

POLICY BRIEF 1

**TOWARDS AN  
ENHANCED ACCESS  
TO FINANCING SMALL  
AND MEDIUM-SIZED  
ENTERPRISES**

**PROJECT:**

“FINANCIAL INSTRUMENTS FOR  
SMALL AND MEDIUM-SIZED  
ENTERPRISES: ANALYSES AND NEW  
SOLUTIONS FOR IMPROVEMENT”

**ACCESS TO FINANCIAL  
INSTRUMENTS IS ONE OF THE  
KEY FACTORS FOR GROWTH  
AND DEVELOPMENT OF  
SMALL AND MEDIUM-SIZED  
ENTERPRISES (SMES)  
THIS POLICY BRIEF IDENTIFIES  
SEVERAL PROBLEMATIC AREAS  
AND PROVIDES SUGGESTIONS  
FOR OVERCOMING THEM  
BASED ON RESEARCH OF  
THE DOMESTIC LEGISLATION  
AND PRACTICE AND IN  
ACCORDANCE WITH  
COMPARATIVE PRACTICES  
OF COUNTRIES FROM THE  
EUROPEAN UNION.**



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## INTRODUCTION

SMEs are of paramount importance to any economy. They are the driving force and they engage a large number of employees, with the potential to grow and to become increasingly significant. Their access to finance is more impeded than it is for big companies, not just because of the rooted imperfections of the financial market, but, more recently, also because of the global financial crisis. In the landscape of SMEs in Europe, there are various legal-organizational forms and models of financing. The most commonly used traditional SME financing tool is, of course, debt financing.

SME access to finance is largely restricted in our country, and at the same time, the European Union has noted it to be a serious obstacle in implementing our industrial policy.

The issue is multifaceted, both for the providers and for the users of financial instruments.

Source of SME financing in Europe	Used in the last 6 months	Not used in the last 6 months, although such experience exists	Unused
Retained earnings or selling of assets	16,0%	10,0%	74,0%
Grants or subsidized loans	6,0%	31,0%	63,0%
Allowed overdraft / Framework loan	36,2%	19,0%	44,8%
Bank loans	19,5%	56,0%	24,5%
Commercial loans	16,8%	17,2%	66,0%
Other loans	4,5%	12,0%	83,5%
Leasing	21,4%	25,6%	53,0%
Factoring	4,0%	2,0%	94,0%
Equity-investments	1,0%	9,0%	90,0%
Debt securities	0,2%	1,8%	98,0%
Other sources	0,2%	3,5%	96,3%

**Data source:** SAFE Survey October 2017 – March 2018, European Commission and European Central Bank.

Other alternative instruments for financing provided in the domestic legislation are factoring agreements, leasing agreements and, to a very limited extent, business angels. The last option is rarely present in practice and, more or less, rudimentarily and/or incompletely covered by domestic legislation. In Europe, other alternative instruments for financing the business of SMEs are used, such as debt securities (or securitization), crowdfunding, equity investments, etc. However, with the exception of crowdfunding and business angels, it is unlikely that these instruments will become attractive in domestic practice any time soon.

The purpose of the conducted research is to contribute to the enhancement of the access to finance for SMEs, in particular: 1) to prepare a legal-financial analysis and to provide draft solutions for legislative amendments/supplements in the regulations; and 2) to propose specific applicative solutions for the utilization of financial instruments. The research was realized with the support of the re-granting program of the project "Strengthening Capacities and Mechanisms for Supporting Chapter 20 Reform Processes".

## APPROACH AND CONCLUSIONS

The methodology of the conducted research is based on two key points:

1. Analysis of the legal and strategic framework for access to financing for SMEs and the policies of financial institutions, their implementation, as well as comparative experiences in this area;
2. Analysis of the collected empirical data (provided through off-site and on-site scanning of the situation with different stakeholders in ten municipalities).

All the research findings, together with the recommendations and conclusions, were presented at the debate titled "Improving the possibilities for financing small and medium-sized enterprises: challenges and perspectives" (June 29, 2018), which included representatives from the banking sector, the Macedonian Bank for Development Promotion, the Fund for Innovation and Technology Development and the Macedonian Chambers of Commerce.

Lending is fully covered by the legislation and the numerous by-laws. From the other financial instruments, the most typical are factoring agreements and leasing agreements.

The strategic documents devote adequate attention to the financing sources for SMEs, but they lack specific measures to achieve the actual utilisation of the sources in practice.

### Main challenges

- **The legal regulations** regarding the use of financial instruments are characterized by high conservativeness and bank-centricity.
- **Insufficient expertise, capacity and experience** for the preparation of quality loan requests for financing on-going or investment projects - the need to strengthen the capacities of SMEs.
- **The conservative approach of the banking sector**, which is due to (1) the relatively higher risk of financing this type of projects; (2) insufficiently substantiated investment studies by SMEs, which require greater financial and administrative capacity.

## Review of the legal regulations and the strategic documents

- The most commonly used option is lending, that is, loan agreements as a means of financing SMEs. Other financial instruments are less common in practice and are more or less covered by legislation.
- Given the market imperfections and the difficult access to funding, institutional support has been translated into strategic documents that are intended to strengthen / complement SME financing sources.
- Recommendations in the Competitiveness Strategy with an Action Plan 2016-2020 are particularly generalized, without precise measures to improve the situation in practice. The strategy correctly identifies that there is a lack of legal certainty and transparency, which limits the development potential of factoring.
- The newly adopted National Strategy for Small and Medium-sized Enterprises (2018-2023) talks about simplifying the procedures for founding and operating financial institutions which offer alternative financial instruments (factoring, leasing, equity funds, etc.).
- Current policies show that there is a certain focus on financing innovative and fast-growing SMEs. In the European Union, in this regard, special emphasis is placed on "equity investments". In domestic practice, financing is provided through the Fund for Innovation and Technology Development, and in accordance with the Law on Innovation Activity.

Emphasis should also be placed on the transparency and the manner of contractual arrangement of the relations of alternative finance providers and SMEs as their beneficiaries.

The lending to SMEs is performed by banks, financial companies and the Macedonian Bank for Development Promotion (MBDP), which also performs lending activities, including approval of loans with subsidized interest rates for realization of projects or government programs.

The central bank monitors the lending conditions for enterprises on a quarterly basis.

Due to the perception of the higher risk of loans for SMEs, they are offered with a significantly higher risk premium (1-2 percentage points above the average active interest rate for the corporate sector) and more stringent conditions for their security.

Awarding grants and subsidizing interest rates should be the main pillars of governmental policy to improve access to SME financing, i.e. allocating more budget funds for institutions that implement these two measures.

## RECOMMENDATIONS FOR POLICY MAKERS

### Strengthening credit support for SMEs

- SMEs are faced with a significantly less favourable level of lending terms compared to large enterprises. When general lending conditions improve, they are more favourable for large enterprises, and in periods of deterioration, lending conditions are less favourable for SMEs.
- The banking sector remains convinced that the demand for loans is insufficiently substantiated by quality investment projects and business plans by SMEs. This market failure should be remedied:

1. in the short term, by subsidizing better preparation of business plans and investment projects (peer review), and
  2. in the mid-term and long term, through comprehensive entrepreneurship and management trainings.
- Proposals for greater reliance on external sources for awarding grants through the Fund for Innovation and Technology Development and for subsidizing interest rates through MBDP are quite justified, given that they reduce the risk for financial institutions from misallocating loans to higher risk SMEs.

### **Establishing a consistent system of regulation**

The work of financial companies and leasing companies is left to the Ministry of Finance. This approach seems problematic and may result in losses for SMEs. This, considering the low level of financial literacy in domestic practice, especially in the light of the low level of transparency of contractual provisions, leads to possible abuses of SMEs that cannot be adequately prevented and/or sanctioned in an underdeveloped supervision system.

### **Need for further development of the guarantee schemes system**

The key activity is the revitalization of the existing loan guarantee scheme within MBDP by simplifying its procedures, in close cooperation with private banks, and by improving the design, structure and conditions of this scheme. The banks' (un)willingness to offer loans/credit lines without proper security is probably "a lesson" the banks learned from risky loan placements made in the past. The development of appropriate guarantee schemes would lead to an increase in private funding, which is also a priority in the European Union, while the corresponding guarantee schemes would lead to greater disposition of banks to approve loans and credit lines to SMEs.

IN THE PROCESS OF REGULATING THE FACTORING AGREEMENT, IT IS NECESSARY TO TAKE INTO CONSIDERATION THE POSITIVE INTERNATIONAL EXPERIENCES, SUCH AS THE PROVISIONS OF THE CONVENTION OF THE INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW (UNIDROIT) ON INTERNATIONAL FACTORING.

### **Explicit and modern regulation of factoring**

The regulation of factoring agreements in domestic law is poorly developed. The Law on Financial Companies contains merely a general definition of factoring. Beyond this, there are no rules specific to the factoring agreement, that is, its specific content, and in accordance with its specific legal and economic characteristics. Therefore, the remaining option is to seek for an answer in the provisions of the Law on Obligations, as general provisions, having in mind the scarcity and partiality of the solutions contained in the special regulations.

### **Reforming the existing regulation on leasing**

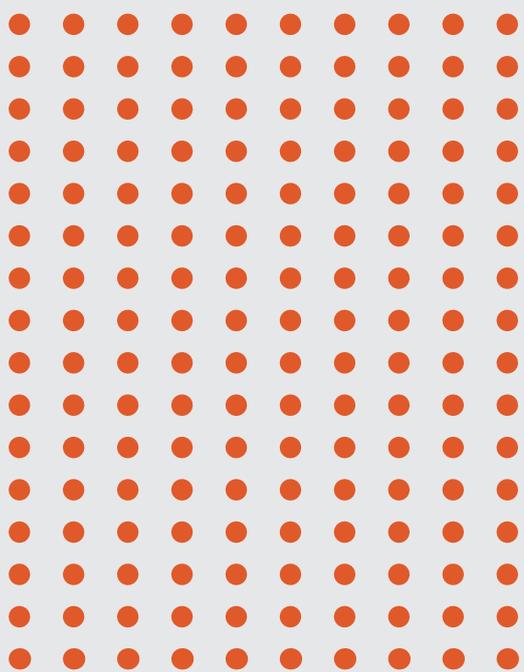
The legal text is non-transparent due to its numerous amendments and supplements. There are also expressed ambiguities regarding the scope of the so-called operating lease, which is also differently perceived in the comparative practice. In this sense, relevant for SMEs is the so-called financial leasing, so reforms need to focus in this direction. The statutory text does not contain adequate safeguards for the users of financial leasing, especially in cases of late payment of the leasing fee.

### **Encouraging platforms for crowdfunding**

Suggestions for the introduction of crowdfunding platforms are a solid, yet underdeveloped baseline for increasing access to SME financing.

### **Strengthening the statistics for SMEs**

SME support policies must be based on much better and more detailed statistics that will monitor the development, demographics and financial performance of SMEs.



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