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MARKET SOURCES FOR FINANCING SMALL AND MEDIUM COMPANIES

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Abstract: To start your own business requires a good idea, but also financial means to realize the idea. Financial resources are necessary for the initial financing of the business, the development of the team, the product or service to be offered, marketing, procurement of equipment, raw materials, liabilities to the state and a number of other costs.

But finances are also necessary to maintain a continuous flow of business activities with all stages of the company's development. When choosing sources of financing, owners must be extremely careful, take into account all factors and costs and skillfully make the ideal combination of cheap and affordable finance to "feed" the business and ensure further growth and development.

Keywords: market, financing, small and medium companies.

1. General characteristics of market sources of financing for small companies

Small companies borrow money and repay it at certain intervals with a certain increase in the amount of interest to use that money. In such a source of financing, the owner of the small company signs an agreement in which he undertakes to repay the amount of the entire debt increased by the amount of interest.

This form of financing the business is a loan, ie borrowing where the owner goes to individuals or institutions and lends money by signing an agreement that in a certain period of time he will repay them together with the amount of interest. Borrowing can be[1]:

- Bank loans,
- Financial leasing,
- Franchising,
- Factoring.

[1] External Sources of Finance / Capital, (2020), efinancemanagement.com

Commercial banks offer a variety of loans to finance small businesses. They offer loans for investments in fixed or current assets, through which the business can provide money for the purchase of office space, equipment, machinery or raw materials, raw materials, finance for the payment of salaries to employees.

Financial leasing is an alternative way of financing in which the licensed leasing company (the "lessor") buys an asset on behalf of its client ("lessee") in return for a contractually agreed series of payments that usually involve an interest element. The lessor retains ownership of the asset, while the lessee enjoys using the asset for the duration of the lease, usually accompanied by the option to purchase the asset at the end of the lease. The lessee bears all costs and risks associated with the use of the leased asset.

A franchise is a type of license that allows the franchisee to access the franchisor's proprietary business knowledge, processes, and trademarks, allowing the franchisee to sell a product or service under the franchisor's business name. In exchange for a franchise, the franchisee usually pays the franchisor an initial fee and annual licensing fees.

Factoring means a financial arrangement between the factor and the client, in which the firm (client) receives an advance in return for receivables from a financial institution (factor). It is a financing technique in which there is a complete sale of trade debt by a firm to a third party, ie. factor, at reduced prices. Factoring is a financial alternative to financing and managing accounts receivable. Lists the terms of the sale in the factoring agreement.

1.1. Loans to commercial banks

Access to credit is the lifeblood of small and medium enterprises as they develop over the years into profitable and sustainable businesses. However, as they move along the growth curve, their funding needs change. Lending is a complex process that consists of different types of relationships built between financial institutions (or different types of organizations), with clients (entrepreneurs) in need of financial resources. Lending to small and medium companies is closely dependent on the development and operation of financial institutions, macroeconomic conditions, monetary system, legal system and other environmental factors[2].

Banking and financial services are important for small and medium enterprises. They provide financing for starting, maintaining or expanding businesses. There are many SME loans designed to help SMEs get started and thrive. Access to bank credit and its availability is one of the key factors that should be considered for the development of small and medium companies. Credit availability varies depending on many factors related to companies and operating banks. One of the characteristics that can be described as distinguishing the terms of credit availability is the size of the enterprise. Small and medium-sized enterprises, despite their importance for economic development, face many difficulties in seeking capital due to insufficient amount of information forwarded to banks. and its asymmetry. However, the better the economic situation of the company and the more information about the company is available, the easier it is to access them with bank financing. Lending to small and medium-sized companies through banks has the following characteristics[3]:

- Lending is one of the most common sources of financing for small and medium enterprises. As a significant advantage of its use is that it increases the purchasing power of the company and the execution of the procurement is at the moment when it is needed and without the necessary funds, with the help of the loan, products can be procured. The loan is an expensive source of financing, because it is usually accompanied by a high interest rate, it takes time and costs for the administrative procedures for approving the loan, the loan reduces the future purchasing power, because the income is tied to credit payment, ie everything earned future should

[2] Wood, S., (2019), The Importance of Credit to SMEs | Finance Business Tradingfinancebusinesstrading.com
[3] Włodarczyk, and others., (2018), The impact of credit availability on small and medium companies, hal.archives-ouvertes.fr

be used for what was bought in the past. Using credit can make a small business owner dependent on using more funds than he or she has.

- In order to protect themselves from credit risk, banks often require additional protection mechanisms from loan applicants such as blank bills of exchange, guarantors, mortgages, guarantors and the like. Most bank loans are designed to help loan applicants meet short-term working capital needs or purchase equipment and assets that require longer periods of financing. Short-term loans are usually in the form of credit lines, also known as loan liabilities where the bank and the borrower agree in advance that the borrower can withdraw from the credit line if necessary up to a maximum limit. Within that limit, the borrower himself decides on the amount and timing of the loans. Thus, credit lines function largely like credit cards. Their main advantage is the flexibility of the arrangement, allowing the borrower who needs temporary financing to receive those funds, and repay them after the sale and collection from their customers.
- Purchases of plant and equipment and other long-term investments, including the acquisition of other companies, are usually financed by a fixed-term loan for a period of one to ten years, usually between three and five years. Fixed-term loans are intended to finance large expenses and repay the loan, together with the interest they distribute over a period that approximately corresponds to the cash flow that will be realized and with which the debt can be serviced.
- Long-term loans belong to the group of secured loans and upon their approval, the clients are required to participate in the total value of the funded asset, ie. the loan amount is less than the value of the collateral. Thus, the bank is partially protected from credit risk.
- Mortgage lending (mortgage loan). This method of lending is applied when the company is in a difficult financial situation and other standard lending criteria can not be applied and in conditions when there is an intervention (urgent) need for loans. These loans belong to the group of secured loans where property with a certain value is pledged.

1.2. Financial leasing

Leasing is a commercial and financial activity through which commercial entities, most often small businesses, turn to a specialized institution to lease investment equipment for a certain period and for a certain fee. Leasing in its simplest form is an instrument for securing financial resources and is broadly defined as "an agreement between two parties, where one party (the lessor) lends an asset to the other party (the lessee) for a certain period of time and for a predetermined fee ". The word lease comes from the English verb "to lease", which means "to lease" or "to rent". Leasing is an activity that refers to a movable and immovable object, in which the lessee determines the lease item that is purchased or produced by the lessor and is given to the lessee to use for an agreed period of time, in exchange. for payment of a fee for the use of the subject of the lease, on the basis of the lease agreement concluded between the lessor and the lessee, according to the conditions determined in it. The lease is taken for new, modern and technically-technologically advanced equipment. There are two types of leasing[4]:

- Financial and
- Operational.

A financial lease is a lease that transfers all the risks and rewards arising from the ownership of an object, whether movable or immovable, with the expiration of a certain period of time the ownership may or may not be transferred.

"Operating lease is any lease that is not a financial lease"

- The advantages of leasing over bank loans are:

[4] Helmut Kraemer-Eis, Frank Lang, (2012), The importance of leasing for SME finance, European Investment Funds, EIF Research & Market Analysis, Luxembourg,
The importance of leasing for SME finance - www.eif.org › research › eif

✓ Much faster and simpler procedure (regulation of all administrative procedures, including signing the contract with the lessor),

✓ Adjustable approval conditions (leasing is much more tailored to specific customer requirements than any other form of financing),

✓ There is no need for a mortgage, balance sheet or off-balance sheet presentation of investments in fixed assets (the way of presentation depends on whether the buyer has decided on financial or operational leasing),

✓ Lower tax base, working capital savings, accurate cost planning (leasing installments are nominated in hard currencies and do not change until the contract expires),

✓ Avoiding the difficulties of reselling equipment in which the small business has invested its own money.

However, leasing also has some weaknesses:

✓ as a financing instrument, leasing is more expensive than bank loans, ie leasing installments, due to the increased risk, are usually more expensive than bank loan repayment installments; it is more difficult to provide guarantees or other collateral compared to bank loans, for which mortgages are usually negotiated as a means of securing loan repayment;

✓ inequality of the contracting parties (the will of the stronger contracting party is imposed);

✓ inelasticity of an already concluded leasing agreement regarding the term of validity, the amount of the fee, the payment period, the possibility for early termination of the agreement;

✓ has a negative impact on the possibility of renewal and modernization of fixed assets of the user of technical and technological equipment because most often the lessee after the expiration of the contract either buys or re-leases the equipment, which is already obsolete.

1.3. Franchising

Franchising is a reputable way to start a business, as it recommends greater business security. When buying a franchise, you become part of a large organization with all the privileges that go with it. The success of a franchise consists in maintaining a consistent relationship between seller and buyer. The franchisee agrees to apply strictly defined standards to the operations given by the seller, and the seller will receive a certain percentage of the sales of the product or service and thus expand his business both locally and globally.[5]

Franchising is a continuous relationship between the franchisee (franchisor) and the franchisee (franchisor), in which the franchisee's entire knowledge, production and marketing techniques are available for use by the franchisee, in exchange for a certain percentage of sales. A franchise is a business relationship between two entities that remain legally independent. Practically, it transfers the technology of work, and knowledge can be transferred orally, through consultations and training. The franchising business format not only gives the franchisee the right to use the franchisor's brand and sell his products and services, but also conveys the full way of running the business, which is established by the franchisor. Therefore, the business form of franchising is the most successful method of distributing goods and services in the economic history of our planet.

Product franchisors are large manufacturers who assist the franchisee in organizing production. The necessary knowledge and experience, the trademark of the product, etc. are transferred to the franchisee. The franchisor and the franchisee agree on the production capacity and the control of the production volume, because that production is a competition in the sale of the products. The customers of the product franchise are small entrepreneurs who are engaged in production. Through franchising, they acquire the right to produce and sell products and services. Franchising customers cooperate with franchisors in choosing the location where the production

[5] What is a franchise? Advice and tips for small businesses, (2018), smallbusiness.co.uk › what-is.

will be organized. They pay a fixed amount to the franchisors. Their advantage is that production has already been conquered and the market has been explored, whereby the risk of investing in additional production capacity is significantly reduced[6].

Franchising is a popular way to start a business because it offers greater business security. When you buy a franchise, you become part of a larger organization, with all the benefits that go with it. Promoting a product or service to a wider region, with ads prepared by the headquarters, is just one of the many benefits. The franchisee agrees to maintain certain standards of operations specified by the seller. He pays a certain amount, and in return gets the right to: sell a certain product or service, use a trademark, use trademarks, technique of operation or technological process. The franchise is ideal for those entrepreneurs who[7]:

- ✓ They do not have their own ideas, but they are persistent and hardworking;
- ✓ Have managerial skills, capital or location;
- ✓ They will not be frustrated by the lack of autonomy.

The most important thing for franchising is to reduce the risk of bankruptcy of newly opened companies. managerial skills and it suits them not to have much autonomy of operation, because they get an already developed and proven management system of a large company.

1.4. Factoring

The subject of the factoring may be an existing or future missing short-term claim, arising from the contract for sale of goods or services, assigned to the factor, up to the amount of the deviation limit, during the validity period of the factoring contract. The word factoring is of English origin (factoring), meaning: agent, creditor, mediator, commission agent. Factoring is based on an obligation agreement between the creditor (exporter) and the factor (the bank or other specialized financial institution), and the essence of this activity is the transfer of receivables and the risk of their collection by the bank client. This modern financial instrument also has a significant credit function[8].

In addition to the services that are directly related to the transferred claim, such as accounting and analysis, examination of the debtor's creditworthiness, tax calculation, statistical records, etc., and the content of the factoring agreement may include other services that are indirect connection with factoring activities.

Factoring is a financial transaction of a company that sells its short-term receivables in the currency of a third factor for a certain commission, and at the same time the cash received in return is used to finance the business. Factoring involves the sale of receivables and their conversion into live cash, which improves the liquidity of the company without borrowing.

In general, factoring is a product for manufacturing companies, especially for those who export their products, who give them deferred payment, who are at the same time forced to make advance payments to their suppliers and also have liquidity problems. The priorities of factoring are: high liquidity, increased flexibility, company growth, competitiveness, improved solvency and credit rating.

Factoring is especially important for small and medium-sized companies that traditionally have difficulty accessing bank loans, due to their low creditworthiness or inadequate means of securing credit, and is one of the best ways to ensure fast and secure collection of receivables arising from sales contracts. of goods or services. The basic functions of factoring are[9]:

- ✓ The financing function provides cash through advance payment. With the help of the factor, the client has cash, and it is very important to know in advance the time interval between

[6] Franchising - Meaning | Advantages and Disadvantages, (2020), accountlearning.com › franch.
[7] Franchises | business.gov.au, (2020), business.gov.au › Planning
[8] Staying liquid: The benefits of factoring for SMEs, (2020), mybusiness.singtel.com › stay.
[9] The Role of Factoring for Financing Small and Medium Enterprises, (2020), openknowledge.worldbank.org

the day when the factor will make payment, until the day when he will get the opportunity, ie the right to collect the claim from the debtor to the client.

✓ The function of securing the collection (guarantee for liabilities of a third party) is a function when the factor assumes the obligation to collect the claim, ie it assumes the risk of insolvency of the debtor to the client. Which recovery risk the factor will take depends on the factoring agreement itself. In American practice, there are factoring agreements, when the factor assumes the responsibility not only for the financial risk, but also the political risks for the collection of the claim, the risk for the delivery of the goods and so on. When the customer delivers the goods, the factor can in no case waive the obligation.

✓ The function of claims management. This is a function and services that are not contained in the previous two functions, and the factor may:

- sues or otherwise secures the receivables he has purchased,
- provides consulting advice to its clients,
- oprotects its clients from bad (uncollectible or difficult to collect) debts, keeps accounting, - calculates commission and tax, etc.

Factoring is also very important for exporters, because in addition to financing by advance payment, it enables the risk of collection and management and monitoring of receivables, which increases the competitiveness and export potential of companies in the international market. At the core of factoring is the transfer of claims arising from commercial contracts.

2. Microcredit

Microcredit has emerged in the recent past as a way to provide small financial resources to companies and to avoid the problems they have in securing financial capital from formal sources of funding. The term "microcredit" is often used in the narrower sense of the word and refers to microcredit, intended for small companies. Microcredit in the modern world is increasingly becoming one of the important links of economic development, with significant socio-economic effects. Microcredit is often the only way to bring financial services closer to those who have limited or no access to traditional financial services providers[10].

In some countries there are highly developed mechanisms of micro lending. This type of loan is provided by micro finance institutions (MFIs). Their main mission is to provide financial services in the development of specific financial "products" and methodology, which can solve one of the basic problems in working with banks and other financial institutions - the lack of appropriate collateral instruments that clients make. suitable for taking different types of loans.

It should be noted that it is extremely wrong to equate microcredit with microfinance. Microcredit is only part of microfinance. In addition to the microcredit service, microfinance includes other services, such as: micro-savings, microinsurance, money transfer, etc.

Potential microcredit borrowers, before applying for a loan, usually contact several organizations that approve this type of loan and are informed in order to compare the conditions for loan approval and use. Micro-credit organizations have consultants who help each client understand the credit terms, fill out an appropriate questionnaire, prepare a business plan and prepare the necessary documentation. If the client successfully realizes all the previous things and his business idea proves to be economically justified, the microcredit organization makes a decision to approve the loan. The final decision on the payment of the credit funds is made by the bank with which the microcredit organization cooperates. After the payment of the loan and the beginning of its use, the microcredit organization monitors and controls the intended use of the funds by the user.

For small companies, using borrowed funds is very risky, as most small companies often expect low cash flows. It may be advantageous for these businesses to use equity financing as

[10] Nyikos, G., (2018), Microfinance and access to finance of SMES, www.researchgate.net › 3287.

opposed to borrowing financing. Capital investments ensure solvency, because the investor does not receive a refund in the event that the company struggles to survive, as opposed to credit financing, where, regardless of everything, the loans must be repaid. Also, capital investors such as investors and business angels often add value to the business in which they invest and often help the business succeed.

Microcredit has a significant role in the growth and development of small businesses, in case they have difficulty in providing the necessary financial capital to realize their entrepreneurial ideas. The basic characteristics of domestic microcredit institutions and microcredit relate to[11]:

- ✓ relatively easy access to credit, without much administration and conditionality;
- ✓ loans are intended for entrepreneurs and micro enterprises that want to start a business and are approved in very small amounts,
- ✓ microcredit institutions generally lend money, without currency clauses, eliminating the client's currency risk;
- ✓ microcredit institutions are characterized by high rates of repayment of approved loans (over 95%) as a consequence of the creation and development of strong relationships with customers and continuous care and support for the development of their business activities;
- ✓ Microcredit institutions provide their clients with different types of assistance and professional training at the same time through education, training, because of which they achieve better communication and cooperation with them and thus provide a higher rate of collection of approved loans compared to the banking sector;
- ✓ microcredit institutions show a high degree of social responsibility;
- ✓ The area of microcredit is not legally regulated, due to which they are forced to work through commercial banks that charge high intermediary fees for their services, which contributes to increase interest rates and increase the price of microcredit.

Microcredit in the modern world is increasingly becoming one of the important bases of economic development with significant socio-economic effects. It is often the only way, with its financial services, to approach those who have limited or no access to those who provide financial services.

Approving a large number of small loans can significantly increase bank costs, which is why banks prefer to approve larger loan amounts to a smaller number of customers and thus minimize their costs. When it comes to securing credit, banks require a guarantee and confirmation of clear ownership, which many micro and start-ups do not have. The reasons why banks are generally not interested in microcredit have led to the emergence of an organization in the market that will provide credit support to low-income families, start-ups and micro-enterprises.

Experiences from the implementation of different microcredit programs in different countries contribute to the increased demand for this source of funding. The reason for this should be sought in the fact that loans to micro and small businesses are very risky for the bank, because these consumers face a number of challenges, such as: dynamic and continuous changes in the market, high degree of failure, unfavorable business environment, lack of adequate legal regulations, problems in securing a pledge and the like.

Potential microcredit borrowers, before applying for a loan, usually contact several organizations that approve this type of loan and get information in order to compare the conditions for approval and use of the loan. Micro-credit organizations have consultants who help each user to understand the credit terms, fill out an appropriate questionnaire, prepare a business plan and prepare the necessary documentation. If the client successfully realizes all the previous things and his business idea proves to be economically justified, the microcredit organization makes a decision to approve a loan. The final decision on the payment of the credit funds is made by the bank with which the microcredit organization cooperates. After the loan is repaid and started using it, the microcredit organization monitors and controls the intended use of the funds by the client.

[11] Cautero, M. R., (2020), What is Microfinance and Why Is It Important? - The Balance, www.thebalance.com

3. Financing through the financial market

The financial market also serves for financing investments, direct, indirect and internal financing. The financial market is a specific market, because it trades specific goods: money, capital, short-term and long-term securities, currencies and foreign exchange, in a specific way and under specific conditions.

Funds needed to finance the operations of small and medium-sized companies can be provided through trading on the capital market, ie by issuing securities commercial bills, corporate bonds and shares and selling them on the financial market.

Commercial bills are short-term securities issued by companies to raise funds to finance their operations. These securities are sold at a discount, ie at a price lower than the face value.

A commercial paper is a short-term instrument with a repayment period of less than one year and usually ranges from 30 to 50 days. It is broadcast in order to overcome the liquidity problem or for short-term financing. By its nature it belongs to the category of discount instruments, ie. instruments issued at a price lower than the face value, with the face value being paid on the due date. The commercial record is basically unsecured - there is no collateral in the form of a mortgage or collateral, although it can be guaranteed by a bank.

Bonds are long-term lending instruments used by both the state and the economy to mobilize funds. They are the most significant form of long-term debt of business entities in developed market economies. A bond is a certificate (usually transferable) that shows that the business has borrowed a certain amount of money and promises to repay it on a certain day in the future. One of the basic features of this method of financing is that if the company is not able to fulfill its obligations regarding the payment of interest and principal to bondholders, they have the right to take a series of measures, from prohibiting the payment of funds to the shareholders, through seizure of the property, until liquidation and opening of a bankruptcy procedure. Bonds as a source of financing for small and medium-sized companies are used as a convenient way to break down long-term capital needs in smaller amounts, which allows the company to sell them to raise a significantly larger amount of funds compared to the money they could get them from just one credit source. Characteristic of the borrowed capital, ie the capital collected through the issuance of bonds, is that it is such a form of capital in which the enterprise as a user of the capital appears in the role of a debtor, and the owner of the capital appears in the role of a creditor and a credit relationship is established between them.

The share is a long-term security, with no maturity and it expresses ownership. It is a financial instrument through which capital is raised to finance operations. Through the issuance of shares, as one of the alternatives of financing, the business entity can raise a significantly larger volume of funds, without the risk of increasing the level of indebtedness. Shares are securities that maintain the ownership position in the companies we call joint stock companies. An important feature of joint stock companies is that it is a special legal form of company which is a voluntary association of individuals with unlimited life of the company and limited liability of the owner. In fact, the property is divided into parts that represent the shares, and the owners can not lose more than what they invested in the purchase. In order for small and medium enterprises to issue shares, a necessary condition is to change the legal form in Joint Stock Companies and to register with the competent authority.

Conclusion

Small businesses are transforming and developing communities. Entrepreneurs create ways to link resources and growth between cultures, political contexts, economic conditions, and political situations that vary from region to region. They must create strategies that will ultimately address the great economic and social challenges and, in this sense, improve the quality of life in the region where they are located.

Small and medium enterprises play an important role in the economic development of the country and the world. Today, small businesses have many advantages and disadvantages in the business environment. Therefore, business entities must evaluate the potential and take advantage of the company for business development.

Determining financing needs is the first step in finding small business financing options. They should identify funding needs, identify different funding options, explain the available funding options, and list the pros and cons of each funding option.

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