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FINANCING OF OHE SMALL AND MEDIUM ENTERPRISES THROUGH THE BANKING SECTOR

Abstract

The advisory role of the banking sector and the role of external sources of financing for the small and media enterprises (SMEs) is huge, especially when development of the SMEs is an important input to the overall economic development of the country. In the Republic of Macedonia in terms of sufficient undeveloped non-traditional sources, the banking sector is a important source of financing.

Financing, as one of the most important areas for encouraging the development of SMEs and has special features compared with the financing of large companies and businesses.

The main distinction consists in the level of risk that is associated with SMEs as well as insufficient management capacity.

In this kind of asterism of relationships, and business environment, is evident the growing interdependence of SMEs from the operations and performance of banks, which depend on the level of interest rates on loans, which are input to the financing of the activities of SMEs.

So it is possible to point out that the development of the banking sector is conditioned by the development of SMEs, because they represent a significant market for banking sector.

From this we can conclude that the attitude of banks and SME sector is based on long term basis, and lately, especially in developed market systems, SMEs for the banks represent the most important target group.

The common denominator of this ratio, beside the economic interest, is the joint management of the risk, that exists for each of the two sides of this relationship.

Keywords: Small and medium enterprises; banking sector; SME financing; SME - market for the banking sector.

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*Those who do not know, let them learn, and those who know,
let them find the pleasure to be reminded.
Latin proverb*

Introduction

The beginnings of banking operations can be seen since 3000 year BC. In the period from 7 to 5th century BC, at Babylon have arisen first private houses that, basically were engaged in banking operations known as “tezauri working”, and people were known as “tezauri”.¹⁾ Tezauri working have dealt with organized storage of relevant goods, usually wheat and other types of product. With the receiving of goods for storage, further it has been given or traded within a certain validity date.

With the changes in socio-economic formation, with the evolution of man, and thus the form of organization, the banking sustain changes although the essence of the first forms of appearance till today has been saved.

The fundamentals of modern banking are set during the XVIII and XIX century, when were established the large banking institutions, which, with own and foreign resources have become an important factor in the development of economy and trade, not only in countries where banks have been established but in overall international relations.²⁾

The overall social economic change, although in fact, have not changed organization and form of the operations of banks from their first forms, which caused to come to significant change in terms of their importance, and their interaction in terms of economic development of companies, countries and regions.

So in condition of undeveloped non-traditional forms of financing of SMEs and increased role of banks in this regard, considering the fact that SMEs constitute the most dynamic segment of any economy, the state must find a way to protect their interests because SMEs have the least bargaining power in the economic environment.

On the other hand, and SMEs have to find a way to help themselves, dedicating more attention of education and training, joining in associations, which will strengthen their negotiating position. By analyzing the forms of loans that are supported kept by

1) Tezauri working (Greek Thesaurus-treasure trove, accumulated wealth,). Nowadays, a withdrawal of money or other valuables from the market in general has a deflator action.

2) www.scribd.com

the commercial banks, the structure of loans as well as analysis of the situation for lending to SMEs by the commercial banks in the Republic of Macedonia, the objective of this paper is to present the necessity of SMEs to acquire the basic understanding of the types of lending that support the commercial banks, to enable it through the preparation of a business plan and application requirements for credit, to get easier to the necessary financial resources.

1. THE BANKING SECTOR AS A SOURCE OF FINANCING OF SMES

The financing of SMEs, is the most important question related to the entrepreneurial company. It is completely understandable if we consider that the commencement of the business and its development is related to the provision of financial resources to a large extent is related to the business environment in each economy. The economic theory of the sources of funding are divided into formal and informal.³⁾

The table that follows present these two types of funding.

Possible sources of financing SMEs

| <i>Informal sources of funding</i> | <i>Formal sources of funding</i> |
|--|---|
| <ul style="list-style-type: none">- founder of the informal investors (friends and relatives), or 3F pairs (founder, family, friends)- Informal risky capital, business angels; | <ul style="list-style-type: none">- Formal venture capital (official resources)- Money from the banks (commercial, developed and International) Money-mobilized by exchange. |

Source: Fiti Taki “Entrepreneurial company”, Skopje, Faculty of Economics-Skopje. 2007, p.119-120

In the part of the formal sources of funding, as shown on the table occupy its place the money from the banking sector, because the biggest transactions are happening exactly the case here. Finance from formal sources, are especially significant in less developed countries, and not by chance represent a single source, especially considering that the alternative ways of funding (informal sources), are very little developed or represent a large unknown.

³⁾ Fiti Taki “Entrepreneurial company”, Skopje, Faculty of Economics-Skopje. 2007, p.119.

1.1. Loaning to SMEs

Loaning to small and medium enterprises in the last 2-3 decades is increased, this trend among the developed market systems as a need impose among the developing countries, and also among underdeveloped. In that direction, governments of various countries, within its jurisdiction, have to assist about creating favorable conditions and alleviating in lending to SMEs. In this context banks as an important link in the ways of lending within its operations have established several forms of lending, which are conditioned mainly by the amount of resources that are required, the time of return of the loan, accuracy, as well as the credit rating of lender.

Short-term loans to reverse the resources. This form of bank loans is approved in principle for the occasional stock or to cover claims from the customer, in principle it is a periodic rotation resources. Starting with the fact that the permanent reverse-equity resources are covered by their own reverse capital, or of medium-term or long-term loans, commercial banks tend to have precise picture of the balance sheet and success among lender or the company. In practice it is often used CREDIT lines that enable companies to take funds at time when they need a maximum credit limit that is previously agreed and with a specified period of duration of the credit line.

Investment loans refer to long-term loans which are approved in order to be used to finance permanent fixed assets and reverse the permanent working capital. There are two forms of funding: institutional financing at the banks and by way of negotiable instruments.

Repayment of investment credits is done according to annual program which must be provided in monthly, quarterly, semiannual or annual term limits, if the company of such a loan customer wants to pay the credit before the deadline for payment, the bank can accept it only if it is paid out of the profit of the company. The interest rate on these loans depends on the movement of the interest rates on the financial market, the level of the creditworthiness of the debtor as well as the amount and maturity of the loan. While, the assessment of the creditworthiness of the debtor is conditioned by the level of its profitability. In practice the signing of the contract for the approved loan between the bank and the company, the bank retains the right for non-fulfillment of some articles of the agreement, on the base of acceleration clause, the loan can be proclaimed, matured immediately.

Revolving loans are of medium-term character from 1 to 3 years. The main characteristic of this type of loans is when conclude a loan agreement, the user of the credit from the bank withdraw funds when he need to repay them, according his financial position, but within the period prescribed in the achieved agreement. In the agreement is determined the maximum amount of indebtedness which may take the company. If the revolving credit contains conversion clause can be converted to the investment loan which can be paid on the base of the annual program.

Loans for financial restructuring. This type of loan is related to the purchase of the company (acquisition), and in this case, the investment group buys the company with the use of bank credits. Specificity for groups of investment is ,to purchase low-profitable companies, so with the use of the bank loans for restructuring, to ensure bigger profitability, better team for management, improving the business strategy, introduction of new technology, in order to increase the competitiveness of market and increase the value of the firm, which in the future can be sold.

2. STRUCTURING OF THE LOANS

Structuring of loans includes deadlines for the maturity of the loans, interests, as well as, protective clause. Informing, relative to these components, is necessary from the aspect of the loaner, because they are related with the decision on the submission of application for credit, as well as the type of credit.

Maturity determine the type of credit, and in relation of that ,the credits are divided into: short-term loans up to 1 year (in the main be used to finance current uses among reverse funds); medium-term loans from 1 to 7 years (refer to the long-term financing of the company, thus the bank financing can change the company - debtor may convert in exchangeable financing with emission of the negotiable instruments) and long-term loans usually term is over 10 years (these types of credits are used to finance permanent assets of the company or their permanent reversed capital).

Interest rates are established on the financial market, where the nominal interest rate is made up of the real interest rate and inflation. The banks calculating the interest rates, calculate the margin, which represents individualization, according to the level of risk for specific debtors, simultaneously with margin is forming the margin which cover the eventual loss of the loan.

Collateral or the real coverage In relation to the approved loans, there are two approaches as follows: the first approach, the bank concluding the loan agreement acquires the right to be charged with the sale of the real assets of the company, if the debtor fails to pay the loan, and when the bank is not looking for real coverage for the approved loans but consider that the payment of the loan is based on the real flow of money in the company.

Protective clause are assurance of the debtor in the bank. In practice there are various protective clause and are related to the financial condition of the debtor, as well as the quality of the management. The most frequent protective clause are: the submission of periodic reports by the debtor to the bank, the debtor is obligated during the payment of the credit to keep his own resources on a certain minimum level; the debtor shall not do any transactions without approval from the bank; the debtor can't withdraw the second credits, and increases the fixed assets of the company without approval from the bank and the debtor cant buy negotiable instruments other than governmental. /4

2.1. Loan process

The fulfillment of the requirements for applying for a loan, does not mean that the decision is made by automatism; with the application itself, starts the process of credit by the bank which includes:

- The process of drafting and adopting of the decision which begins with submission of the request for a loan which on base of the information submitted , available data, external data available to the bank, is making valuation of the creditworthiness.
- Monitoring of credit, a process that takes place after the adoption of the credit decision, and its aim is to be seen the quality of the whole loan, as well as the performances of each individual on the loan.
- Preparation of remediation scenarios in case of a problem, in case of liquidation of the debtor company.⁴⁾

3. BANKING SECTOR AND FINANCING OF SMEs IN THE REPUBLIC OF MACEDONIA

In Macedonia most frequent source of funding for SMEs represent the banks, and that is due to the underdevelopment of alternative ways of funding, particularly non-traditional sources of funding such as initial funds, funds of financing, leasing, business angels, etc. The researches about the source of funding indicate that the participation of the banks is dominant, and almost all SMEs believe that bank loans represent the main source of funding.⁵⁾

The increase of the credit activity is due to several factors , without making analysis of the reasons for the such increase, from the topic of this study should be noted that according to the structure and the purpose of loans, most are intended for consumers, according to the purpose or the loans, the increase for the loans for the households is higher compared to the increase for the loans for enterprises. From the aspect of the commercial banks , the decisions of solvency of the clients is a factor and has exceptional importance for the assessment of the creditworthiness of the company, and from there the issue what is happening with those businesses that should start.

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⁴⁾ *ibidem*

⁵⁾ Poposka Klimentina. Entrepreneurial problems, dilemmas and perspectives,. Institute of Economics-Skopje. 2007: 86.

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In relation to the change in the banking sector, despite the General improvement of the banking environment and the improved performance of banking in the last few years, the Macedonian banks believe that there are certain constraints among SMEs in the application for the loans. From the aspect of the Macedonian companies, they believe that the bank loans are very expensive way of funding and that there are a number of restrictions in the providing financial funds. Such a ascertainment by the both sectors is justified, but despite the fact that bank loans represent the dominant and in the greatest number of cases, the only way of funding.

3.1. Limitation in the financing of SMEs from the aspect of the banks

Limitations that appear from the aspect of the banks, in relation to the financing of SMEs are: lack of long-term resources; the regulations; low preparation of SMEs for the cooperation with the banks, management among small and medium enterprises often is not sufficiently prepared and experienced; the production program of SMEs often is based on only one non reputable product; The SMEs rarely have to offer coverage for resources (credit), lack of good projects, non prepared exposure to SMEs for preparation of the projects and business plans; unsafe or suspicious reports for the balance, uncertain credit history, inadequate guarantees, there is a mistrust of SMEs from the side of the banks, the banks are not satisfied with the quality of the arrangement of the business plans, a high percentage of written off fixed funds and obsolete technology by SMEs, as well as the fact that most of the small enterprises are micro enterprises, or have the status of an individual.

Because of this, from the aspect of the banks, the main interest is concentrated towards: short-term lending, lending among big enterprises, unpreparedness for sharing the risk with SMEs.

3.2. Organization in financing from the aspect of the SME

According to empirical researches, most of the SMEs the access to finance, they see as main obstacle in their own functioning, while the experience with financing through the banking sector, although shows a bigger use of financial instruments, as well as the use of certain credit lines are characterized certain restrictions from the aspect of the SMEs, as follows: conservative approach of the banks to loans, high requirements for collateral, the existing judicial system, poorly defined legislation;

high interest rates, lack of medium-term and long-term loans; Non standardized methodology of the preparation of a business plan, slow, expensive and complicated procedures of the credit assessment of the loan applicant and the huge number of documents which are required to be submitted at the application for the loan, presents a significant obstacle for SMEs.

Conclusion

Finances are the most important support, which is needed to ensure the entry of new participants and the development of their enterprises. Without widely developed financial market, it is very difficult to maintain a certain level of development. The questions related of financing are the most significant in the part of encouraging the development of small and medium businesses.

Financing of SMEs is a major problem in all countries including the Republic of Macedonia, and also in conditions of not sufficiently developed financial market, the traditional sources of funding, as well as the alternative ways, the banks as a traditional source have a fulminating role.

Banks as most typical of any participants in the capital market, are important because provide two types of support, as follows: cash and advisory support.

The performance and functioning of the banking sector affects on the interest rate at which SMEs shall provide financial resources for its functioning. In the years backwards was registered moving forward in the banking sector, aimed at increasing credit activity, however the results of some observations indicate that in such conditions, the financial sector is approximately towards the requests of the companies, but not sufficient to satisfy the needs of the new and small companies.

The need to overcome the limitations in terms of the two involved parties, the banking sector and SMEs is inevitable, just as it is inevitable the joint risk management. In the interlaced and dependent relationship between the banking and the SME sector, are inevitable changes. The decrease on interest rates, as well as the need for new technology to the procedure for processing and approval of loans, simplification of the procedure and facilitating the access to finance, as a change is inevitable, that must implement the banking sector. The companies have to improve their negotiating position, a part with the help of the state and part and with the production of quality programs and business plans through which banks will see endurance, as well as the ability of SMEs, regular and timely servicing of the matured liabilities, on the base of principal and also on the base of interests.

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