ACCESS TO FINANCING FOR SMEs – Problems and Challenges

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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 a 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