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NEEDS CAPITAL FOR SMALL AND MEDIUM ENTERPRISES

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Abstract: Many SMEs to grow face the challenge of increasing the need for access to capital and competencies to enable the company to grow and develop new products or expand into new markets. SMEs may have limited access to loans from banks and credit institutions, or access may mean capital investment by company owners. SMEs typically use different types of finance, often provided by different service providers, they can work with two or three banks, and they can access other sources of financing, both internal and external; their combination. To get started, small businesses initially rely on their own sources of funding, which include their own funds, assets from the sale of property, or retained earnings. In the course of operations, the need for capital exceeds the internal capabilities of the company and then it must consider the possibility of using external sources of financing to provide funds for business development and the necessary investments. Financing from external sources is especially problematic for most new companies that do not have a long history in their operations and lack funds for new innovation projects.

Keywords: capital, small and medium-size enterprises (SMEs), financing.

CHARACTERISTICS OF SMALL AND MEDIUM COMPANIES

Small and Medium Enterprises (SMEs) are enterprises that meet certain criteria in terms of number of employees, size of property or annual turnover. Companies classified as small and medium-sized enterprises (SMEs) are officially defined by the European Union as entities with less than 250 employees. They are independent of the larger companies in their operations. Small and medium enterprises have an annual turnover of up to 50 million euros or an annual balance sheet not exceeding 43 million. There are three types of SMEs¹:

- Micro-enterprises, which have less than 10 employees,
- Small enterprises, which have between 10 and 49 employees,

¹ Entrepreneurship and Small and medium-sized enterprises (SMEs), http://ec.europa.eu/small-business/policy-statistics/facts/index_en.htm> SME definition.

- Medium-sized enterprises, which have between 50 and 249 employees.

This definition is crucial in determining which companies can benefit from European SME support programs or specific policies, such as competition rules for SMEs, etc.

Small and medium-sized companies are becoming more and more important in every country of today's society because they are a place where new employment opportunities are created and are key factors in the well-being of local and regional communities.

Caring for small and medium-sized companies should become a leading policy. To achieve this, the principle of "thinking small first" should be unconditionally rooted in policy-making, from regulations to the public service, ensuring that the new rules reflect the majority who will use them. Small and medium-sized companies must be helped to thrive. When opening a new business and during its growth, unnecessary obstacles are imposed, they must be removed. When small and medium-sized companies lag behind as a result of market problems, they must be addressed. The Small Business Act for Europe proposes a partnership between the European Union and its member states. What is needed now is a strong political commitment at the highest level to make real progress.

The SME sector covers all types of companies, from sole proprietors to cooperatives. Some small and medium-sized companies provide extremely traditional services, while others are fast-growing that use high technology. However, despite all the differences between them, European small and medium-sized companies are bound by the multitude of challenges they face.

Small companies are an important category in any national economy. Their importance is widely known and caring for them should be the main policy of every country. World experience and economic science studies show that there is no stable economic development without a significant presence of small and medium companies.

The characteristics that are often discussed as typical for small and medium enterprises are the following²:

- Limited resources - Small and medium enterprises generally have limited resources. This is especially true for start-ups.

- Informal governance style - For small and medium enterprises, governance is usually informal. The owner has to do almost everything and the employees are usually expected to be able to do things without a clear division of tasks.

- Flexibility - The company has more flexibility to adapt to changes in the environment due to its size and informal structure. For example, any changes in government policy or technology can have a strong impact on firms because immediate changes require additional resources or capital. This can become a constraint for companies to compete and stay in the market.

- Dependence on individual decision makers - Companies are managed by the owner. Business entrepreneurs run the company and play a role both as an employee and as an employer. The growth of companies is determined by the owner. Decision making is usually done by the owner.

THE NEED FOR CAPITAL OF SMALL AND MEDIUM COMPANIES

Small and medium-sized companies need financial resources to finance their working capital (working capital) and to use the tools to manage potential business risks or to finance a business investment (investment financing)³:

- ✓ Working capital tends to be used for:
- ✓ Payment of wages or suppliers, for example, if there is a delay when wages or suppliers need to be paid and when the client pays an invoice;
- ✓ Payment of other fixed costs, for example, rent; and
- ✓ Contingency safety net, for example, if any difficulties arise.

² Characteristics of the Small And Medium Enterprises, (2020), www.ukessays.com/essays.

³ How medium-sized businesses access finance, (2020), www.british-business-bank.co.uk.

Investment financing tends to be used for:

- ✓ New equipment e.g. machines;
 - ✓ Purchasing other business activities;
 - ✓ Provision of new premises;
 - ✓ Moving to new markets, for example, investing in new factories or businesses abroad;
 - ✓ Internet, new platform for services or delivery; and
 - ✓ Restructuring the business e.g. realizing the value of assets or property within the business.
- ✓ Restructuring the business, for example, realizing the value of assets or property within the business.

Access to finance is an important factor for small and medium-sized companies because securing financial resources allows them to expand their operations, modernize equipment or move to new enterprises, which will increase their competitiveness and achieve growth. Access to finance is usually correlated with the size of the firm, which means that the smaller the firm, the more difficult it is to take advantage of external financing options. This can be for many reasons, including a higher perceived risk profile, fewer security options and less financial management capacity⁴.

A major problem facing SMEs is access to adequate funding sources. Investors and banks often shy away from financing start-ups and start-ups due to the presence of risk. The companies themselves sometimes do not fully understand the fears of investors, which makes it even more difficult to find the necessary financial support. Given that the financial markets fail to provide the necessary financial support for small and medium-sized companies, the European Commission has created financial instruments - guarantees schemes that will help small and medium-sized companies more easily get the financial support they need. Financial instruments cover the various needs of small and medium-sized companies, whether they are start-ups or existing companies⁵:

- Support for high-growth and innovative companies provides capital for innovative small and medium-sized companies in their early or expansion phase.
- Grant support provides greater loan security for SMEs, which aims to encourage banks to make more lending available to them, including microfinance and MEZANIN-type financing, reducing the risk that banks need to take on burden of its operation.

Microcredit (loans of less than 25,000 euros) has a serious impact on the companies that are their beneficiaries. However, there is a lack of such loans, which most directly affect the opening of new businesses by the unemployed, women entrepreneurs or members of ethnic minorities. The European Commission thus increases the availability of microcredit through its own financial instruments and encourages Member States to increase and facilitate access to microcredit for small businesses.

The European Investment Bank Group (EIB) is expanding the way it supports small and medium-sized companies by simplifying its financing mechanisms, making them more transparent and better focused on the specific needs of small businesses across Europe. Additional funds as well as several types of financial support - including MEZANIN financing, guarantees and microcredit - are made available to small and medium enterprises by constantly adapting the specific conditions to local conditions and the specific needs of companies. The European Investment Bank is also expanding its operations to new areas of financing, such as non-financial instruments - investing in research and development, establishing a distribution network or ensuring business continuity and retiring its founders.

⁴ Chapter 7. Access to finance for SMEs (Dimension 6) in the Western Balkans and Turkey, (2017), www.oecd-ilibrary.org/acce.

⁵ Directorate-General for Enterprise and Industry, Small businesses are our priority Europe is good for SMEs, SMEs are good for Europe European Commission, www.aprrm.gov.mk/webdata/dokumenti/Zakonoz.

POSSIBLE SOURCES OF FINANCING FOR SMALL AND MEDIUM COMPANIES

One of the most important issues for any company is choosing the right source of funding for the company. The decision on how and from what sources to finance the company and the growth and development are of strategic importance for every entrepreneur, owner or manager. Small and medium-sized companies usually face limited access to favorable sources of financing and to the money market and the capital market, especially in terms of prices and conditions for their use.

Small and medium-sized businesses can use internal and external sources or a combination of these to provide funding. The most important consideration when deciding on the source of finance for small and medium enterprises is to achieve a balance of capital and debt and to ensure that the source of finance corresponds to the business. The sources of financing for small and medium enterprises can be divided into two categories: internal which includes (personal savings, family and friends) and external (investments, bank loans, grants, bank overdraft)⁶.

To get started, small companies initially rely on their own sources of funding, which include their own funds, assets from the sale of property, or retained earnings. In the course of operations, the need for capital exceeds the internal capabilities of the company and then it must consider the possibility of using external sources of financing to provide funds for the development of the business and the necessary investments. Financing from external sources is especially problematic for most new companies that do not have a long history in their operations and lack funds for new innovation projects.

Sources of financing in small companies are generally divided into:

- informal and
- formal.

Informal sources include funds raised by family, friends, or wealthy individuals or business angels.

The personal savings of the owner are the most important source of capital financing. Especially for new small and medium enterprises, short-term finance as initial activities is obtained mainly from non-institutional sources. Owners-managers are satisfied with self-financing during their establishment. However, personal savings are often insufficient due to low savings rates. Therefore, entrepreneurs often borrow from family, relatives and friends. Studies have shown that the high percentage of SME funding comes from informal. Although small and medium-sized enterprises rely on personal savings when they are established, most of them still actually need external finance to grow and develop.

Formal sources of financing include various types of traditional borrowing (loans to commercial banks and other financial institutions, microcredit, leasing, as well as venture capital funds, factoring, etc.). Companies often use a combination of several different sources of financing, taking into account the relationship between equity and borrowed capital.

Each of the sources of financing has its own price, which is a certain cost for the company. The costs of long-term resources are of great importance for the company, because they directly affect the overall stability of the company. The amount of costs depends on the interest rate of the borrowed loan or the issued securities. The cost of own funds is usually more difficult to determine, while borrowed funds have lower costs but limit the creditworthiness of the company and carry risk in case of problems with repayment.

Regardless of which source will be used to finance small companies, each of these sources of funding has specific advantages and disadvantages, as well as criteria that will be used to evaluate the company⁷.

⁶ Major Sources of Finance and Funding for SMEs - UK Essays, (2017), www.ukessays.com/business.

⁷ 7 start-up financing sources for your business | BDC. (2020), www.bdc.ca/pages/start.

Self-financing

When starting a business, the first investor of the company is the owner himself, ie his own money. or by securing your funds. Self-financing means those processes and procedures when the company provides funds from its own sources, without the obligation to return them. Self-financing has a number of advantages over other types of financing, because it is free, ie. no interest is paid, which increases the independence and efficiency of the operation.

The equity available to the owner-manager of the small business is the most important and definitely unavoidable source of finance, especially if it is a new business, in the economic literature called "start-up". The personal finances (savings) of the owner include relatively small amounts in form of bank deposits, funds on current accounts, credit cards, etc. This type of sources of finance includes his property in securities (stocks, government or company bonds, etc.), as well as real estate (land, houses, office buildings, etc.).

Loan financing

This is money borrowed from a spouse, parents, family or friends. Investors and bankers consider this to be a "capital of patience", which is money that will be returned later as the company's operating profit increases. When borrowing money, it must be borne in mind that:

- Family and friends rarely have a lot of capital,
- They may want to have capital in the company,
- Doing business with family or friends is not always easy.

If it is a loan from family or friends, these funds are easy to obtain and the pressure to repay them is less; in the third case, the owner-manager gets a business partner, whose skills and experience can help in managing and managing the business. This type of financing for small companies often occurs in the form of loans or investments, then you can find immediate gifts, additional or deferred compensation or reduced or unpaid rent.

The advantage of using money borrowed from family or friends is that they are free, ie not subject to interest. Apart from being a loan, money from family and friends can also come as share capital. Relatives and friends often provide small amounts of funds, primarily due to the relatively small need to invest in a newly started business.

In addition to family members and friends, other entities can apply for starting a business, which by investing funds become partners in the business. In this case, the person or persons who have invested their money in the company are assigned a share in the capital, and the company takes the form of a business organization called a partnership. The partnership allows the company to raise additional capital to finance development in the early and critical stages of its development. The interest of business partners is to gain a share of the profits.

Venture capital

One of the possible options offered to small companies to finance entrepreneurial activities is venture capital funds. In fact, it is equity from external sources that is commonly used to finance new, growing businesses. Venture capital is not necessary for all small companies, ie for their owners or entrepreneurs. It is important to be aware from the outset that venture capitalists are looking for technology-driven businesses and companies with high growth potential in sectors such as information technology, communications and biotechnology. Venture capitalists also expect a healthy return on their investment, often generated when a business starts selling shares to the public.

Formal risk funds comprise institutional investors, ie. pension funds, insurance funds, wealthy families, venture capital departments of commercial banks, etc. They function as asset owners and as a limited partner, but also as a general partner, as a form of venture capital that manages the assets that institutional investors have temporarily transferred to the official risk fund.

The general principles of risk fund operation are⁸:

- venture capital funds invest in other people's money,
- risk funds invest large sums of money,
- when choosing a business, the quality and professionalism of the management team are most important for the official venture capital,
- the motives of the risk funds are purely commercial,

This type of investment in small and medium companies is present in the financing of risky ventures and those ventures that have an above average rate of return. Usually venture capitalists identify with the entrepreneur's business partners, especially in the growth and development phase of the company. Risk investors are not passive observers of the operation of small and medium companies, but on the contrary they actively participate in the management of the company and contribute to its development by applying their experience and knowledge of business opportunities.

Business angels

Business angels are generally wealthy individuals or retired executives of companies that invest directly in small companies owned by others. They are often leaders in their field who not only contribute with their experience and network of contacts, but also for their technical knowledge management. Angels tend to finance the early stages of small business operations and retain the right to oversee company management practices. This type of financing has become known as informal venture capital because there is no place in the market where these individuals regularly invest. These investors also named themselves business angels. The most important characteristics of business angels as sources of finance for small companies are⁹:

- acquisition of ownership and management rights in the businesses in which they invest funds - the invested funds are invested by business angels, mainly in exchange for shares;
- careful choice of business, based on the business idea, business plan and study of the personality of the entrepreneur;
- business angels usually invest in family businesses;
- post-investment involvement - engaging in the business in which they have invested funds by providing advice and expertise; their involvement in the work of the business is usually not full-time and is applied through: giving advice and consulting, reading the financial statements, participation in the board of directors of the company, etc.

The economic importance of business angels is on the rise. They are investing more and more money in new businesses. Business angels invest in small businesses at the most critical moments, usually when the entrepreneur runs out of equity money and is not yet able to attract formal venture capital funds or bank loans.

In addition to capital, business angels provide business management experience, skills and contacts for the entrepreneur. Experienced angels also know that they may have to wait for the return on investment. Therefore, they can be a good source of "smart and patient" capital. Business angels play an important role in the economy. In many countries, they are the second largest source of external funding for start-ups, after family and friends. They are increasingly important as venture capitalists and contributors to economic growth and technological progress¹⁰.

Business incubators

Business incubators (or "accelerators") typically focus on the high-tech sector by providing support for new businesses at different stages of development. Typically, business incubators invite prospective businesses and other small start-ups to share their premises as well as their

⁸ Evaluation of important credit risk factors in the SME segment, (2020), jois.eu/files.

⁹ Business angels: what are they and why are they important?, (2012), theconversation.com/busine.

¹⁰ Business angels | Internal Market, Industry, Entrepreneurship, (2020), ec.europa.eu/funding-policies.

administrative, logistical and technical resources. For example, a business incubator may share the use of its laboratories so that the new company can develop and test its products more cheaply before starting production.

Generally, the incubation phase can last up to two years. Once the product is ready, the business usually leaves the incubator premises to enter the industrial production phase and is alone. Small companies that receive this type of support often operate in state-of-the-art sectors such as biotechnology, information technology, multimedia or industrial technology.

Business incubators support the development of start-ups, providing them with advisory and administrative support services. The primary goal of the incubator is to produce successful and financially viable companies that can survive on their own. Incubators first focus on technology companies or a combination of industrial and service companies, and then work with companies from a variety of industries:

Incubators help beginners save on operating costs. Companies that are part of an incubator can share the same facilities and share the main costs, such as utilities, office equipment rental and reception services. Start-up companies can also take advantage of lower rental rates if the incubator is located in low-rent industrial zones. Incubators can also assist start-ups with their financing needs by directing them to business angel investors and venture capitalists and assisting them with presentations.

In addition to financial assistance, start-ups need guidance on how to compete successfully with established participants. Incubators can use their networks of experienced entrepreneurs and retired executives, who can provide guidance and operational assistance. For example, a start-up biotechnology company will benefit from the advice of retired pharmaceutical directors who have first-hand experience with drug development and clinical approval. Similarly, a restaurant entrepreneur can learn about the difficulties of expanding abroad from retired catering executives. Start-ups usually benefit from having respected individuals on their boards and scientific advisory panels, as these individuals bring invaluable connections and table experience.

The close working relationship between the beginners of the incubator creates a synergy. Even after the start-up companies leave the incubator, the connections and networks established through these connections can last a long time. Start-up entrepreneurs can give encouragement to each other, and employees can share ideas for new approaches to old problems. Start-up companies can plan joint marketing campaigns and collaborate on product development initiatives. These synergies do not have to exist among start-up capital-financed companies, because fundraising companies do not have to know each other and can be located in different geographical locations.

CONCLUSION

SMEs are key to the economic and social development of almost all developed and developing countries in the world. These companies generate revenue and create many jobs. However, access to finance for small and medium-sized companies remains severely limited. Owners and entrepreneurs point out that access to capital is one of their most challenging challenges. Finding money to start their own small business is usually one of the first problems that entrepreneurs face. For most people, this process can be difficult and very frustrating.

To start a business, every company, small or large, requires financing, in a timely and appropriate manner. For most entrepreneurs, fundraising comes in the traditional way, which means approaching financiers, convincing potential supporters of the project's future viability, and then contracting. The main problem for small and medium enterprises to get finance is uncertainty. Investors often do not rely on small and medium-sized enterprises to invest because many of them fail to survive. Banks are quite distrustful of investments, as small and medium-sized enterprises pose a high credit risk.

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