Eva Jancikova[1], **L'ubomira Strazovska**[2]

NEW TRENDS IN FINANCING SMALL AND MEDIUM ENTERPRISES IN THE EU

The article reviews the newest trends of SME financing in the EU, considering the fundamental role of these firms for the economies of all EU members. In detail the "Horizon 2020" and other support programes are considered, special attention is paid to venture capital issues, greater access to bank capital for SMEs and other advanced financial options.

Keywords: *small and medium enterprises; venture capital; Horizon 2020; crediting.*

Єва Янчікова, Любоміра Стражовська

НОВІТНІ ТРЕНДИ ФІНАНСУВАННЯ МАЛОГО ТА СЕРЕДНЬОГО БІЗНЕСУ В ЄС

У статті міститься огляд найновіших тенденцій у фінансуванні розвитку малого та середнього бізнесу в ЄС, з урахуванням особливо важливої ролі фірм такого розміру для економік всіх країн-членів ЄС. Детально описано можливості фінансування в контексті «Горизонт 2020» та інших програм підтримки, особливу увагу приділено питанням венчурного фінансування, доступності банківського капіталу для малого та середнього бізнесу та інших новітніх варіантів фінансування розвитку бізнесу.

Ключові слова: *малі та середні підприємства; венчурний капітал; «Горизонт 2020»; кредитування.*

Рис. 1. Табл. 1. Літ. 22.

Ева Янчикова, Любомира Стражовска

НОВЕЙШИЕ ТРЕНДЫ В ФИНАНСИРОВАНИИ МАЛОГО И СРЕДНЕГО БИЗНЕСА В ЕС

В статье представлен обзор новейших тенденций финансирования развития малого и среднего бизнеса в ЕС, с учётом особо важной роли фирм такого размера для экономик всех стран-членов ЕС. Детально описаны возможности финансирования в контексте «Горизонт 2020» и других программ поддержки, особое внимание уделено вопросам венчурного финансирования, доступности банковского капитала для малого и среднего бизнеса и к другим новейшим вариантам финансирования развития бизнеса.

Ключевые слова: *малые и средние предприятия; венчурный капитал; «Горизонт 2020»; кредитование.*

Introduction. Small and medium enterprises (SME) play a fundamental role in European economy making up to 99% of all companies operating in Europe and providing about 67% of the total EU employment. Nearly all large companies started as SMEs. SMEs are important for economic and social reasons. SMEs are the providers of a range of essential products and services for daily life, from hairdresser's to electronics. SMEs provide diverse employment opportunities. Such employment may not allow significant career advance, but the diverse set of skills required to work for an SME is good for job quality and life in general (Pawera and Smehylova, 2015).

According to Fabian (2011) specific goals of SMEs further development and their access to funding can be set as follows:

- supporting newly established SMEs and the expansion of existing ones;

[1] University of Economics in Bratislava, Slovakia.
[2] Comenius University in Bratislava, Slovakia.

© *Eva Jancikova, L'ubomira Strazovska, 2015*

- restructuring of production processes taking into account the efficiency and energy savings;
- using new innovative technologies and development of efficient information flows;
- introduction of Environmental Management and Audit Scheme (EMAS);
- encouraging participation in international exhibitions and fairs;
- establishment of professional counselling centres for entrepreneurs.

Survival and enhancement of SMEs is conditioned by providing easy access to finance, especially to bank loans which are the most important way for external financing of these companies. Unlike large enterprises, small- and medium-sized ones have fewer financing alternatives, which lead to their overwhelming dependence on banks. Access to bank loans of SME sector has deteriorated significantly due to lower availability of bank loans during the last financial crisis. According to the report of the European Commission, in cooperation with the European Central Bank one third of small and medium enterprises couldn't get a bank loan in full or not at all. Overall, 13% of entrepreneurs were rejected when applying for a loan. SMEs also faced a problem with sales. Consumption in the EU has fallen rapidly and only 13% of SMEs exports beyond the borders of the EU. In April 2009, the G20 approved financial support for export credits in the volume of 250 bln USD to speed up the recovery of trade and investments. The effort to solve the crisis "globally" significantly contributed to the avoidance of excessive protectionism and trade wars (Fojtikova, 2011). The crisis also affected the attitude of Europeans to business. 3 years before the crisis, 45% of European citizens wanted to do business, after that only about 37% (Roman and Rusu, 2012).

In 2013 in the EU-28 21.6 mln SMEs employed 88.8 mln people and generated 3,666 trln EUR in value added in the non-financial business sector. This is equivalent to 28% of the EU-28 GDP. Overall, SMEs accounted for 99.8% of all enterprises active in the EU28 non-financial business, 66.8% of the total employment and 58.1% of the value added (Table 1).

Table 1. **SMEs vs. large enterprises: number of enterprises, value added and employment in EU-28 in 2013** (European Commission, 2014)

	Micro	Small	Medium	SMEs	Large	TOTAL
Number of Entreprises						
Number	19,969,338	1,378,374	223,648	21,571,360	43,517	21,614,908
%	92.40	6.40	10	99.80	0.20	100
Employment						
Number	38,629,012	27,353,660	22,860,792	88,843,464	44,053,576	132,897,040
%	29.10	20.60	17.20	66.90	33.10	100
Value added at factor costs						
mln EUR	1,362,336	1,147,885	1,156,558	3,666,779	2,643,795	6,310,557
%	21.60	18.20	18.30	58.10	41.90	100

Microenterprises accounted for 92.4% of all enterprises in the EU-28 non-financial business sector. However, employment distribution and value added across the groups of SMEs was more equal, with micro, small and medium enterprises accounting for 43%, 31% and 26% of the EU-28 SME employment, respectively, and

37%, 31% and 32% of the value added generated by SMEs in the EU-28 non-financial business (European Commission, 2014).

SME Access to External Finance. Access to finance is vital for SME in particular for investments and ensuring growth, for start-ups it is even more important. SMEs have very limited access to standardised public equity and debt market for funding. They are highly dependent on bank loans which put them under pressure when banks stringent credit conditions like it happened during the financial crises. And additionally this tightening of credit criteria is connected with the increase in the rate spread. In the research material of Deutsche bank they underlined the importance of political debate to bring a number of mitigating measures to ease SMEs access to bank lending and more favourable rates. These aims are either supporting the liability side of banks' balance sheets – through long-term refinancing operations, or the asset side – via securitisation of SME loans. From the banking sector perspective, the perception of risks regarding the outlook for many SMEs together with the banks' own refinancing costs at market rates, which remain elevated, may make it difficult to relax lending conditions form SMEs (Kaya, 2014).

Important issue in this field is the evaluation of investment risks which means the possibility to fail in achieving investment return and/or loss of invested capital. This risk is based on a number of causes, depending on the specific structure of a product. Investors should, however, pay particular attention to the risk relating to credit rating of an issuer of a product, ignoring this can mean significant loss of invested funds. Description of risks for investment product is based on the typical characteristics of a product, but it also depends on the structure of product (Jamborova, 2013).

The ECB provides cheap funding to banks in the form of long-term refinancing operations (LTROs). Indirectly they are helping bank lending to SMEs. Recently, the ECB has introduced targeted longer-term refinancing operations (TLTROs) to promote bank lending to real economy, i.e. bank lending to the euro-area non-financial corporations and households excluding loans for house purchase. The two TLTRO operations (the first conducted in September, the second in December 2014) allow banks borrow up to 7% of their outstanding loans to the non-financial private sector in the euro area. ECB loans have the maturity of maximum of 4 years and are priced at 10 bp above the benchmark interest rate (Kaya, 2014).

Cheap ECB liquidity does not find its way to SMEs spite of big effort of ECB. The reason can be that banks may refrain from transmitting favourable conditions of central bank funding to their clients due to their own balance sheet constraints, high refinancing costs or perceived risks in the SME sector which has much higher probability of default than corporations. Banks are rather conservative and selective in supplying loans to SMEs. At the same time SMEs need bank loans more and they don't have access to additional funding options at capital markets.

In addition to mitigating measures that provide liquidity at favourable conditions and thus support the liability side of banks' balance sheets, there are other measures such as securitisation that target the asset side of banks' balance sheets to facilitate lending to SMEs. This can be achieved by creating tradable or collateralisable securities linked to SME loans, thereby transferring their credit risk to capital markets in an effective manner. Strengthening SME securitisation may be one of the most effective ways to facilitate the flow of funds to real economy, while not creating too much distortion. Potentially this could also involve at least temporary buying by the ECB of high-quality paper backed by SME loans, limitations due to relatively small market size notwithstanding (Kaya, 2014).

Attractiveness of Private Equity and Venture Capital for SME in the EU. One constantly repeated complaint with regard to providing capital to SMEs is the lack of venture capital. The EU is way behind the US in this respect. The task of providing such capital would normally be one for banks and venture capital funds to undertake (Vesterdorf, 2005).

Private equity and venture capital enables companies grow and develop, supporting companies which would have had lower growth or are not able to survive without it. It improves the performance of thousands of companies and allows the development of new technologies and their applications. The industry's focus on improving fundamental business performance means that private equity and venture capital investment may be one of the most potent forces driving economy-wide improvement in corporate productivity (EVCA, 2007).

Private equity is simply equity raised by a corporation privately, i.e., not on a public market. However, rather than funds raised privately from, say, personal contacts or family, it has come to mean equity investments arranged by private equity firms. These are professional services firms that raise funds from investors for a defined period (typically 10 years) with a mandate to: invest money in equity stakes in companies; participate in the governance of these companies by exercising the voting rights of the fund (and typically, by joining the board); improve their operational and strategic performance; increase value through private sale or public flotation; and return funds with accumulated gains or losses to investors – usually at the end of the 10-year commitment period. Private equity is part of the wider "alternative" asset class (as opposed to traditional direct investment in publicly listed equities and debt) also including hedge funds, debt funds, commodities, real estate etc.

Venture capital covers the earliest stages of a company and is often further subdivided into "seed", "early stage" and "late stage" – i.e., from the first concept to the point where the company has developed its first product to the point where the company needs capital to expand commercial operations. Venture capital firms typically focus on identifying emerging industries and invest heavily in many companies in these chosen industries. In most cases these companies will be seeking to commercialize a specific innovation. Working closely with talented entrepreneurs, venture capitalists typically use their network to help build company's management team, and their industry contacts and credibility to promote products, services and interests more broadly.

In Figure 1 we can see the typical growth path of a company. For some countries it is very important to change the general culture what requires a lot of time. Important differences lay in entrepreneurial culture between Europe and the USA, but also within the EU itself. Improvement is necessary especially in education; raised skills and enhanced aspirations form a vital part in the modernization of all EU member states.

In the Communication on the Review of the "Small Business Act" for Europe, the Commission stressed the need to take into account the financing needs of SMEs, and in particular, the problem with financing the initial start-up and growth phases of new companies. They acknowledged that venture capital is an essential source of finance, in particular, for innovative start-up businesses that face difficulty in accessing traditional bank lending or finance through stock exchanges (European Commission, 2011).

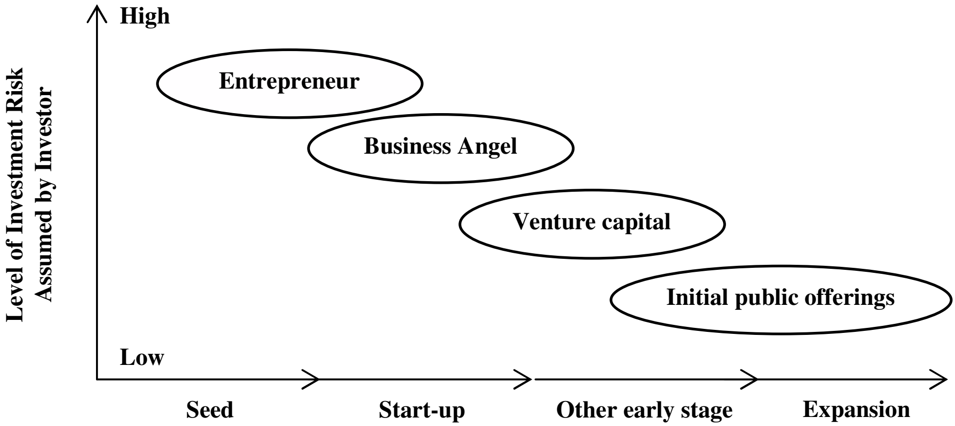

Figure 1. **Stages of Entrepreneurial Development** (Cowie, 1999)

EU programmes focused on better access of SME to finance. The European Union has adopted a 10-year economic strategy "Europe 2020" in 2010 with measurable targets for the ten-year period. On 19 November 2013 the European Parliament confirmed the contents of the interinstitutional agreement reached in June 2013, according to which in the period 2014–2020 will be the Union's expenditure amounting to 960 bln (commitments) and 908 bln EUR in payments (in 2011) (Euractiv, 2014a).

The EU financing programs are generally not provided as direct funding. Aid is channeled through local, regional, or national authorities, or through financial intermediaries such as banks and venture capital organizations that provide funding through financial instruments.

The EU initiatives are focused on better access of SME to finance (EC, 2014a):

- The Communication An action plan to improve access to finance for SMEs recognizes that Europe's economic success depends largely on SME growth but that difficulty in accessing finance is the main obstacle to their growth.
- The 2014–2020 programme on the Competitiveness of Enterprises and Small and Medium-Sized Enterprises (COSME) will make it easier for SMEs to access loans and equity finance.
- The 2007–2013 Competitiveness and Innovation framework Programme (CIP) financial instruments helped SMEs raise equity and debt financing.
- COSME financial instruments will operate in conjunction with those of the "Horizon 2020" Framework Programme for Research and Innovation "InnovFin – EU Finance for Innovators".
- The SME instrument of the "offers funding and support for innovation projects that help SMEs grow and expand their activities to other countries.

In this paper we would like to review new trends in SME funding through special EU programmes focused on increasing SME competitiveness.

Horizon 2020 – an integrated approach to SMEs. SMEs participation in the programme is encouraged through a new SME instrument. "Horizon 2020" takes an integrated approach to SMEs, based on different rated dynamics. It stimulates SME participation across the whole programme, yet with a particular focus on close-to-market support. At the end of the day, if R&D activities aren't translated into innovation, i.e. value creation from invention, SMEs can't take profit from those activities. Great ideas need to be picked up by users, customers and the market, before they can really transform society.

Overall, it is expected that 20% of the total combined budget for all Societal Challenges and the specific objective Leadership in Enabling and Industrial Technologies will go to SMEs. This means that at least 8.65 bln EUR of the EU support for research and innovation activities will find its way directly to SMEs; most of them are part of consortiums participating in the EU collaborative research and innovation projects (EC, 2014b).

In direct support, a dedicated SME-exclusive instrument encourages for-profit companies to put forward their most innovative ideas with the EU dimension that can't find financing at the market because of their high-risk character. SME instrument targets highly innovative SMEs showing a strong ambition to develop, grow and internationalise, whether they are high-tech and research-driven or non-research conducting, social or service companies. With the budget of over 3 bln EUR over the period 2014–2020, the SME instrument ambitions to take innovation in SMEs to the next level, by granting tailored support to SMEs that have ground-breaking ideas with high market potential, but are short of certain resources, or a real strategy to deliver (Pawera and Smehylova, 2014).

Moreover, the SME instrument addresses the financing gap in developing high-potential, but also high-risk innovative ideas of small companies and bringing them closer to the market. This has been a widely recognised EU-wide market failure which relates to the market's difficult relationship with uncertainty and estimating the potential value of new technologies, new products, new resources, new firms or new entrepreneurial capabilities.

On top of the support to SMEs, the "Horizon 2020" specific objective "Innovation in SMEs" will boost the innovative capacity of SMEs, including through the Eurostars Joint Programme which will continue to promote transnational collaboration of R&D performing SMEs.

Last but not least, about one third of the Access to Risk Finance budget under "Horizon 2020" (which is more than 900 mln EUR) will flow to SMEs and small mid-caps. This support consists of:

- a debt facility providing loans, that guarantees and other forms of debt finance to entities of all forms and sizes, notably research and innovation-driven SMEs;
- an equity facility providing finance for mainly early-stage investments, with a particular focus on early-stage SMEs with the potential to carry out innovation and grow rapidly (EC, 2014b).

Their aim is to support the achievement of the R&I objectives of all sectors and policy areas crucial for tackling societal challenges, enhancing innovation and fostering sustainable growth. They are implemented via the European Investment Bank and the European Investment Fund and/or other financial institutions of comparable stature.

The SME instrument will cover all fields of science, technology and innovation in a bottom-up approach within a given societal challenge or enabling industrial technology so as to leave sufficient room for all kinds of promising ideas, notably cross-sector and inter-disciplinary projects. It will also provide easy access with simple rules and procedures, as well as a staged support in 3 phases covering the whole innovation cycle. These 3 phases can be summarised as follows:

1. ***Proof-of-concept:*** exploring scientific or technical feasibility and commercial potential of a new idea in order to develop an innovation project, with the help of a 50,000 EUR grant, and receive more support in case of a positive outcome. The feasibility part will allow assessing the technological and commercial potential of a project; it will tackle then the feasibility of concept, risk assessment, IP regime, partner search, design study, pilot application intention, business plan II.

2. ***Development and demonstration:*** development of a sound, ground-breaking business idea further with the help of a grant (from 500,000 EUR to 3 mln EUR) for a market-ready product, service or process. A main grant will be provided to undertake R&D with the emphasis on demonstration and market replication. More in details: development, prototyping, testing, piloting innovative processes, products and services, miniaturisation/design of products, planning & developing scaling-up (market segments, process etc.), market replication, business plan III.

3. ***Go-to-market:*** taking advantage of additional EU support to enter the market successfully (no grants). The commercialisation phase is supported indirectly through simplified access to debt and equity financial instruments as well as various other measures, for example, IPR protection (EC, 2014b).

The SME instrument has been designed specifically for single or groups of highly innovative SMEs with international ambitions, determined to turn strong, innovative business ideas into winners of the market. The instrument provides full-cycle business innovation support from the stage of business idea conception and planning (phase I) over business plan execution and demonstration (phase II) to commercialisation (phase III). Participants are able to call on business innovation coaching for the duration of their project.

COSME: the first EU programme for SME. COSME is the EU programme for the Competitiveness of Small and Medium-sized Enterprises running from 2014 to 2020 with the planned budget of 2.3 bln EUR.

The objectives and the budget are built on 4 main goals of COSME. The total budget of 2.3 bln EUR is divided to improve SMEs' access to finance (60%), improving access to markets (21.5%), business support (11%) and improving the framework conditions for enterprises competitiveness (2.5%). It is expected that the loans covered by the guarantees financed by the program gets up to 330,000 SMEs and the total amount of COSME resources for the purposes of loans may reach up to 21 bln EUR. On the basis of the experience acquired in the programme on competitiveness and innovation (CIP) from the previous programming period, it is expected that 90% of beneficiaries will be companies with 10 or less employees (Euroactiv, 2014b).

Tools to achieve the objective in the area of finance participate in making the single portal on access to resources in the form of non-repayable contributions, loans or venture capital. The key role here belong to national financial intermediaries. They use two tools – credit and capital. Offering loans through credit should increase their offer for SMES by around 20 bln EUR. Such support through national financial intermediaries could be accessible for 330 ths companies. Capital tool will be given to investments in venture capital funds. To SMEs in the growth phase should go about 4 bln EUR (Euroactiv, 2014b). This is an important EU response to the problems SMEs are facing today.

Basic tools of the COSME programme:

- The Loan Guarantee Facility. The COSME budget funds guarantees and counter-guarantees for financial intermediaries (e.g., guarantee organisations, banks, leasing companies) to help them provide more loan and lease finance to SMEs. This facility also includes securitisation of SME debt finance portfolios. By sharing the risk, the COSME allow the financial intermediaries expand the range of SMEs they can finance. This facilitates access to debt finance for many SMEs who might otherwise not be able to rise the funding they need. Thanks to CIP, the previous programme supporting business competitiveness more than 240,000 SMEs have already benefited from a guaranteed loan or lease.

- The Equity Facility for Growth. The COSME budget is also invested in funds that provide venture capital and mezzanine finance to expansion and growth-stage SMEs, in particular those operating across borders. Fund managers operate on a commercial basis, to ensure that investments are focused on SMEs with the greatest growth potential. The CIP has mobilised more than 2.3 bln EUR in equity investments (EC, 2014c).

COSME aims at lightening the administrative burden on businesses by removing unnecessary reporting and information requirements. As research indicates, SMEs are disproportionately affected by regulation. Special focus is thus needed to create more favourable conditions for them. Identification and exchange of best practices among national administrations improve SMEs policy.

Analytical tools for better policy to facilitate the preparation of new legislation at the EU and national levels, and compare performance of different policies in member states, conferences and analytical tools, such as competitiveness report, will be supported.

Conclusion. SMEs play a fundamental role in the EU economy. Survival and enhancement of SMEs is conditioned by providing easy access to finance, especially to bank loans which are the most important way of external financing for these companies.

The European Commission cooperates with financial institutions to improve the funding available to SMEs by stimulating the provision of loans and venture capital through financial instruments. They also help the EU countries share good policy on improving access to finance which allows them benefit from the experience of others. EU financing programmes are generally not provided as direct funding. Aid is channeled through local, regional, or national authorities, or through financial intermediaries such as banks and venture capital organizations that provide funding through financial instruments. This program COSME can be used by SME to create new products or services and improve their activities at domestic and international markets. Similarly, "Horizon 2020" can be used by SME for innovations and improvement. We also appreciate the new approach of EC to the preparation of new projects with less administrative burdens.

References:

Ayyagary, M., Beck, T., Demirguc-Kunt, A. (2003). Small and Medium Enterprises across the Globe: This Draft: March 2005 // siteresources.worldbank.org.

Euroactiv (2014a). Parliament gives final approval to EU long-term budget // www.euractiv.com.

Euroactiv (2014b). COSME – prvy program EU pre male a stredne podniky, 2014 // www.euractiv.sk.

European Commission (2011). Communication from the Commission "Review of the "Small Business Act" for Europe. COM (2011) 78 final, 23.2.2011 // ec.europa.eu.

European Commission (2014). Annual Report on European SMEs 2013/2014 – A Partial and Fragile Recovery // ec.europa.eu.

European Commission (2014a). Access to finance for SMEs // ec.europa.eu.

European Commission (2014b). Horizon 2020 // ec.europa.eu.

European Commission (2014c). More favorable conditions for business creation and growth // ec.europa.eu.

EVCA (2007). Guide on Private Equity and Venture Capital for Entrepreneurs. An EVCA Special Paper November 2007 // www.evca.eu.

EVCA (2009). Private Equity and Venture Capital in the European Economy An Industry Response to the European Parliament and the European Commission // www.fvca.fi.

Fabian, A. (2011): Szlovakia. In: Fabian Attila (szerk.). Alkalmazott strukturalis politikak Kozep-europaban 2000–2013 (pp. 245–297). Nyugat-magyarorszagi Egyetem Kiado, Sopron.

Financing SMEs and Entrepreneurs 2013. An OECD Scoreboard (2013) // www.oecd.org.

Fojtikova, L. (2011). Business Strategy of the European Union on the Way Out of the Crisis. In: Proceedings from the 9th International Conference Economic Policy in the European Union Member Countries (pp. 92–104).

Jamborova, M., Furdova, L. and Pavelka, L'. (2013). Riadenie rizik v medzinarodnom obchode. Bratislava: Vydavatel'stvo Ekonom. 240 p.

Kaya, O. (2014). SME financing in the euro area. New solutions to an old problem. Frankfurt am Main: Deutsche Bank Research // www.dbresearch.com.

Lipkova, L'. a kol. (2011). Europska unia. Bratislava: Sprint 2. 402 p.

Pawera, R., Smehylova, Z. (2015). Equal Opportunities in the Labor Market. The Case of the Slovak republic. In: CER Comparative European Research. Londyn: Sciemcee publishing.

Pawera, R., Smehylova, Z., Urbanova, G. (2014). 25 years after the political regime change – socio-economic inequalities persist. Hradec Kralove: Magnanimitas. 887 s.

Roman, A., Rusu, V.D. (2012). The Access of Small and Medium Enterprises to banking financing and current challenges: the case of EU countries // www.oeconomica.uab.ro.

Small and Medium-sized Enterprises in Central Europe: An Overview // www.spf.org/publication.

Strazovska, H., Strazovska, L'., Pavlik, A. (2007). Male a stredne podniky. Obchodne podnikanie. Bratislava: Sprint. 327 p.

Vesterdorf, P.L. (2005). Small and medium-sized enterprises and the European Union. Books on Demand GmbH, Kobnhavn, Danmark. 155 p.

Стаття надійшла до редакції 26.05.2015.