ACCESS TO FINANCING FOR SMEs – Problems and Challenges

Prof. dr Dejan Erić
Belgrade Banking Academy
Member of the ERENET Network
2005.
WHY SMEs?

- SMEs – very heterogeneous group, which include a wide variation of firms
- Is there alternative?
- Big companies - Yes - No?
- SMEs – offer new jobs, development of entrepreneurial and managerial spirit, new kind of values and organizational culture…
- Development of SMEs provides a lot of benefits for economy, especially in transition…
SOME COMMON PROBLEMS OF SMEs

• There are so many similarities among SMEs (especially in the region of SEE)
• TECHNOLOGY – technological gap, inefficiency,…
• HUMAN CAPITAL – knowledge, education, productivity
• MARKETING
• R&D, Innovation…
• FINANCING – start-up, growth, expansion, transformation, reorganization, modernizations…
OPEN PROBLEMS IN FINANCE

• Financial gap – shortage on supply of capital to meet demand
• Microfinance and credit guarantee schemes – how to finance start-up and micro firms
• Uncertainty and asymmetric information
• Market inefficiency
• Lack of information
• Lack of knowledge and skills
• For less developed countries – loopholes and weak institutions
FINANCE OF SMEs

• Financing of SMEs could be required at several stages in the firms development
  – Pre start-up phase
  – Start-up
  – Expansion
  – Turnaround

• There is a financing lifecycle for SMEs
• Early stages – seed money
• Break even point – venture capital, private equity...
• Expansion – more possibilities…
FINANCE OF SMEs

• Variety forms:
  • Government programs
  • Venture capital (VC) or BANs
  • Access to loans
  • Access to equity market
FINANCE OF SMEs – GOVERNMENT PROGRAMS

• Government could help bridging the financial gaps with a lot of government schemas and measures
  – Direct loan programs
  – Loan guarantee schemes or guaranteed coverage
  – Schemes to pool risk
  – Export credit schemes
  – Tax stimulations and measures (variety)
  – Consolidation of financial system
  – Creation of efficient financial market and institution
  – Financial regulations and regulatory and self regulatory bodies (Central Bank, Securities Commission, SE, Sores)
FINANCE OF SMEs – VENTURE CAPITAL (VC)

• VC financing of SMEs usually takes the form of equity (shares, rights, warrants, convertibles..)
• Time period – 4-7 years
• Target rate of return – 30-40%
• Financial partners required high rate of return
• 2 main exits: IPO, trade sale
  • **IPO** – firms issues shares to the public – become public
  • **Trade sale** – firms is sold to larger company
FINANCE OF SMEs – VENTURE CAPITAL (VC)

• Some investors preferred certain industries (biotechnology, telecommunications…)

• In less developed countries and economies in transitions - VC financing of SMEs still remains at an infant stage of development

• 2 main reasons:
  • Lack of exit mechanism
  • Undeveloped institutional investors – pension funds, insurance companies, investment funds…
FINANCE OF SMEs – BUSINESS ANGELS NETWORKS (BANs)

• BANs in recent years become one of major source of financing of SMEs
• BANs tries to bring together private investors seeking good investment opportunities with entrepreneurs searching to raise capital
• Number of BANs raising
  – in EU – 1999 – 64
  – 2002 - 157
FINANCE OF SMEs – ACCESS TO LOANS

• A lot of SMEs offer – high risk – high return possibilities for investors

• In the case of dept financing Investors return is very limited, but exposure to risk is high

• Problem – high interest rate – high cost of capital for SMEs

• Smaller SMEs have additional problem – more difficult to obtain loan (there is no tangible assets to secure the loan)
CONCLUDING REMARKS

- The first Conference of Ministers responsible for SMEs – Italy, June 2000. – 50 countries adopted “Bologna Charter for SME Policies”
- Started dialogue and monitoring known as “OECD Bologna Process”
- Minister stressed the importance of access to financing SMEs as one of essential ingredients in facilitating innovation process
KEY POLICY RECOMMENDATIONS

• Concentrate policies for promoting availability of risk capital to innovative SMEs mainly in early stages of the financing of the firm

• Recognize the need for proximity between suppliers of the fund and those who require capital

• Increase the managerial and technical expertise of intermediaries whose role is to evaluate and monitor companies

• Facilitate international transfer of institutional infrastructure and expertise

• Encourage accounting bodies to recognize, measure and report intangible assets of small business
MORE RECOMMENDATIONS

- Ensure political and economic stability
- Ensure stabile and competitive financial system, especially in banking industry
- Effectively manage public sector loan guarantee and equity guarantee schemes
- Support VC and BANs
- Improve level of financial reporting and disclosure of financial data and statements
- Transparency and principles of Corporate Governance
- Increase access to global capital market