FINANCING OF THE SMEs IN THE EUROPEAN UNION THROUGH CREDIT INSTITUTIONS

Valentina Diana Ignătescu
"Alexandru Ioan Cuza" University of Iaşi

Abstract: *It is widely acknowledge that financial constraints are the most visible problems of the SMEs. So through this paper we propose to analyze the main sources of financing that SMEs use to conduct their business. And, from these sources, we should focus on the ways of financing offered by credit institutions. Thus, we will identify the main sources of financing available to SMEs and offered by credit institutions. Banks are increasingly seeking to become facilitators and partners with their SME clients. In other words, they try to offer a broader range of products, better service quality and better prices. Through this paper we will see if the bank offers are truly advantageous for SMEs.*

Keywords: internal funds, bank loans, trade loans, European Investment Bank, subordinated loans
JEL Classification: F36, F33, F34

1. INTRODUCTION

An economic agent, who could not cover his full costs on his own resources, or through internal funding or self-financing, is forced to resort to external financing. From the analysis realised by the American economists John Gurley and Edward Shaw (developed in 1960 in their paper *Money in the Theory of Finance)*, we extract two ways of external financing of the economic agents (Boariu, 2003, p. 12), namely:

- *The direct funding*, characterized by the fact that the agents that have available capital fund directly the agents that need financial resources. This direct financing is made by buying the securities issued by the agents that need capital on the financial market. This type of financing is done through the capital markets and the opened money markets.

- *The indirect funding* or "the intermediate funding" differs in that a financial intermediary is interposed between the agents in need of capital money and the agents who want to place their surplus cash capital. Intermediaries which made indirect financing are represented by banks and other financial authorized entities.

The indebtedness provides to the enterprise the possibility to obtain the necessary funding to conduct the business. This financing arrangement is indispensable for the proper functioning of the entire financial apparatus of the company, but its use must fall within certain limits to maintain the financial autonomy of the company.

The traditional instruments of indebtedness are the loans taken on different times and at different levels of interest.

2. THE EXTERNAL FINANCING OF THE SMES

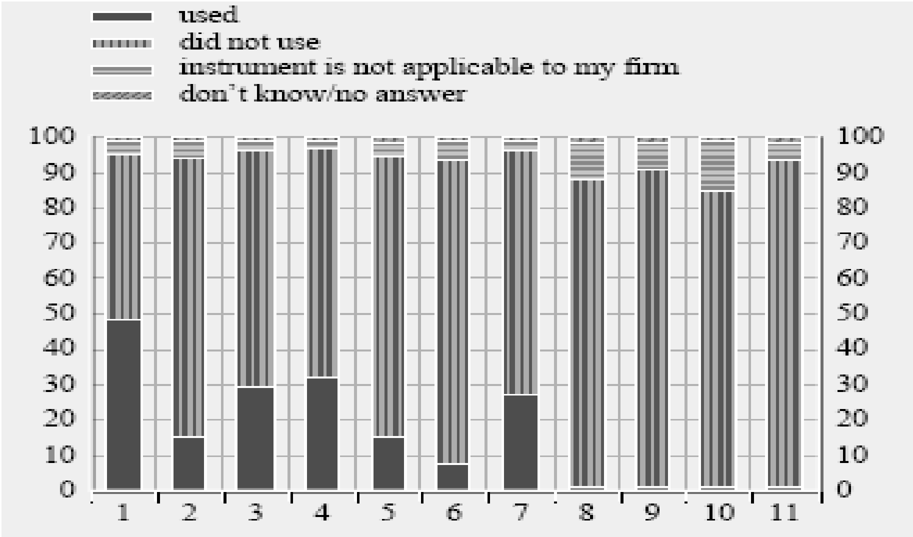
Traditionally, internal funding (from personal savings, retained profit and sales of assets) is an important source of financing for SMEs.

Bank loans (used by 32% of SMEs) and bank overdrafts, credit lines and credit card overdrafts (used by 30% of SMEs) had been the largest source of external financing for SMEs during the preceding six months. So we observe the traditionally important role of bank financing for SMEs in the euro area (see Figure no.1).

Indeed, bank loans, credit lines and overdrafts are not only used to finance investment but also as working capital. Leasing, hire purchase and factoring (27%) and trade credit (15%) had also played a relatively important role, while market based financing had been of minor importance to the financing of SMEs during the preceding six months (1% had issued debt securities and 1% had issued equity or relied on external equity investors).

Large firms had also barely relied on market-based financing (2% used either debt securities issuance or equity issuance or external equity investors) during the preceding six months, relying to a much greater extent on bank loans (used by 38% of the large firms) and on leasing, hire purchase or factoring (36%).

Figure 1 Financing structure of euro area SMEs over the preceding six months (%)



Source: European Central Bank, 2009, p. 10

Legend: 1= Internal funds; 2 = Grants or subsidised bank loan (involving support from public sources); 3 = Bank overdraft, credit line or credit card overdraft; 4= Bank loan (excluding overdraft); 5 = Trade credit; 6 = Other loan; 7 = Leasing, hire purchase or factoring; 8 = Debt securities issued; 9= Subordinated loans, participation loans or similar financing instruments; 10 = Equity issuance or external equity investors; 11 = Other.

Also from this study we observe that in all branches of economic activity, the net percentage of SMEs reporting an increase in their need for bank loans was positive (ranging from 10% in services and trade to 13% in construction). As regards trade credit, between 32% (in construction) and 42% (in services) of the SMEs replied that the instrument is not applicable to them. Among the SMEs to which this instrument was applicable, the majority reported an unchanged need.

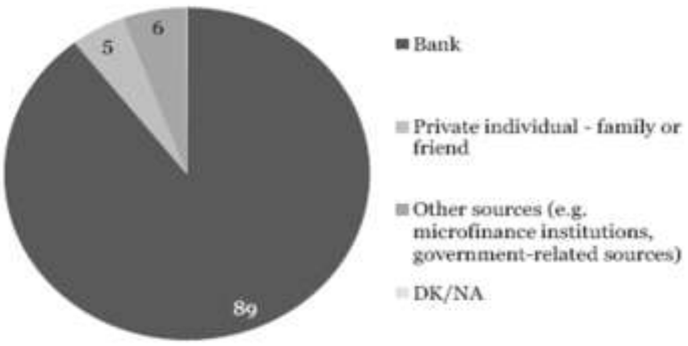
3. MOST POPULAR PROVIDERS OF LOANS

To see which were the main providers of loans to the SMEs in the last two years we will analyze the study made by the Flash Eurobarometer No. 271 about the Access to finance of the firms from the European Union in the past six months. This study was made on 9.063 companies from the European Union, Croatia, Iceland and Norway.

The study noted that the banks were the most popular providers of loans in the European Union; they were mentioned by 89% of companies that had obtained a loan in the past two years. One in 20 managers of such companies had received a loan from a private individual such as a family member or friend.

Other sources - such as micro-finance institutions or government-related sources - were mentioned by 6% of interviewees as the provider of their most recent loan, as can be seen and the figure no. 2, shown below.

Figure 2 Most popular providers of loans for the SMEs (percentages of firms)



Source: Flash EuroBarometer, 2009, p. 29

Banks were the most popular source for a loan in all countries in this study. Small businesses and their enormous development potential for the next years have attracted the attention of the commercial banks. Thus, ever more financial institutions have improved their credit supply.

The banks are increasingly seeking to become loan facilitators and partners to their SMEs customers. This requires more contact between banks and customers, greater commitment, trust and support from banks. Instead of taking in account the turnover, the number of employees of the company, etc., the banks now examine other characteristics of the firms such as:

- The market segment in which the company is operating;
- The Contractor (analyzing the age, the education, the experience);
- The age of the company;
- The target of the company.

In other words, banks try to offer a wider range of products, better service quality and better prices.

Indeed, the progress in many countries is facing the same direction. There is a clear and general trend favouring the financial liberalization across the Europe. Financial liberalization has a mixed impact on SMEs finance. First there is a trend to lower the interest rates due to competition between banks. Moreover, banks are becoming increasingly aware of the risk, which often leads to greater detaining in providing loans to customers who are considered to involve greater risks than the average. Here we speak of a paradox: although interest rates are more "friendly" for SMEs, the increased risk and the banks attempt to minimize it determines that they are reluctant to provide credit to smaller applicants.

4. LOANS GRANTED BY THE EUROPEAN INVESTMENT BANK

The European Investment Bank is a European Union institution. The European Investment Bank task is to contribute to the integration, to the balanced development, to economic and social cohesion of the Member States by financing low-risk investments.

Through its credit lines for financial institutions, the European Investment Bank subsidizes usually the projects implemented by SMEs and by the municipalities. Since 1990, the European Investment Bank has signed loan agreements with Romania worth 6.6 billion euros, of which approximately 530 million euros (including current loans) were to support projects of the SMEs and the municipalities.

The European Investment Bank has granted to Romania in September this year two interim loans to support small and medium-sized projects: 80 million euros for Bancpost and 60 million for EFG Leasing (European Investment Bank). The loan for Bancpost is intended to finance small and medium-sized projects of SMEs in various sectors of industry, agriculture, tourism and services.

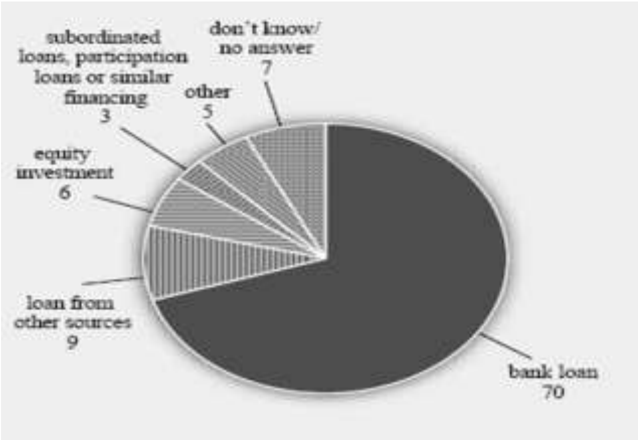
The loan for EFG Leasing aims to support up to 30% smaller projects of SMEs in Romania in the fields of industry, services including tourism, agriculture, health, energy and environmental protection. EFG Leasing will also benefit from facilities of financing of SMEs as a special aid scheme promoted by the European Community. This scheme is focused on continued and competitive growth of small and medium enterprises in Romania.

The European Investment Bank loans for SMEs are mainly for reduce the impact of the economic crisis. These loans are aimed at improving access to medium and long term funds that are financially benefit.

For this, the Bank has simplified the procedures and it also expands its scope of funding, covering the investments in intangible assets and in the working capital. In addition, the Bank is increasing its transparency, endeavouring to effectively transfer of the benefits of the EIB funds to the final beneficiaries.

The European Investment Bank, The World Bank and The European Bank for Reconstruction and Development (EBRD) pledged in February this year offer up to 24.5 billion euro for the banking system and the real economy form Central and Eastern Europe. European Investment Bank will provide almost half (11 billion) of the total amount.

Figure 3 Euro area SMEs' preferred sources of external financing for realising growth ambitions



Source: European Central Bank, 2009, p. 20

5. BANK LOANS FOR FUNDING SMES FUTURE GROWTH OPPORTUNITIES

It appears that bank loans are not only the most used source of external financing but also the preferred source for future use. 70% of all SMEs reported that they would prefer bank lending to finance their growth aspirations while 9% would use loans from other sources and 6% equity investment (see Figure no. 3). In addition, as in the actual use of financing sources the more sophisticated sources of financing, such as subordinated loans and other types of structured loans, were chosen only by a very small minority of SMEs (3%).

6. CONCLUSIONS

From the ones presented above we see that banks play a major role in financing of the SMEs in the European Union. The bank loans are used to supplement the internal funds use by the companies in financing their activity. It has not turned to bank loans only those SMEs which have funded their all activities through internal funds or a small proportion of the SMEs which felt that they would not get the required credits.

In the present the banks have a strong policy for financing the SMEs. In addition they provide and support assistance services, especially for the start-ups.

Currently the European Union promotes a whole program of support and financing the activity of SMEs, either through structural funds or through loans from the European Investment Bank for the credit institutions of member countries.

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