

**ANALYSIS OF SMEs FINANCING IN THE REPUBLIC OF MACEDONIA –
CONDITIONS AND PERSPECTIVES**

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Abstract

SMEs play a crucial role in furthering growth, innovation and prosperity. Unfortunately, they are strongly restricted in accessing the capital that they require to grow and expand. Banks in developing countries are in turn hampered by the lack of lender information and regulatory support to engage in SME lending. Hence, the main aim of the research is identification of factors that significantly influence the access to the capital, and determine the financial state of the investigated entities in Macedonia. Considering the facts from the analysis in the end of the paper will be propose many recommendations for improving the financial support for SMEs in Macedonia.

Cuvinte cheie: SMEs, capital access, financial state

Clasificare JEL: G21, G32

1. Introduction

Today, the globalization processes create ambience that has radically changed and the world is becoming one big market where national, regional and local markets have lost their significant. The businesses face the phenomenon of globalization, and operate in a dynamic environment characterized by increased uncertainty, complexity in operation and continuous competitive fight. On the other hand, the modern world and new entrepreneurial economies impose the need for continuous innovation and highly sophisticated technology that implies changes in the way of making business policy.

Hence, there is a need to develop an innovative, as well as adaptable SMEs sector. SMEs are characterized with flexibility, independence, spontaneity in business relationships, creativity, and they quickly and easily adapt to new conditions. They become increasingly important for the creation and development of a modern, dynamic and knowledge-based economy. Unfortunately, they are strongly restricted in accessing the capital that they require in order to grow and expand. For instance, nearly half of the SMEs in developing countries rate the access to finance as a major constraint. They might not be able to access finance from local banks at all, or face strongly unfavourable lending conditions, which is more pronounced following the recent financial crisis (European Commission, 2011). Many small businesses start out as an idea and mainly by one or two individuals who invest from its own resources and in some cases borrow from family and friends (Govori, 2013). Lack of capital or financial resources was a major barrier for SMEs and entrepreneurs who usually have to mobilize their own capital or their own resources in order to establish or expand their business.

According to analytical report of “SMEs’ Access to Finance survey” published by the European Commission in 2013 the most common factors that influence access to finance are the following: company size; turn over; sector; type of enterprise – autonomous and part of an enterprise; length of time active; ownership structure – listed company, family or entrepreneurs, other firms or business associates, venture capital (VC) companies or business angels and businesses with only one owner.

Considering the previous the main aim of the paper is to identify the managers’ perceptions about the determinants of financial state of the business entities in Macedonia. For that reason will be conduct a questionnaire and the empirical analysis using LOGIT model will show the key factors that influence of the financial state of the investigated entities in Macedonia. At the end considering the facts from the analysis will be present many recommendations for improving the financial support for SMEs in Macedonia.

2. SMEs financing and capital access

Nowadays, the on-going processes occurring in the business environment are characterized by dynamic technological changes, increased global competitiveness, uncertainty and risk, that initiate necessity of creating and developing small and medium enterprises. In most of the cases the SMEs innovativeness, creativity, permanent productivity growth and flexibility, match newly created conditions and significantly contribute to overall social development. When defining small and medium enterprises, there is not only one approach. In this context, the definition of the European Commission is generally accepted, and according to its last revision from 2003, the following criteria are taken into account: number of employees, turnover or balance sheet (European Commission, 2003). The differences in categorization of enterprises are presented in Table 1.

Table 1. The definition of micro, small and medium enterprises according to European Commission

Category enterprise	Number employees	Turnover	Balance sheet
Medium	< 250	≤ € 50 million	≤ € 43 million
Small	< 50	≤ € 10 million	≤ € 10 million
Medium	< 10	≤ € 2 million	≤ € 2 million

Source: European Commission

SMEs in EU represent 99% of the total number of enterprises. Their development allows us to feel their effects on the macroeconomic performance in terms of employment, production growth, strengthening competition and, entire social and human development. Therefore, the policies to promote the development of SMEs are common in both developed and developing countries (Levitsky 1996 and Storey, 1994).

Financing SMEs and their access to finance plays a crucial role in the growth and development and it is a key determinant for business start-ups. It is worth mentioning that SMEs have very different needs and face different challenges with regard to financing compared to large businesses (Manchester, 2006).

In this context, The Investment Climate Survey carried out by the World Bank shows that access to finance improves the firm performance. It does not only facilitate market entry, growth of companies and risk reduction, but also promotes innovation and entrepreneurial activity. Furthermore, firms with greater access to capital are more able to exploit growth and investment opportunities. In other words, aggregate economic performance will be improved by increasing the access to capital (European Commission, 2011).

Usually, entrepreneurs can provide money easier and faster from informal sources, because there is not any formal-legal procedure which has to be completed before. At the same time, important sources of financing are the entrepreneurs’ own savings and loans from their families, relatives, the so called 3F (founders, friends, family) money and the money from informal risky capital such as business angels. For using the formal sources such as: money from the official financial institutions; the formal risky capital; money from the banks and the money mobilized through the stock exchange ect, there are procedures for approval and use of the resources. As a consequence of the financial and economic crises, and more frequent turbulences in the financial markets, the SMEs financing nowadays has become even more difficult. SMEs often complain that their growth and competitiveness are constrained by a lack of access to financing and the high cost of credit (Hallberg, 2000).

According to the research of the European Commission together with the European Central Bank (2013), carried out in into 37 countries, including EU-28 and 17 other countries from the Euro zone, in the periods June-July 2009, August-October 2011 and August-October 2013, the following results have been obtained, related to the conditions for providing capital (European Commission, 2013):

- Characteristics influencing access to finance: company size; turn over; sector; type of enterprise – autonomous and part of an enterprise; length of time active; ownership structure – listed company, family or entrepreneurs, other firms or business associates, venture capital (VC) companies or business angels and businesses with only one owner.
- Access to finance was the second most pressing problem mentioned by 15% of EU SMEs managers.
- When looking at sources of financing used in the last six months, just over half of EU SMEs (54%) said that they had used only external financing. Just over one in five had used both internal and external sources of financing, whilst only 4% had used only internal sources (unchanged from 2011 levels).
- The most widely used external sources of financing in 2013 were bank overdrafts (39%), leasing/hire purchasing/factoring (35%), trade credit (32%) and bank loans (32%). Overall, 75% of EU SMEs had used at least one form of debt financing (excluding debt securities and equity) in the past six months and this is unchanged from 2011 levels.
- Equity financing was little used, by just 5% of EU SMEs in the past six months.
- Half of EU SMEs have taken out a loan in the past two years, the same overall level as seen in 2011 but still up on 2009 (46%).
- Just over a fifth (21%) of EU SMEs had applied for a bank loan in the past six months, up from 19% in 2011. The same level (21%) had applied for a bank overdraft. One in six (16%) had applied for trade credit and one in seven (14%) for some other form of external financing.
- Bank loans were also most likely to be given in full to the largest companies (72% for large sized enterprises compared with 65% for SMEs) and larger SMEs rather than micro-SMEs. Younger and smaller firms were more likely to get only some of the bank loan requested or to be rejected. 18% of micro-SMEs had bank loans rejected compared to only 3% of LSE applications, and the rejection level was 27% for SMEs active for less than two years.

Also the financial problems may arise as a consequence of weak banking institutions, lack of capital market and inefficient legal framework regarding credit and collateral assessment. Access to finance was always a main concern for SMEs, but the recent developments in the finance sector worsen the situation even more. In 2011, the cost of SMEs credit trended upward in most countries, as evidenced by the increase in nominal interest rates charged to SMEs (OECD Scoreboard, 2013). Many SMEs are not able to finance their needs for investment.

Despite this, UEAPME (The European Association of Craft, Small and Medium-sized Enterprises) expects the new European Commission and the new European Parliament to strengthen their efforts to improve the framework conditions for SMEs finance. In this context, UEAPME proposes policy measures in the following areas: New Capital Requirement Directive: SMEs friendly implementation of Basel II; SMEs need transparent rating procedures; SMEs need an extension of credit guarantee systems with a special focus on Micro-Lending; SMEs need company and income taxation systems, which strengthen their capacity for self-financing; Risk Capital – equity financing (UEAPME, 2004). It is noticeable that the external equity financing does not have a real tradition in the SMEs sector. On the one hand, small enterprises and family businesses in general have traditionally not been very open towards external equity financing.

3. An overview of SMEs financing in Macedonia

The small and medium enterprises are a key driver of the economic growth in Macedonia. They represent 99% of the total number of enterprises, while their participation in GDP and employment is over 60%. Classification of business entities in Macedonia, as per their size, is made according to the revised definition of the European Commission from May 2003, and the following criteria are taken into account: number of employees, capital turnover and balance sheet.

Having in mind the importance of the small and medium businesses for the economic growth, Macedonia, as a candidate country for EU membership, has been continuously taking measures, creating policies and strategies for supporting SMEs development. This is in accord with the principles of the Small Business Act (SBA) that was passed in 2008 by the European Commission, which clearly states that the economic policies of each country should be directed to encouraging entrepreneurship and eliminating the problems in development of small and medium enterprises (Commission of the European Communities, 2008).

Concerning SMEs financing, Macedonia is in a similar position as many other emerging countries. It is completely clear that for establishing and successful functioning of a given small or medium sized enterprise, appropriate financial sources are necessary. Successful financial management of a SME is a balance between the size and structure of the necessary business resources and the size and structure of sources for their financing. Although there are different sources of financing such as: loans, leasing arrangements, securitization, business angels, risky capital etc., this problem is still present among SMEs. The reasons for this situation are insufficient development of the

financial system from the one hand, and the insufficient information on the available financing sources, on the other hand.

While there is a practice worldwide that SMEs in the start-up phases finance themselves by business angels, or in initial developing phases by risky-capital, while in the developing phases by securitization. However, the evidence shows that it is not a case in Macedonia. Namely, these sources are in the initial phase of their implementation, while some of them are not implemented at all. The first network of business angels in Macedonia was established in May, 2011 at the Center for Innovations as USAID project, and has only ten members. This way of financing has long practice in USA, Australia and, Slovenia being an example among the countries in our close neighborhood.

The crediting, as an external source for financing small and medium enterprises is traditionally most frequent, but at the same time it is an expensive way of financing. The bank institutions usually avoid micro and small enterprises, especially newly-established ones, due to the following reasons: insufficient assets and poor capitalization; limited ideas for development and sensitivity of the market movements in combination with the limited technical, managerial and marketing skills of the small businesses owners; small percentage of returned credits by SMEs, due to high operational expenses; poor and non-appropriate financial statements, which do not show the key indicators for financial assessment of working etc. High mortgage demands and disadvantages appearing in the regime of safe transactions still remain as serious problem related to SMEs crediting.

In contrast, SMEs have on disposal large number of donor credit lines, and resources from these credit lines are available for the enterprises through commercial banks. First, these are the credits from the World Bank and the European Bank for Reconstruction and Development (EBRD), especially in the sphere of encouraging the small and medium enterprises by FARE program, donations obtained from some developed countries (Germany, Italy, Switzerland etc.), credits from FAO, IPARD, direct private ventures etc.

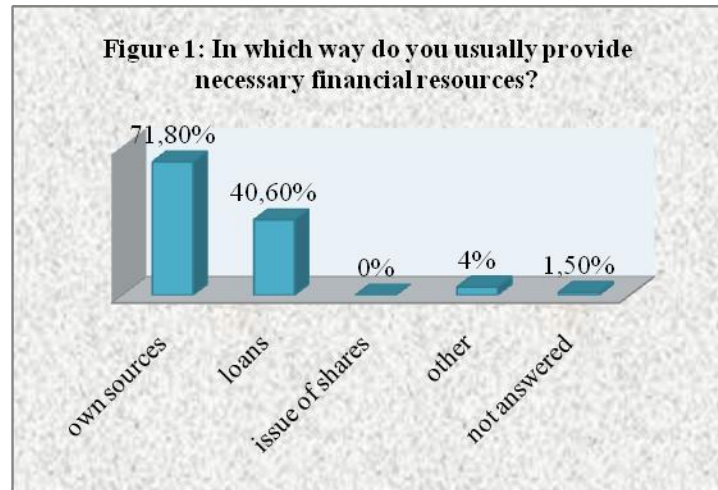
From the above outline we can conclude that the access to the capital, which largely determines financial stability of SMEs is influenced mainly by the industry, number of employees, year of establishment, capital structure, institutional support, information on the available credit lines etc. The problem with the access to the finances is negatively reflected to the financial state of small and medium enterprises, since as financial state we consider the size and structure of the resources, sources of these resources and financial result, expressed in money (Trajkoski and Trajkoska, 2002). Thus, the enterprise financial state is defined by its ability to provide permanent matching of monetary flows, i.e. as a sum of the assets positions at a given moment, classified according to the degree of their maturity (Rankovic, 1997).

4. Empirical analysis

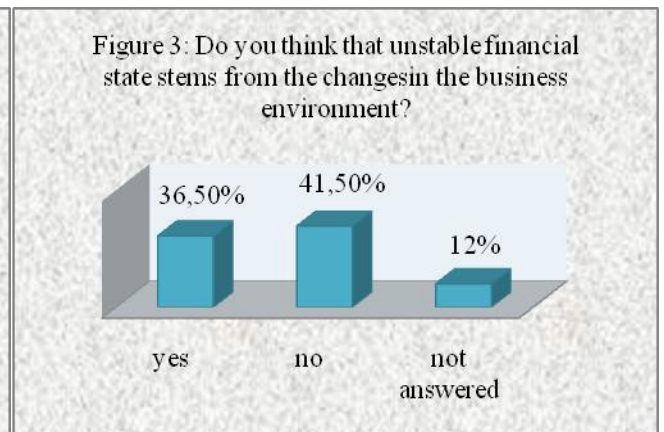
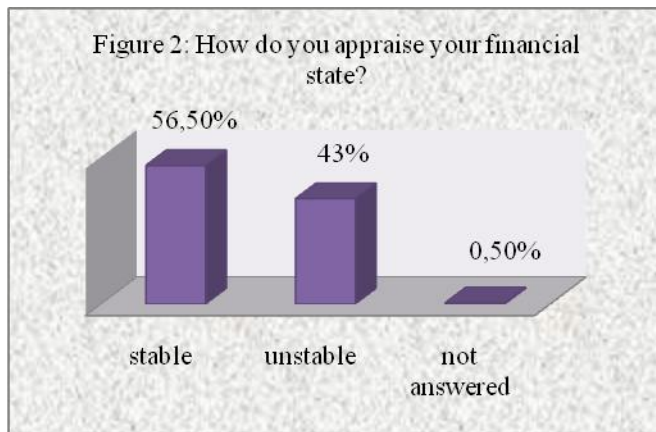
In order to identify the managers' perceptions about the determinants of financial state of the business entities, a sample survey of 200 SMEs in Pelagonia region, has been carried out. The rationale for research, i.e. for assessing the small and medium sized enterprises and barriers in their development is generated from the following considerations: First, the small and medium sized enterprises are the most represented in the country, they are driving force of the economic growth; second, creation of stable business climate is a key factor for stable financial state and development of small and medium enterprises. Hence, the aim of the research is identification of factors that significantly influence the access to the capital, and determine the financial state of the investigated entities.

In order to realize the research and to provide necessary data, have been used several data collection methods such as: survey carried out on a representative sample of SMEs; interviews with managers; research through internet ect. From the answers, we notice that about 30% of the respondents operate in retail and wholesale trading, 40% are from the production sector, and 30% are from the servicesector. Furthermore, large part of the companies that have been sampled, have been operating more than 5 years.

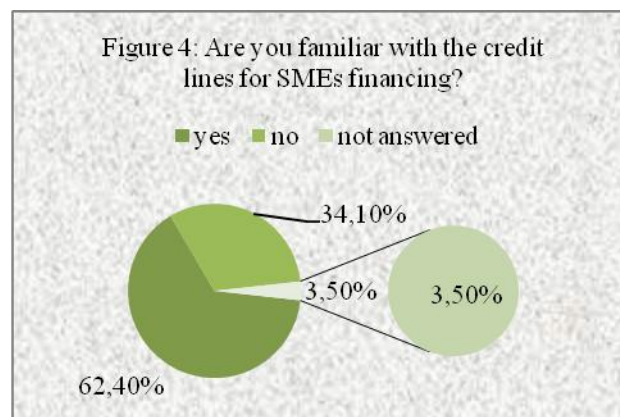
On the basis of the performed analysis of the SMEs, the following issues have been identified as problems: lack of initial capital; frequent changes in legal regulation; high interest rates; insufficient and unstable consumption; strong competition from the big companies. Therefore, it can be concluded that lack of initial capital is the key problem, since over 50% of the respondents identified as problem the difficult access to capital. The small and medium business entities in the country usually provide necessary financial resources from their own sources. That is also confirmed by the answers to the question: In which way do you usually provide necessary financial resources? Namely, on this question, 71.8% of the respondents have pointed out that they provide necessary financial resources exclusively from their own sources, while 40.6% have used loans.



Furthermore, 56.5% of the respondents stated that their financial state is stable; 43% that is not stable, while 0.5% have not given any answer to this question. In a very close relation with this question is the following question: Do you think that unstable financial state stems from the changes in the business environment? The analysis shows that 36.5% of the respondents stated that their unstable financial state is a consequence of the changes in the business environment, while 41.5% think that there is no close correlation between unstable financial state of their business entity and the changes in the business environment.



In order to provide better functioning of SMEs, financial and institutional support is indispensable, which is a reason for additional questions in order to obtain information on financial and institutional support of SMEs in Macedonia. With respect to the extent to which respondents are informed about the available credit lines, are shown in the figure 4.



Although most of the respondents have been informed about the available credit lines, those resources remain insufficiently used. As a primary reason for this outcome are the unfavorable conditions under which these loans are offered, especially the high interest rate. That is confirmed by the answers to the question if they think that the loans offered by the bank institutions have high interest rate. In this context, 92.1% of the respondents stated that the interest rates are high, which was somewhat expected, whereas only 5.5% of the respondents have opposite opinion. Similarly, the fiscal facilities that have been implemented for the SMEs up to the present days are not sufficient. Namely, 51% of the respondents stated that they are insufficient, while only 18.3% estimate them as quite sufficient. In order to estimate the factors that influence the financial situation of the companies we estimate the following LOGIT model:

$$\text{logit}(E[Y_i|X_i]) = \text{logit}(p_i) = \ln\left(\frac{p_i}{1-p_i}\right) = \beta_0 + \beta_1 x_{1,i} + \dots + \beta_m x_{m,i}$$

The dependent variable Y takes value 1 in the case the manager perceives the financial situation of the company as stable and 0 in the opposite case. On the other hand, X_i is a vector of independent variables whose impact on the financial situation of the company is measured by the estimated coefficients β_i and their statistical significance. The results from the estimated LOGIT model are presented in Table 2.

Table 2. Estimated LOGIT model for the financial situation of companies

Variable	Coefficient	Standard error	t-value	Difference in odd ratio
Intercept	-0.9895	0.6593	-1.5006	
Have information about the credit access for SMEs	0.5855	0.3624	1.6155*	79.6%
Have impression that the interest rate is high				
Have impression that the fiscal policy is supportive	0.2217	0.5041	0.4397	
Have information about the institutions for SMEs support	1.3053	0.4990	2.6155***	268.9%
Have impression that the institution support for SMEs is sufficient and appropriate	-0.4444	0.3562	-1.2477	
Number of years since established	0.5289	0.4239	1.2476	
Number of employees				
Perceive the business environment as stable	-0.0069	0.0207	-0.3377	
Provide finance from own sources	0.0153	0.0083	1.8268*	1.5%
	1.4703	0.6029	2.4387**	335%
	0.3915	0.3716	1.0533	

Note: *, ** and *** represent statistical significance at the 10%, 5% and 1% respectively.

From the estimated LOGIT model we can conclude that the companies that have information about the credit access for SMEs are about 79.6 percent more likely to have stable financial situation. Having impression that the fiscal policy is supportive exerts strong impact on the financial situation of the companies. Namely, these companies on average are more than two and a half times more likely to have stable financial situation. An additional employee increases the probability of having stable financial situation by 1.5 percents which means that smaller companies are more likely to experience financial difficulties. Finally, those companies that perceive the business environment as stable are more than three times more likely to have stable financial situation. Hence, the business environment plays important role in providing finance which influence the successful development of companies.

5. Recommendations for improving the financial support for SMEs in Macedonia

From the previous elaboration we can conclude that SMEs in Macedonia face serious problems, in providing the necessary financial resources. The SMEs usually get finances from their own sources, that are often not sufficient, while on the other hand, the banks' products are still expensive. Hence, there is an immanent necessity of creating alternative sources such as: equity funds, credit funds, private credit bureaus, providing loans under favorable terms, decreasing of interest rates, creation of credit guarantee funds, simplifying of financial transactions for creating financial support, etc. The Budget for 2012 within the B2B (business to business) program – development of small and medium enterprises, comprises a project for SMEs financing, which is financially supported by a loan from the European Investment Bank, in order to meet the requirements of the business community for providing fresh capital for SMEs' needs aiming to alleviate the consequences of the financial crisis. In the future, such projects should be more intensive, while for higher financial support, i.e. more easier access to finances for the SMEs, the following measures appear as necessary:

- Improvement of the collaboration with the banks, public financial institutions and SMEs, i.e. creating special instruments for crediting, according to the needs and capacities of SMEs;

- Creating favorable conditions for the banks in order to lend the resources with interest rates close to those observed in EU (5-6%), because in this way the loans will become cheaper and available for the SMEs. For that purpose, it is indispensable to decrease the discount rate and the rate for compulsory reserves of commercial banks with National Bank, mainly for increasing their credit potential and creating conditions for lowering the interest rate. Namely, in 2012, the National Bank decided to decrease the compulsory reserve by the amount of the credits which the banks would approve on the exporting companies and companies that produce electric power. In addition, a reduction of the interest rates from 0.5 to 1 percentage points is expected, depending on that if those are foreign currency or denars credits;
- Development of instruments only for financing SMEs, especially through issuing guarantees, the so called credit-guarantee scheme;
- Special fund for bankrupt preventing, that provides guarantees for bank credits intended for entrepreneurs, i.e. support of SMEs financing;
- Removal of non-financial barriers in crediting the SME sector by the banks, simplifying and decreasing the number of procedures for credits approval and elimination of hidden expenses for loan arrangement;
- Development of micro funds in order to improve the access to SME finances on local level;
- Intensifying intensification and extending extension the credit lines for start-up businesses, i.e. credits with low interest rates and longer grace period. In this context, it is worth to mention that bigger promotion of the credit lines is necessary as well. In Macedonia up to the present days there have been many credit lines, but only small part of them have been utilized.
- Education and training the entrepreneurs and employees for using different kinds of financial support as an important instrument for providing positive effects of the financial support. Namely, a large number of the SMEs that use loans, often lack knowledge not only about the available credit line, but also about the area of management, business planning, marketing, business communication etc. All this leads to bad business results and with that to problems with credit resources returning, i.e. their repeated placement to new users. In this context, it is indispensable to mention that SMEs need more support and elaboration of business plans and investing programs, which, on the other hand, are the base for getting subsidies or some other kind of financial support.
- Furthermore, activities for education of the representatives of SMEs and public sector for improving the access to grants and higher utilization of the FP7, CIP/EIP mechanisms, are indispensable. In Macedonia, there is no system for their utilization hence, it is necessary to create appropriate regulation and accreditation for using those resources, because they can be provided at much lower interest rate than the already existing loans.

6. Conclusion

Financing the SMEs is a complex process, but in the same time it is crucial for their establishment and further development. Statistical data and analyzes show that the development of different forms of the business organizations is determined by the necessity and eternal struggle to provide additional sources for financing their development. In the developed countries, the small and medium enterprises have numerous alternatives for providing additional capital, which is not a case with the developing countries. In Macedonia, these business entities are faced with many limits at providing not only capital, but in the performance of further developing activities as well. In direction to identify the factors that influence the access of the SMEs to the capital in Macedonia, an empiric research has been carried out and from that, we can point out the conclusion that information for the available credit lines, stability of the business environment, number of employees and the height of the interest rate are the key things that have significant influence on capital providing.

Because for that, many measures are suggested in the final part of the study, which will mainly mean easier access to the capital, i.e. increasing of the financial support for these business entities in Macedonia.

Having in mind the results of the performed research and actual situation in the country, future researches should be directed to improvement of business ambient and strengthening of the financial and institutional support for the small and medium enterprises in Macedonia.

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