From 2005 to 2009, enterprises in Albania increased by approximately 55%.

TABLE 1: ACTIVE ENTERPRISES DURING THE YEARS

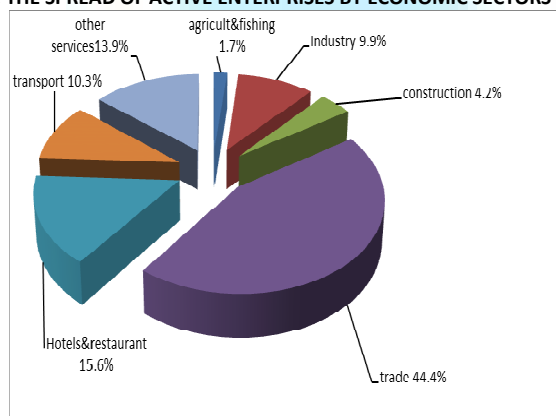


Source: INSTAT 2011

Micro companies dominate the Albanian sector SMEs in numbers, turnover and total value added. However, Small and Medium Enterprises are becoming more productive and economic efficiency increases with the size of the undertaking.

From a sectoral perspective, SMEs are concentrated in the retail sector. Trade and services sectors are dominated by micro and small enterprises, while industry and construction sectors are dominated by medium-sized businesses.

FIGURE 3: THE SPREAD OF ACTIVE ENTERPRISES BY ECONOMIC SECTORS IN ALBANIA



Source: INSTAT 2011

The spread of SMEs according to economic sector:

- Trade – 44.4%
- Industry – 9.9%
- Hotels, coffees, restaurants – 15.6%
- Transport and communication – 10.3%
- Other services – 13.9%
- Construction – 4.2%
- Agriculture and fishing – 1.7%

6. DEVELOPMENT OF TECHNOLOGY AND INNOVATION FOR SMES FOUND OF INNOVATION

Albania has registered a rapid growth in the number of enterprises, a fact which indicates a high degree of entrepreneurial desire instead. Yet, weaknesses persist as regards the provision of support to Small and Medium Enterprises (SME), innovation policy and environmental standards. There was no progress with approval of legislation related to regulatory impact assessment. There was some progress on implementation of the Business Innovation and Technology Strategy. An Innovation Fund of approximately € 285,000 has been established for 2011-2014. The Albanian Investment Development Agency has been fully staffed and its board adopted the regulation for the implementation of the Innovation Fund. CDM No. 104, dated 9.2.2011 was passed Strategic Programme for Innovation and Technology Development for SMEs, and the Action Plan for the period 2011 to 2016, which aims to:

- Assistance to companies in the process of innovation, improving technological capacities;
 - Implementation of a proactive policy of innovation;
 - The creation of an innovation system to increase interoperability in enterprise support institutions;
 - Filling a gap and creating a better connection between SME development policy with that of science and technology.
- Strategic program being implemented by the government is focused on four key areas: 1) Innovation Fund; 2) Services for business innovation; 3) business incubators program; 4) program for the development of clusters;

The innovation fund is created by CMD No. 667, date. 28.09.2011 for the 4 years. The grant by 12 mil. Lek/year. Innovation Fund to provide assistance in the form of direct subsidies, micro, small and medium-sized, up to **400,000 lek**. Depending on the assessment for the project submitted by the applicant. The scheme covers from **30% to 50%** of eligible costs of the project. Argue that assistance through the Innovation Fund will help increase economic activity beneficial to the development of Technology and Innovation for SMEs.

There was little progress in the field of enterprise and industrial policy instruments. Measures to facilitate access to finance for SMEs continued under the Credit Guarantee Fund for SMEs and the European Fund for South-East Europe. Implementation of the credit support scheme financed by the Italian government continued, with preparations being finalized for a second phase of the scheme covering the period 2012-2014. According to Europe Commission for Albania 2012 report progress some measures were taken to facilitate access to financing for SMEs and to improve the regulatory framework for doing business. Overall, preparations are moderately advanced.

7. INNOVATION PERFORMANCE IN ALBANIA

Yet, these days Albania represents a deficit in innovation, with a poor performance, which becomes a handicap for the competitiveness of its enterprises. It ranks 123 out of 144 in Global Competitiveness Report 2012-2013. This puts in risk the competitiveness (ranked 78th out of 144 countries) and sustainability of economic growth and employment. However, Albania is ranked 62nd in terms of technological capacity.

In the Global Competitiveness Report 2012-2013, Albania is listed as a country in Stage 2 of development in the terms competitiveness. This indicates that the country is an efficiency-driven economy characterized by "efficiency enhancers" such as higher education and training; goods market efficiency, labor market efficiency, financial market development, technological development and market size. However, it still lacks the innovation and sophistication factors that characterize the Stage 3 innovation-driven economies.

Albania has not yet reached the innovation-driven stage in which companies must compete by producing new and unique products using sophisticated production processes and innovation. According to the World Bank Report on Building Competitiveness in Albania (2009), private companies "technological capacity" to upgrade by absorbing existing advanced technologies is weak.

Technological readiness, Albania ranked 62. Is an indicator with which an economy adopts existing technologies to enhance the productivity of its industry? In today's globalized world, technology is becoming an important element for firms that they are competitive and have prosperity. Access (including the presence of a suitable regulatory framework) and the use of ICT is included in this column as an essential component of the overall level of technology readiness.

Innovation and business sophistication in which the high standard of living and the development of competing economies through new and unique products using the most sophisticated production processes and innovation. At this stage, Albania is ranked 102.

Innovation, Albania ranked 123. Under the indicators that influence these indicators are:

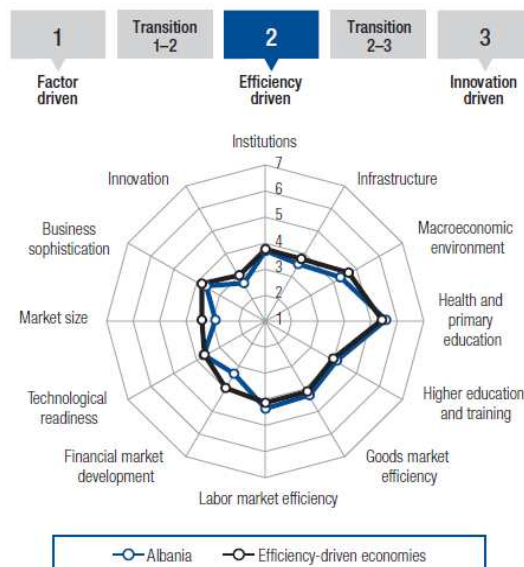
- a. The capacity for innovation, ranked 119
- b. Quality of scientific research institutions, ranked 134
- c. Expenditure on R & D companies, ranked 51
- d. Cooperation university-industry R & D, ranked 139
- e. Government procurement in advanced technology products, ranked 58
- f. Availability of scientists and engineers, ranked 126

These results indicate that the Albanian economy, despite the progress made in recent years, its competition is (still) based on cheap labor power, low productivity reflected in low wages, while public institutions are required to be consolidated further.

The Global Competitiveness Index

	Rank (out of 144)	Score (1-7)
GCI 2012-2013	89	3.9
GCI 2011-2012 (out of 142)	78	4.1
GCI 2010-2011 (out of 139)	88	3.9
Basic requirements (40.0%)	87	4.2
Institutions	84	3.6
Infrastructure	91	3.5
Macroeconomic environment	98	4.3
Health and primary education	79	5.6
Efficiency enhancers (50.0%)	92	3.8
Higher education and training	76	4.1
Goods market efficiency	58	4.3
Labor market efficiency	68	4.4
Financial market development	120	3.4
Technological readiness	77	3.7
Market size	98	2.9
Innovation and sophistication factors (10.0%)	113	3.1
Business sophistication	98	3.6
Innovation	123	2.6

Stage of development



Source: Global Competitiveness Report 2012-2013

According to Global Competitiveness Report 2012-2013, note that Albania innovation is ranked last in comparison with other Western Balkan countries.

TABLE 2: INNOVATION IN WESTERN BALKAN COUNTRIES

Country/Economy	Innovation and sophistication factors		Innovation	
	Rank	Score	Rank	Score
Albania	102	3.18	123	2.58
Bosnia and Herzegovina	108	3.13	104	2.84
Croatia	82	3.37	76	3.09
Montenegro	59	3.62	50	3.39
Serbia	118	2.99	97	2.90
Macedonia, FYR	104	3.14	105	2.81

Source: Global Competitiveness Report 2011-2012

According to Jonida Narazani (2011, p.28): "There are two main factors that present challenges for funding of innovation policy. Firstly, there is the limited share of GDP dedicated to R&D and innovation in the country. Secondly, is the still-constrained innovation creation and absorption capacity resulting in part from the fact that the country has tended to purchase innovations on the market rather than developing them domestically."

Given government budgets constraints, it is evident that additional funding will have to come from international donors and the private sector, including foreign investors which might set up research facilities in Albania to develop tailor made products or technologies for the Albanian market. In fact, *The National Strategy for Science, Technology and Innovation (NSSTI)* specifically seeks to increase innovation in 100 medium and large private companies either through investment in own R&D or in partnership with academic research institutions or foreign partners.

8. CONCLUSIONS

Innovation is important on different levels and is also important for different reasons. For nations, (and regions) innovation is an important driver of economic growth and improvement. For firms, there are a number of reasons, including survival, growth and shareholder return.

Albania has registered a faster growth in the number of enterprises, a fact which indicates a high degree of entrepreneurial desire in the country. However, continues to lag behind other countries in terms of innovation. This puts in risk the competitiveness and sustainability of economic growth and employment. To remain competitive and sustainable in the market SMEs need to invest in innovation.

SMEs can implement innovation using their resources through networks including support institutions, such as research institutions or other external stimuli, or through interaction with providers and clients.

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