THE ACCESS TO FINANCING OF SMALL AND MEDIUM ENTERPRISES IN ROMANIA AND IMPLICATIONS OF CURRENT CRISIS

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Abstract

The easy access to financing of enterprises in general and of small and medium enterprises (SMEs) in particular is of crucial importance, for it conditions their creation, survival and development, and, eventually, economic growth and the creation of workplaces. In comparison with large enterprises, SMEs are faced with numerous obstacles when obtaining financing resources, due to the reticence of the financial markets to take risks, as well as to the insufficient guarantees offered to the creditors.

The aim of this paper is to analyze the particularities of the financing received by small and medium enterprises in Romania in comparison with other EU countries, the implications of the current crisis on the access to financing of small and medium enterprises, as well as the measures adopted by public authorities in order to support these enterprises.

Keywords: SMEs, financial structure, bank loans, financial crisis, anti-crisis measures
JEL classification: G01, G21, O12

1. INTRODUCTION

Generally, enterprises can use internal funds or funds from external sources in order to finance their activity. The selection, by an enterprise, of a particular type of financing is explained by the pecking-order theory, originally developed by Myers [1984] and Myers et Majluf [1984], according to which enterprises would rather use internal resources than external ones, and, as concerns the latter, they would prefer debt finance to equity finance. The preference of enterprises for internal financing is financially justified in the sense that, due to information asymmetries between firms and their potential investors regarding the firms' current operations and future prospects, the investors will ask a return on the capital that is lent (in case of debt finance) or invested (in case of equity finance). The preference for external debt finance instead of external equity finance is indicative of the managers' or the entrepreneurs' desire to maintain control over the enterprise.

According to specialized studies, the finance options of an enterprise are influenced by the entrepreneurs' preferences and especially by the options that are available on the market [Demirgüç-Kunt et al, 2008, 57]. The availability of external finance is influenced, in its turn, by a series of factors that are internal or external to the enterprise. For example, external finance depends on the situation of the enterprise (level of internal finance, credibility of the entrepreneurs' business plan, their willingness to share control), as well as on the existence and efficient operation of financial institutions.

Traditionally, SMEs finance themselves, to a great extent, from internal sources, which include owner investment, as well as financing through retained profits, and / or the sale of assets. The preference for internal finance, of small and new enterprises in particular, is due, as previously mentioned, to more significant information asymmetries that determine the investors to require greater returns on capital. However, for many small and medium enterprises, and especially for fast growth firms, internal sources do not suffice, for example, for financing new investments, and, thus, they are forced to resort to external financing sources. They can be “informal financing sources”, for example money raised externally through the so-called three F's – “friends, families and fools" and/ or through Business Angel investment and more conventional sources of (formal) external financing (debt finance in the form of loans from bank and other financial institutions, micro credits, leasing, hire purchase, risk capital, factoring, trade credit) [European Commission, 2009b, 14].

According to the European Venture Capital Association (EVCA), the financing sources for SMEs, especially for high growth enterprises, can differ, depending on their lifecycle (see table 1).

Table no. 1 Financing sources of SMEs by stage of development

Phase in SME lifecycle	**Type of financing**
Seed stage	Informal equity from founder and associates. Bank loan if available and needed.
Start-up stage	Informal equity from founder and associates and contacts. Bank loan if available. Leasing for equipment.
Expansion stage	Equity from original sources, plus trade investments or venture capital. Loans from bank. Other sources of finance including leasing and factoring.
Replacement Capital	Trade investment, venture capital or initial public offering (IPO)

Source: [European Commission, 2002, 8]

The easy access to finance of enterprises in general and of small and medium enterprises in particular is of crucial importance, for it conditions their creation, survival and development, and, eventually, economic growth and the creation of workplaces.

The studies conducted by OECD show that inadequate financing constitutes an obstacle to the development of small and medium enterprises, and especially of innovative ones, problem also known under the name of “finance gap” [OECD, 2006]. The concept of “finance gap” does not have a universally valid definition in economic theory. However, numerous studies which deal with aspects related to the inadequate financing of small and medium enterprises, including the studies conducted by OECD invoke the Canadian definition. According to this definition, there is a “finance gap” when the enterprises that would deserve financing cannot obtain the financial resources they need from the financial market (from banks, capital markets or other suppliers of finance), as a result of its imperfections [Industry Canada, 2001].

In comparison with large enterprises, SMEs face, even when economy functions at its normal pace, numerous obstacles in procuring finance sources. This is due to the reticence of financial markets to take risks (especially due to the incomplete informing of the equity suppliers with regard to the situation and development perspectives of small and medium enterprises) and to the insufficient guarantees offered to creditors. For example, if one takes into consideration bank financing, one may notice that some banks refuse to grant loans or increase interest rates for operational SMEs that do not offer adequate guarantees or do not have a credit history, for they have just started their activity or they have a degree of solvency that does not fall into the limits imposed by the banks in question. As for equity financing, the amount of funds which small firms seek may be too small for investors to justify the costs related to making the required investment.

This study is structured as follows: Section 2 surveys the literature related to the financial structure of SMEs and to their access to financing; section 3 highlights the particularities of the financing of SMEs in Romania in comparison with the other EU countries. Section 4 focuses on some implications of the current crisis on the access to finance of SMEs and on the measures adopted by public authorities in order to support these enterprises. The study ends with the conclusions.

The methodology we used in this paper consists of: the analysis of Romanian SMEs financing structure compared to other EU Member States, highlighting the implications of the current crisis on SMEs access to finance, especially on financing through bank loans and the main measures adopted by public authorities to support the SME sector. Based on this methodology, our concluding remarks outline that access to finance is one of the most important obstacles to SMEs development and that public authorities need to strengthen their actions in order to support this process, especially in the area of bank loans access.

2. LITERATURE REVIEW

The issue of the financing of small and medium enterprises is dealt with in numerous studies that, using the World Business Environment Survey (WBES) as a source for statistical data showed, based on a number of enterprises from a significant number of countries, the primary factors that influence the financial structure of SMEs. Thus, Demirguc-Kunt et Maksimovic [1999] examine capital structure in 30 developed and developing countries and show that differences in financing patterns are indeed mostly due to the differences in the development of stock markets and banks, as well as differences in the underlying legal infrastructure. Demirguc-Kunt et Maksimovic [1998] show a relation between the development of financial institutions, external financing and firm performance. Beck, Demirgüç-Kunt et Maksimovic [2008] showed, based on a survey conducted at the level of enterprises from 48 countries, that the differences related to the financing modalities of enterprises are influenced by the size of the firm, the development level of the financial systems and the property protection rights.

Also, numerous studies based on inquiries emphasize the fact that access to finance is one of the most frequently mentioned problems by enterprises, which see it as a significant obstacle to their growth. For example, Beck, Demirgüç-Kunt et Maksimovic [2005] proved that finance related constraints lead, in comparison with other constraints, to a much more significant reduction of the sales of an enterprise. The study conducted by Ayyagari, Demirgüç-Kunt et Maksimovic [2006] shows that, although the enterprises interviewed on the occasion of the survey also identified other obstacles to their growth, access to financing remains one of the most important factors which prevents firm growth.

Beck, Demirgüç-Kunt, Laeven and Maksimovic [2006] show that access to finance and credit costs are much more important obstacles for SMEs, in comparison with large enterprises, and that these factors affect their performances. Beck and Demirguc-Kunt [2006] show that access to finance is an important growth constraint for SMEs, that financial and legal institutions play an important role in relaxing this constraint, and that innovative financing instruments can help facilitate SMEs' access to finance even in the absence of well developed institution.

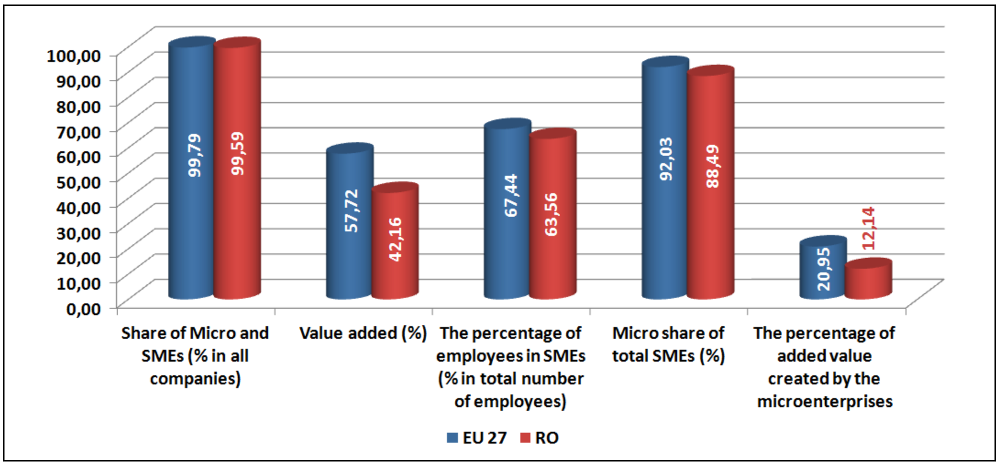
3. SMES FINANCING POSSIBILITIES IN ROMANIA

3.1. Importance of the SMEs sector in national economy

The necessity of knowing the financing possibilities of SMEs and the obstacles they face when trying to obtain finance resources results from the significant role of these firms in national economy.

A considerable part of specialized literature highlights the major importance of SMEs for the economic and social growth of a country. The significant role of SMEs results primarily from the fact that they generate a large part of the gross domestic product of a country and offer workplaces for a large sector of the employed population. For these reasons, the sector of SMEs is considered the engine of the economic and social growth of a country.

The role of small and medium enterprises in national economy can be shown based on the data in figure 1.



Source: processed after [European Commision, 2010]

Figure no. 1 Key indicators for SMEs in the EU and Romania, 2008

From figure 1 it results that the percentage of SMEs in the total number of firms in Romania (99.59%) is approximately equal to the EU average. As concerns the structure of SMEs according to size classes, one may notice that the percentage of microenterprises in the total number of SMEs is smaller in Romania, which means that the percentage of SMEs is bigger.

As concerns the contribution to workplace occupancy (63.56% in Romania in comparison with the EU average, of 67.44%), and especially to the creation of added value (42.16% in Romania in comparison with the EU average, of 57.72%), one may notice differences that do not honour our country. This situation is due to the microenterprises with poorer performances in comparison with the EU average; hence the necessity of continuing the process of real convergence.

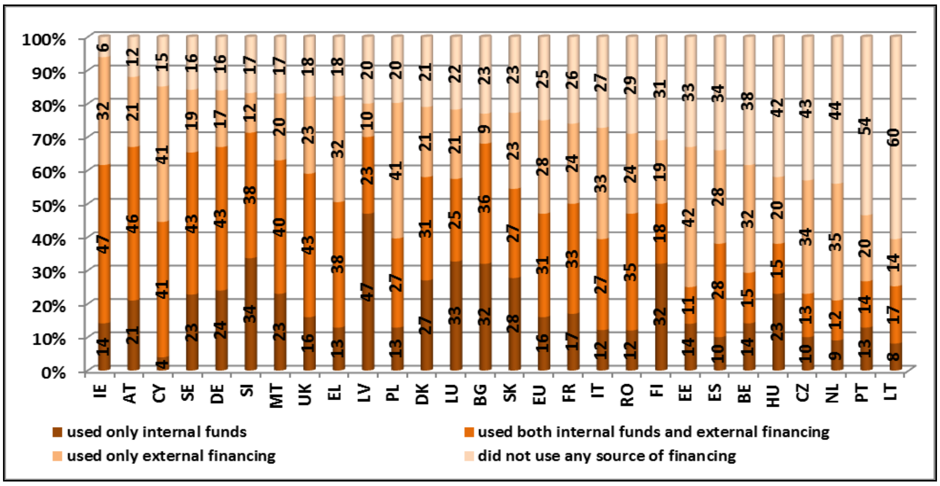
3.2. SMEs financing structure

Material and method

In order to identify the financing sources of the activity of SMEs in Romania, the existing differences in comparison with other EU countries, as well as the difficulties these firms face when trying to access financing, one will take into consideration the results of the survey conducted by Flash Eurobarometer no. 271. This study was conducted by the European Commission and Central European Bank in order to identify the access to finance of enterprises from EU and from other three countries. The study focused on approximately 9000 enterprises in the EU, Croatia, Iceland and Norway, and took place over the period January – July 2009. The interviews were taken over the period June – July 2009, and the analyzed sample of enterprises was structured according to their size class, distributed as follows: 50% - micro enterprises (1-9 employees), 30% - small (10-49 employees), 10% - medium enterprises (50-249 employees) and 10% - large enterprises (with 250 employees and over). As it results from the distribution of the sample, small and medium enterprises cover an overwhelming segment (90%); hence, one can consider that the results of the Flash Eurobarometer survey are relevant to this research.

Results and discussions

As concerns the financing resources used by SMEs in Romania in comparison with other countries, the results of the Flash Eurobarometer study reveals the existence of some significant differences between countries (see figure 2). Over the period January – July 2009, in Romania one may notice that the highest percentage of firms (35%) preferred to use for financing purposes both internal and external sources of finance. In comparison, the highest percentage of firms that used such financing was registered in Ireland (47%), Austria (46%), and the lowest percentage in the Czech Republic (13%), the Netherlands (12%) and in Estonia (11%).

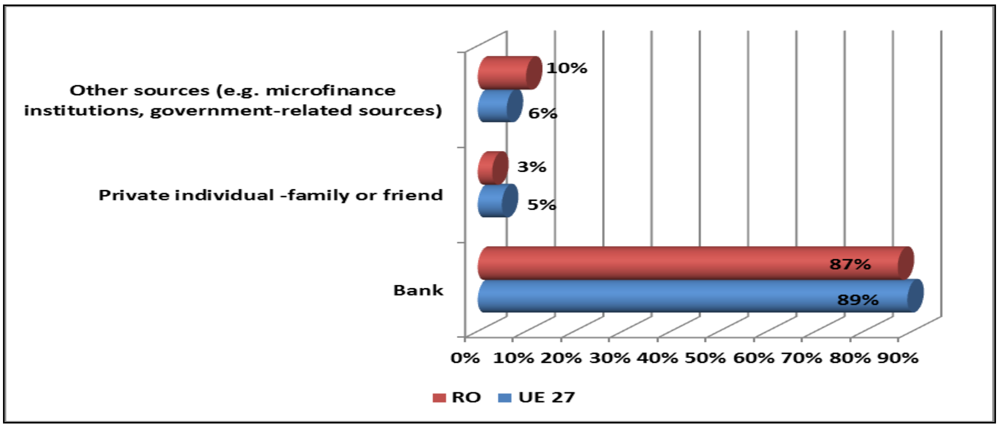


Source: [European Commission, 2009a]

Figure no. 2 Financial structure of the enterprises in the EU, Croatia, Iceland and Norway

As concerns external financing, the results of the Flash Eurobarometer study show that the bank was the popular source for all the countries that participated to this survey. Such a result is natural if one considers that the financial systems of the EU countries rely, to a great extent, on banks. In the case of Romania one may notice that, during the last two years, 87% of the small and medium enterprises interviewed over the period June – July 2009 resorted to bank credits, only 3% to loans from family or friends and 10% to other sources (see figure 3).

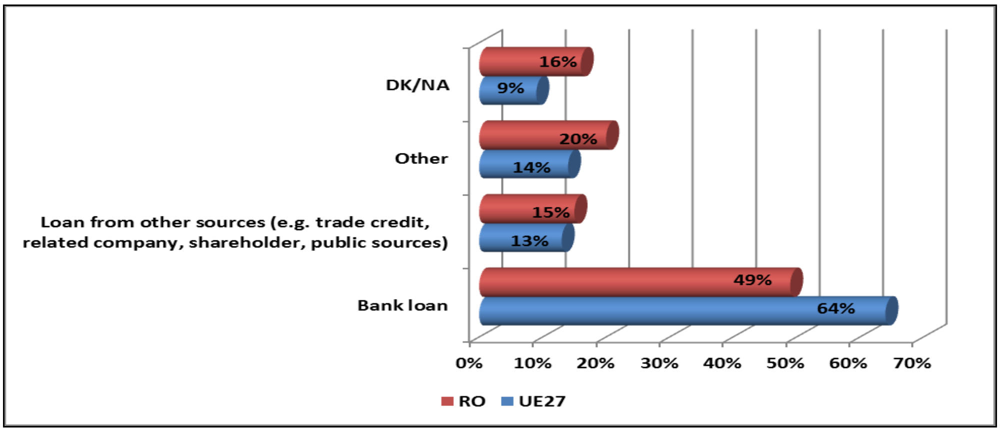
Consequently, small and medium enterprises are highly dependent on banks, aspect that can be explained by the fact that this type of enterprises has fewer financing options in comparison with large enterprises. On the other hand, the high dependence on banks, especially that of microenterprises and small firms makes these enterprises very vulnerable to a credit crisis [European Commission, 2010, 32].



Source: [European Commission, 2009a]

Figure no. 3 External financing sources of enterprises in the EU

The bank credit was the type of external financing most frequently used by small and medium enterprises, as well as the most preferred type for future use (see figure 4). In Romania, the results of the survey show that approximately half (49%) of the interviewed small and medium enterprises mentioned the preference for this type of external financing in the future.

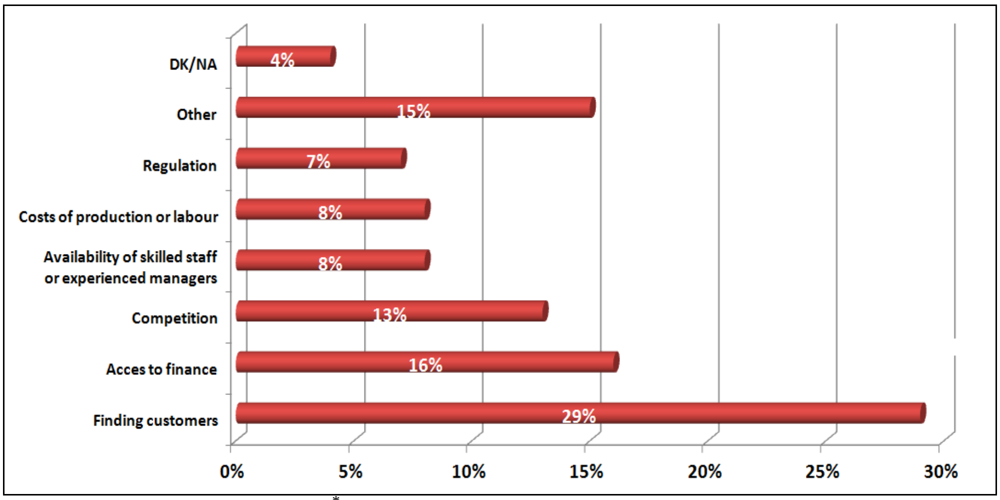


Source: [European Commission, 2009a]

Figure no. 4 Most preferred type of external financing to realise growth ambitions

4. IMPLICATIONS OF THE CURRENT CRISIS ON THE ACCESS TO FINANCING OF SMES AND MEASURES ADOPTED BY PUBLIC AUTHORITIES

Access to finance of the firms is their main concern, as shown in the Flash Eurobarometer survey, from June 17 to July 23, 2009, on a sample of 9.063 companies from EU countries, Croatia, Iceland and Norway. Thus, to the question "What is currently the most pressing issue your firm is facing?" 29% of companies surveyed identified the most pressing problem finding customers, and access to finance was considered as the second pressing issue, as identified by 16% of respondents (see figure 5).

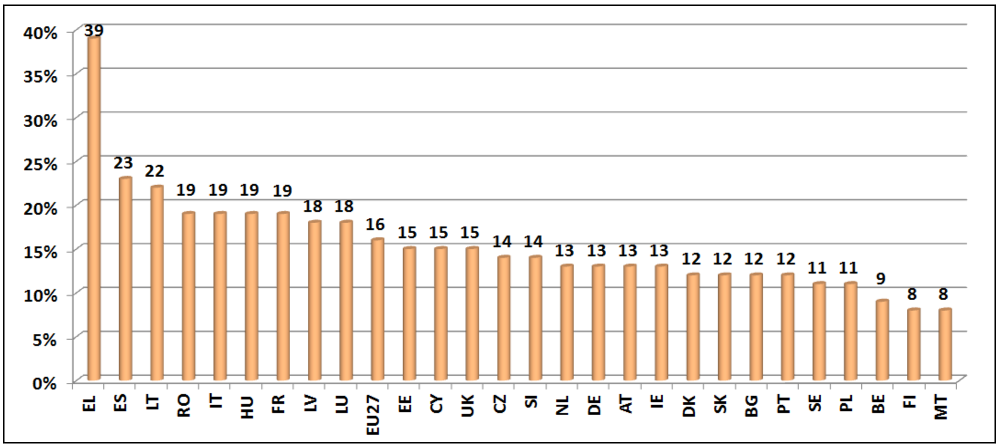


*Base: all companies EU-27, in %.

Source: [European Commission, 2009a]

Figure no. 5 SMEs' main problems*

Regarding the response of the managers of the companies from different countries to the mentioned question, the survey results show significant differentiation between some countries (see figure 6). In Romania, the access to finance was identified as the most pressing problem by 19% of interviewed enterprises.



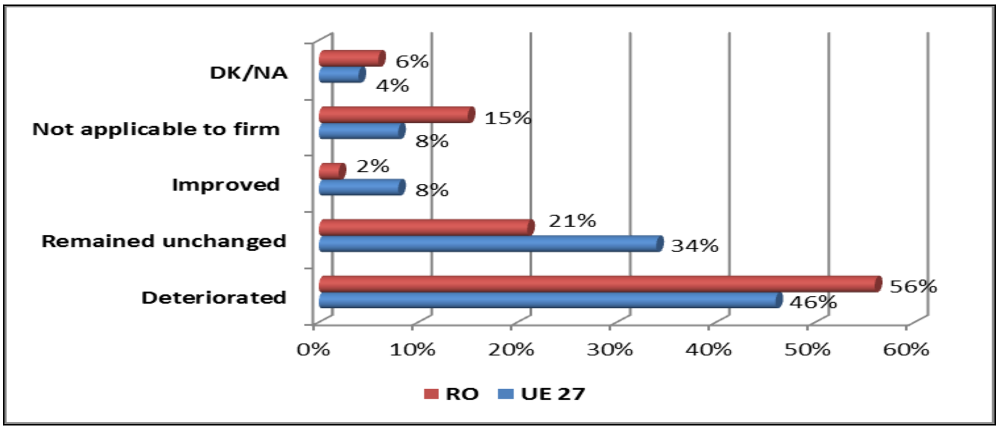
Source: [European Commission, 2009a]

Figure no. 6 Companies identifying access to finance as the most pressing problem

In the context of the current crisis, the deterioration of the economic environment and, implicitly, of the financial situation of small and medium enterprises, the rise of the costs of the financing resources on international financial markets determined banking institutions from numerous countries, including Romania, to be reticent in granting credits. Thus, microenterprises and small firms in particular meet significant difficulties when trying to obtain financing resources. The reaction of the banks was to make the crediting standards harsher and to increase interest rates. According to the survey conducted by the National Bank of Romania, the main factors that determined the roughening of the bank crediting standards are the expectations concerning the general economic situation, the risk related to the industry in which the enterprise activates and the risk related to the requested guarantee [National Bank of Romania, 2010]. From the total number of interviewed crediting institutions, over 90% reported the increase of the crediting risk of small and medium enterprises and the deterioration of the quality of the credit portfolio, especially for microenterprises and small firms. Also, approximately a third of the credit institutions reported a reduction of the demand for new credits.

The decrease in the demand for credits, of microenterprises and small firms in particular, was determined by the harshening of the crediting norms, by the diminution of the debt limit, as well as by the uncertainties concerning the evolution of the economic environment. In the context of the reduction of the bank credits supply and demand, a diminution in the availability of bank credits was registered. For example, according to the Flash Eurobarometer study, almost half (46%) of the interviewed firms that requested at least one type of external financing over the period January – July 2009 reported the reduction of the availability of bank credits. In the case of Romania, this percentage is of 56% (see figure 7).

The international crisis affected the SMEs sector much more seriously than the sector of large firms, as SMEs are generally more vulnerable in times of crisis for several reasons, among which we mention: it is harder for them to reduce their activities since they are already small; they are less diversified individual within their business; they have a weaker financial structure (eg lower capitalization); they have a lower credit rating; they are strongly dependent on credit and have fewer financing options [OECD, 2009, 15].



Source: [European Commission, 2009a]
Figure no. 7 The availability of bank loans

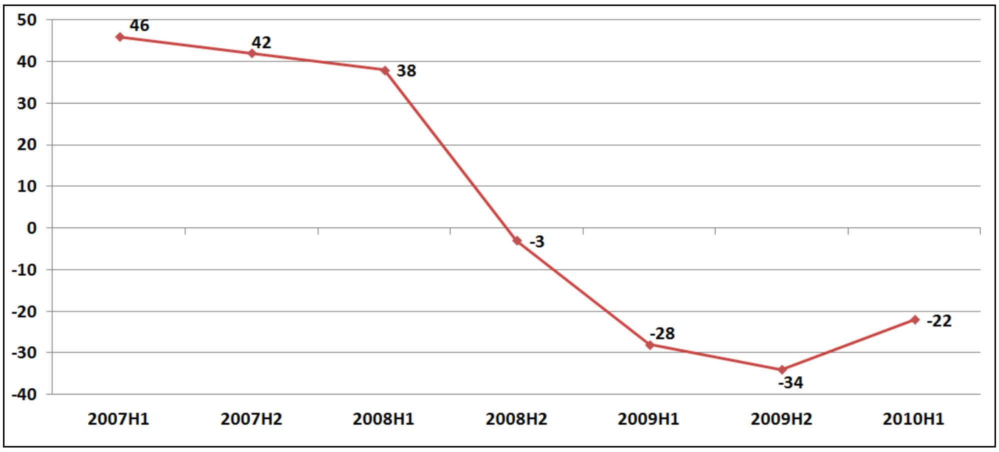
The evaluation of the situation of the SMEs sector in Romania, in the context of the current crisis, can be conducted according to the index of evolution of SMEs, calculated by CNIPMMR by summing up the scores of 11 indicators (registrations of commercial companies, number of defunct commercial companies, number of profitable companies, number of SMEs with losses, SMEs debts, average turnover per SME, average profit per SME, average loss per SME, average number of employees per SME, SMEs investments, exports of private enterprises). The maximum value for this index is 100 and its significance is presented in table 2.

Table no. 2 Score grid, according to the index of evolution of SMEs

Index of the evolution of SMEs	**Grade**
- 64 – 0 points	Very unsatisfactory
0 – 20 points	Unsatisfactory
20 – 45 points	Satisfactory
45 – 70 points	Good
Over 70 points	Very good

Source: [CNIPMMR, 2007-2010]

As we may notice in figure 8, the evolution of the situation of the SMEs sector in Romania has been subjected to a descending trend, especially in the second semester of 2009, being evaluated as extremely unsatisfactory.



Source: centralized data on [CNIPMMR, 2007-2010]

Figure no. 8 Index of the evolution of the SMEs sector in Romania over the period 2007 - 2010H1

Given the extremely negative implications of the current crisis on small and medium enterprises, as well as their important role in national economies, public authorities reported a series of measures aimed at facilitating the access of this sector to financing. According to OECD studies, SMEs have suffered a double shock: a drastic drop in demand for goods and services and a tightening in credit terms, which are severely affecting their cash flows [OECD, 2009, 30]. In this context, the measures adopted by public authorities in numerous states focused on: supporting sales and preventing depletion of SMEs' working capital, enhancing SME's access to liquidity and helping SMEs to maintain their investment level.

In order to alleviate the effects on SMEs of the twin shock of falling sales and more difficult access to financing, governments are using two different approaches to increase availability of credit to SMEs [OECD, 2009, 31]: (a) on the incentive side, the creation and extension of guarantee schemes for loans to SMEs, or when that fails direct public lending; (b) on the discipline or sanction side, setting targets for SME lending for banks that have been recapitalised by public monies, putting them under administrative monitoring or putting in place specific procedures to solve problems between individual SMEs and banks.

As concerns the member states of the EU, besides the structural funds allocated to small and medium enterprises, new measures for supporting this sector were conceived. For example, the European Commission simplified state aid rules and introduced new rules on aid intensities for SMEs with the introduction of the new General Block Exemption Regulation.

The increased difficulties faced by SMEs in obtaining financing resources, following the significant restriction of the bank crediting activity and the increase of the risk averse of risk capital investors determined the European Commission to grant considerable importance to the adoption of measures meant to support the access to finance of the SMEs. In this respect, it is worth mentioning the adoption of the Communication **"**Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis"**,** which offers to all the member states of the EU, Romania inclusively, additional possibilities in the field of state aids, especially for SMEs, in order to cope with the effects of crediting restrictions. The main measures envisaged by the Commission include: the granting of a limited amount of aid, aid in the form of guarantees, aid in the form of subsidised interest rate, aid for the production of green products, risk capital measures. These additional measures can be granted by the EU member states to SMEs, as well as to large enterprises, for a limited time period, respectively until December 31, 2010. By implementing these measures, the EU states primarily aim at unblocking bank credits for enterprises and at encouraging them to make investments.

Deteriorating the business environment in Romania has imposed, as well as in other states, the adopting of a set of anti-crisis measures from the Government, including: non-taxation of reinvested profits, the possibility of compensation of recoverable VAT with payable VAT, outstanding deferred payment obligations to the state budget, state aid, support for export production by guarantee and indemnity (in particular, by Eximbank), CEC Bank and Exim Bank capitalization to support SMEs, the establishment of the Counter-Guarantee Credit Fund for SMEs, improving the investment law, including by reducing the amount of investment eligible for facilities from 50 million to 10 million Euro, establish a state aid scheme to facilitate access to finance in the current period of economic and financial crisis, consisting of guarantees granted to SMEs and large enterprises.

In order to relaunch the Romanian economy and, directly, the resumption of bank lending, the central bank also reduced interest rate monetary policy and bank reserve requirement rates. However, deteriorating ability to pay the bank customers, especially SMEs, still causes negative economic outlook for banks to be reluctant to grant credit.

5. CONCLUSIONS

The easy access to financing of enterprises in general and of small and medium enterprises in particular is of crucial importance, for it conditions their creation, survival and development, and, eventually, economic growth and the creation of workplaces.

In comparison with large enterprises, SMEs are faced, even when the economy functions at its normal pace, with numerous obstacles when obtaining financing resources, due to the reticence of the financial markets to take risks, as well as to the insufficient guarantees offered to the creditors. Moreover, according to the OECDE studies, small and medium enterprises are generally more vulnerable in times of crisis, for several reasons, among which we mention: it is harder for them to reduce their activities since they are already small; they are less diversified individual within their business; they have a weaker financial structure (eg lower capitalization); they have a lower credit rating; they are strongly dependent on credit and have fewer financing options.

According to the Flash Eurobarometer study, access to financing is considered to be the most urgent problem by 19% of the enterprises interviewed in Romania and by 16% of the enterprises in EU 27.

The analysis of the financing modalities of small and medium enterprises in Romania, conducted in this paper, emphasizes the significant importance of bank credits in the external financing of enterprises. This aspect can be explained by the fact that microenterprises and small firms in particular have fewer financing options in comparison with large enterprises.

In the context of the current crisis, the access of small and medium enterprises to bank finance faces new difficulties. This is due to the fact that the deterioration of the economic environment and implicitly of the financial situation of small and medium enterprises, the increase in the costs of the financing resources on the international markets determined the bank institutions from numerous countries, including Romania, to be reticent in granting credits and to require bigger interests, as well as more guarantees. On the other hand, a reduction in the demand for credits was also registered, in particular in the case of microenterprises and small firms, following the increase of risk aversion and the uncertainties concerning the evolution of the economic environment. In the context of the reduction of the supply of and demand for bank credits, a diminution in the availability of bank financing for small and medium enterprises was registered.

The important role of small and medium enterprises in national economies, as well as the extremely negative implications of the current crisis on this sector determined the public authorities from numerous countries, including Romania, to adopt certain measures meant to facilitate the access of this sector to finance. According to the OECD studies, the most widely used policy measure to increase access to finance has been until now the extension of loans and loan guarantees. Despite all the measures, one cannot speak, for the time being, of the improvement of bank financing for small and medium enterprises. Consequently, one considers that the adoption of a series of measures by public authorities, as well as the strengthening of the dialogue between banks and small and medium enterprises are equally important for improving access to bank financing. One cannot dispute the fact that given the role of small and medium enterprises in national economies, their revival is conditioned by the access to financing of small and medium enterprises.

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