

CONSIDERATIONS REGARDING GROWING FINANCING CAPACITY OF SME'S

Nanu Roxana Maria

University of Craiova, Faculty of Economic and Business Administration, A.I. Cuza no.13, Craiova, Romania, rnanu30@yahoo.com, 0724228821

Spulbar Cristi Marcel

University of Craiova, Faculty of Economic and Business Administration, A.I. Cuza no.13, Craiova, Romania, cristi_spulbar@yahoo.com, 0722309021

Buziernescu Radu

University of Craiova, Faculty of Economic and Business Administration, A.I. Cuza no.13, Craiova, Romania, radu@profcons.ro, 0722350573

Small and Medium Enterprises are very important part of both developed and less developed national economies. The European Union experience shows that it has a significant contribution to the GDP and to the reduction of the unemployment rate. In Romania, as in many countries in the area, there is still a long way ahead for reaching an adequate support for SME development potential. Romania has a sector which, although has recently followed a positive trend, it possess performances which are still low in comparison with the countries from European Union, including the countries which entered the European Union in May 2004. The paper highlights financing methods used by SME, the reasons for the present situation as well as the measures thought to be the best for its improvement. In order to amend the situation the Romanian SME are in, Romania must take multiply sided actions, the main role being assigned to government, banks and guaranteeing institutions, that must develop a series of transparent, efficient and correct instruments.

Cuvinte cheie: SME's, financing, credit, leasing, guaranteeing funds, structural funds

The challenges caused by regionalization and globalization of markets demand the compliance of SME to the competitive environment, by consolidating their market position and benefit from the economical opportunities. If traditionally, small and medium enterprises were considered economical operators belonging to the internal market, today a growing number of SME are managing to conquer the global markets. Approximately one fifth of the SME involved in the productive activity in the OCDE countries realize a proportion of 10 to 40% of the their turnover from international activities. SME contribute in a high proportion to the global industrial exports and increase the volume of foreign direct investments worldwide.

In the European Union, SME play an important role, their number being predominant: nearly 99% of the companies are SME, while 90% of them are micro enterprises. At the same time, European SME work force accounts for nearly 70% of the total confirming the social role of SME. In fact, all EU Member States have taken steps in stimulating entrepreneurial spirit. These measures widely vary and consist of loans and grants offering, on one hand, and, on the other hand, in offering support services, such as technical, juridical, managerial consultancy and information centers for setting up companies, training possibilities for potential candidates and new entrepreneurs and market studies.

In Romania, the role of SME is lower from the point of view of the turnover percentage or the added value created in economy, but, on the other hand, at their level, there exist 57% workers of the total number of employees. As for SME structure, there is a slight tendency of micro enterprises predominance and most of the employees may be found in the services sector.

Comparative definition between Romanian SME and European Union SME

Necessary conditions for situating within SME	Micro	Small	Medium
Romania			
Employees number	<10	<50	<250
Turnover (in millions EUR)	<8		
Other conditions (other companies 'shares/social capital)		25%	25%
European Union			
Employees number	<10	<50	<250
Maximum turnover (in millions EUR)	n/a	7	40
Maximum own capitals (in millions EUR)	n/a	5	27
Other conditions (other companies 'shares/social capital)	n/a	25%	25%

As we may see, the notion of SME is the same in the Romanian legislation and in the European Union; nevertheless, there are slight differences regarding turnover and their own capitals that insure equality conditions for Romanian SME on EU integration.

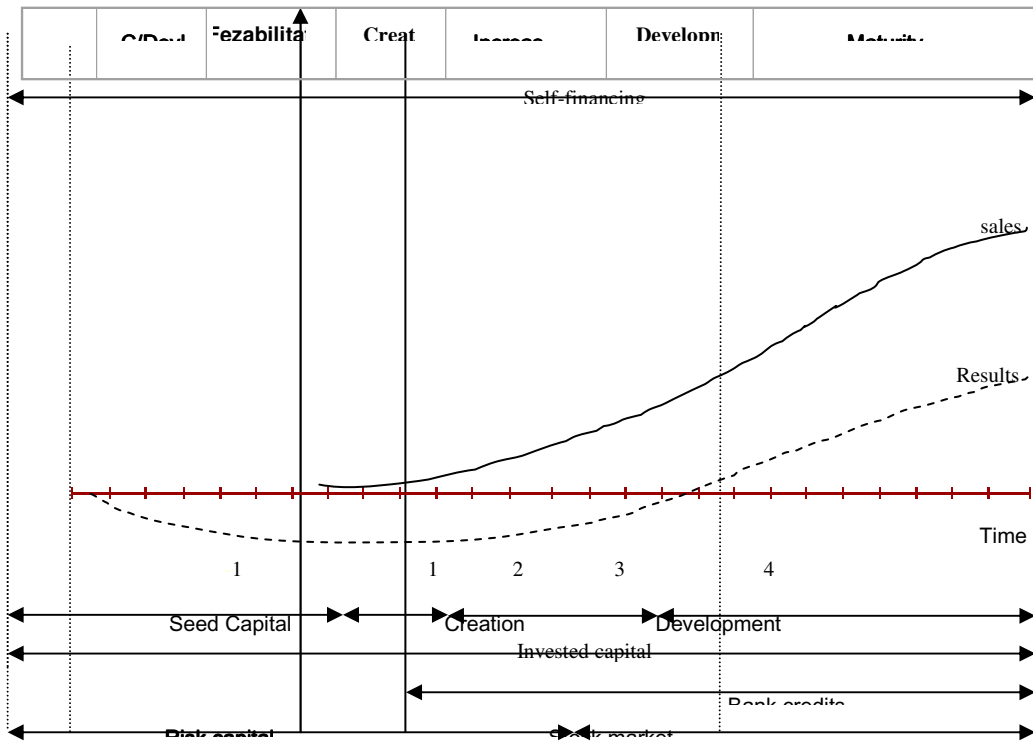
In spite of a positive dynamics, registered during recent years in the tendency towards productive sector as well as in the resources of the local entrepreneurial spirit, SME contribution at GDP still remains low; this fact proves the necessity of stimulating quantitative and qualitative increase of the SME sector. SME access to capital, technology and infrastructure is much beyond the extent that would allow using SME significant role in strengthening economic competitiveness, in particular adaptability to market demands and introduction of new processes.

In the context of competitiveness, most of the small and medium enterprises in Romania need financial support if we were to take into account that their productivity is lower than the big enterprises'. SME financing has gone a long way in the last 17 years in Romania. However, we still have to wait a little longer until we reach an adequate support for SME development potential.

We must bear in mind that, on their evolution, SME have to pass different business development stages, and that in each of these stages, there are needed other types of financing having different terms and conditions.

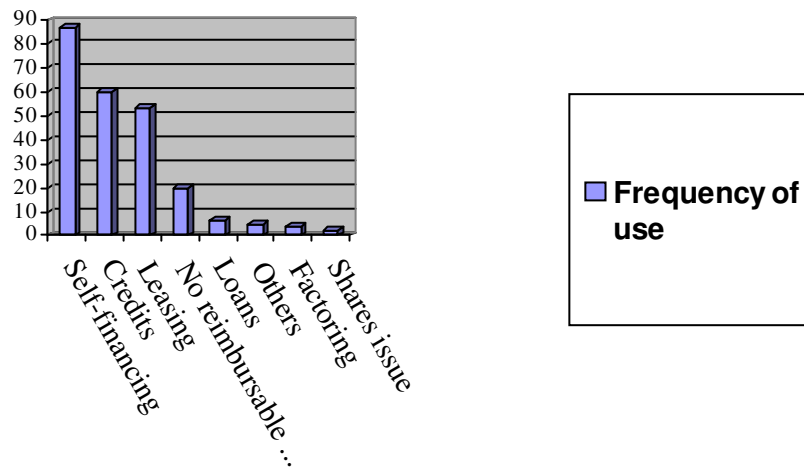
As we may see in the chart, the main financing method that SME dispose of, consists of self-financing, irrespective of the development stage, while banking credits as well as the resources originating from stock market, are relevant only in SME raise, development or maturity stages. Likewise, in the first SME development stages, we may also use risk capital financing.

SME access to financing represents an important side of the entrepreneur's stimulation; we may improve this aspect by financial system and public sector support. The role of the financial system tends to be offered a particular size, all its sectors (banking, leasing, and credit guaranteeing funds) having a significant potential in SME development.



Financing types in different business development stages

The results of some surveys on financing methods used by SME prove that 57.66% of SME carry on their activity only through their own sources. Thus, the most frequently seen financing methods used by SME consist of self-financing (used by 86.7% of companies in the survey), banking credits (60.1%) and leasing (53.2%). This is due primarily to difficult crediting conditions in Romania (high interest rates, high bonds, numerous and difficult grant formalities etc) but also to the possibility for some companies to finance their own activities, especially in the trade sector. We may see the SME method used in financing in chart no.2.



Used financing methods

Covering the financing necessities, primarily from own sources, generates a decrease in liquidities total of companies that may prevent, first of all, taking advantage of some business opportunities and secondly, financing investments having an impact on technological modernization. The lack of liquidities is emphasized by the delayed deduction of delivery as well as the increased tax system. These shortcuts in financing small and medium enterprises generate and develop the vicious cycle of illegal payments that are not included in bookkeeping, thus triggering tax avoidance and corruption.

Although in 2005, SME bank debts represented only 10.5% of total debts, in the first half of 2006, the increase in banking financing was considerable (33%), but if we compare to the European Union where SME financing is around 79% by means of banks, we may easily conclude that there is still a long way ahead of us.

In the last three-year period, according to the ENSR-Survey, 76 % of UE SMEs which asked for a bank loan, received it. The reasons for not obtaining bank financing differ between size classes: lack of collateral mostly affects micro and small enterprises, while poor business performance and insufficient information are the main reasons for medium-sized firms. In fact, in the last period, taking into account the remarkable potential of SME sector, the banks from Romania have begun to offer products and services aimed at these companies, in line with their needs and capital. However, at the same time, starting with January 1, 2007, there are important changes in the banking system also together with the appliance of new requirements of Basel II. Thus, trade companies must have a very good rating in order to receive credits according to new requirements of capital equalizing; in this respect, they must have capital accumulation and select the activities that may offer them good financial results. According to new capital requirements, SME credits will be balanced by 100% if they fall under the category of corporate or by 75% if they fall under the retail category, which means maintenance of the existing situation or even an improvement regarding credit risk appreciation of SME.

Thoroughly analyzing the causes preventing SME banking credit system from developing, we may discover the difficulties that entrepreneurs claim in their relation to banks. Decreasingly, difficulties with negative impact on banking credit system are the following: bank officer relationship, thorough documentation required by the bank in view of granting a credit; the length period of approving the credit by the bank; guarantees level and interest rate.

The ENSR Survey 2002 reports that European SMEs are satisfied with bank services. About two thirds of the SMEs are satisfied, approximately 12 % dissatisfied. The major reasons for dissatisfaction are: poor service, bank charges and frequent changes of contact persons. Especially in the case of medium-sized enterprises, banks do not seem to offer the best solutions to their clients. Medium-sized enterprises are also more often concerned by the refusal of additional loans or the withdrawal of existing credit facilities. There is a certitude that entrepreneurs are not reluctant in soliciting credits primarily because of the interest rate (that they include in products price anyway), but mainly because of reasons regarding client-bank relationship. There is a serious alert for banks that, in the context of market economy, would have to choose between adapting its policies to clients that is, always satisfying the clients' increasing needs and cut in turnover and profitability.

From the UE SMEs' point of view, the cost of borrowing (interest rates as well as charges) is still an important issue. External finance tends to be more expensive for smaller enterprises than for large ones as the fixed costs of lending (e.g. administrative costs and the costs of collecting information about the borrower) are not proportional to the size of the loan and make small loans more expensive than large ones¹³². This price difference is also caused by different risk positions taken by banks and some other size-related factors such as the greater financial acumen existing in LSEs and the greater leverage often available to LSEs.

These difficulties on obtaining a credit are doubled by the ones specific to reimbursement: fluctuating exchange rate, further costs generated by payment reallocation of unsuccessful credits, interest adjustment during the credits reimbursement period.

In order to have an easier access to banking credits, SME should benefit from a series of measures, such as:

- Thinking the business over in perspective;
- Presenting a well-structured and conceived business plan;

¹³² Wagenvoort, R., Are finance constraints hindering the growth of SMEs in Europe?, EIB Papers, Vol. 7, No. 2, 2003.

- Apply to specialty consultancy unless they dispose of their own expertise to start with;
- Developing their own expertise in carrying out their relationships with the financing bank;
- Building up a mutually confident relationship with the bank: carrying on the operations through accounts opened at the bank from which the loan is asked for, credible and solid information, information supply in due time;
- Operatively informing the bank on further difficulties encountered during the credit period; and talking the solutions over.

A solution would come up if banks and guaranteeing funds had a common strategy for SME financing because one of the most important issue that entrepreneurs deal with when accessing a financing line is the lack of guarantees. Guarantees work on the principle of shared risk between the bank and the guarantee association, thereby significantly reducing the degree of risk for the bank. In the context of regional policy, guarantee schemes can play an important role in improving access to finance, creating private sector funding leverage and encouraging the development of SMEs. Guarantee schemes are especially suitable for very small loans to micro enterprises unable to provide the lender with the required collateral. In table the advantages and disadvantages for the participating parties are listed¹³³.

Advantages and disadvantages of guarantee schemes

Advantages	Disadvantages
SMEs, which cannot easily get finance, benefit from facilitated access to loan financing on better terms.	Only a part of the risk is covered by the guarantee society or fund.
Risk sharing between the guarantee society or fund and the bank reduces the capital requirement of the Basel rules.	By reducing the risks to banks, guarantee schemes may also reduce the extent to which banks scrutinize new loan applications.
Through guarantee societies and funds, private sector financing for SMEs is leveraged promoting regional development.	The extent to which guarantee associations and guarantee funds receive support from public authorities varies across the European Union and is mainly dependent on the prevailing banking culture.
Guarantee societies and funds provide local input and tailored business support and advice.	

In most of the European countries loan guarantee funds and mutual guarantee schemes offer guarantees to SMEs with insufficient collateral, especially micro enterprises. Loan guarantee schemes are often used by 'young' enterprises (12 % of SMEs with less than 5 years compared to 8 % of SMEs with more than 10 years in business). In this respect, in Romania was founded the SME Credit Guaranteeing Fund, a ventured capital institution aiming at facilitating the access to financing through credits guarantees or letters of bank guarantee for SME not having enough financial resources and material guarantees, but with viable business projects.

Another method of financing for SME is leasing. In the European Union, one of two SME has already used a leasing operation for business financing. The average penetration of leasing is estimated to be about 12 % in the European Union.

In Germany, over 70% of small and medium enterprises prefer leasing or loan in order to buy machines and equipments. A study made by the Directorate for Enterprises and Industry of the European Commission indicates that nearly half of small and medium enterprises in the old EU countries have already used the leasing system, loan and account overdraft for investments financing. After Germany, the SME of Austria (65%) and Sweden (63%) take the second place in their preference for leasing or loan. In Romania, the leasing market experienced a significant growth; the specialists think that this sector attraction is closely related to leasing development for the means of transport as a more approachable and easier way of financing for small entrepreneurs.

¹³³ European Commission, Guide to Risk Capital Financing in Regional Policy, Brussels, 2002.

Within the EU economic and social cohesion policy, Romania will benefit from structural funds of nearly 30 billion EUR during 2007-2013. These EU structural funds are treated by the European Commission and aim at financing structural aid measures at the Union level in order to promote low developed areas, reconversion of areas experiencing industrial decline, abolishing long-term unemployment, professional insertion of the youth or promoting rural development. One of the main fields of intervention for operational programmes (Sectorial operational sector – Economic competitiveness increase) aims at accomplishing productive investments and preparing for competitiveness on the European market of small and medium enterprises, the allocations in this field being managed by the National Agency for Small and Medium Enterprises. The Programme of Competitiveness Improvement for SME consists of 6 priority axes, the main ways through which small and medium enterprises will be able to access funds within the sectorial programme, that is:

Axis 1 – Production modern system;

Axis 2 – Research, technological development and innovativeness for competitiveness;

Axis 3 – Information and Communication technologies for private and public sector;

Axis 4 – Energetic productivity increase and durable development of the energetic system;

Axis 5 – Romania, attractive destination for tourism and business;

Axis 6 – Technical assistance

In order to improve the current situation of the Romanian SME, we must take various steps, the main role being played by the government, banks and guaranteeing institutions that must develop a series of efficient, correct and transparent instruments. We strongly recommend priority actions concerning:

- Setting up a system of guaranteeing and co-guaranteeing funds at a national and regional level for enterprises financing;
- Significantly diminishing guarantees values and commissions required by banks on granting credits in line with the European Union procedures;
- Simplifying credit granting procedures;
- Subsidizing interests for SME credits, in particular for the ones in certain fields and categories;
- Drawing up a national training programme for enterprisers in order to access structural funds based on the principle of public-private partnership;
- Granting adequate grace periods for investments credits and periods increase;
- Promotion of the use of non-traditional financial instruments such as risk capital funds etc.

Bibliografie

1. BNR, April 2006, The role of non-financial Romanian companies in insuring and preserving financial stability
2. European Commission, Observatory of European SMEs 2003, No. 2
3. European Commission, Guide to Risk Capital Financing in Regional Policy, Brussels, 2002.
4. National Council of Small and Medium Private Enterprises in Romania 2005, survey titled Financing methods used by SME, www.tribunaeconomica.ro
5. Wagenvoort, R., Are finance constraints hindering the growth of SMEs in Europe?, EIB Papers, Vol. 7, No. 2, 2003Referinte 1