Re-evaluating the Supply Side of Finance Availability for Lithuanian SMEs

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Abstract

Finance availability continues to be one of the most significant challenges for the creation, survival, and growth of small and medium-sized businesses (SMEs), especially the innovative ones. As a result of 2008 financial crisis and the following economic downturn, there is a tense situation not only in SMEs but in all businesses financing volumes and conditions. The access to finance is recognized as a key challenge and a barrier for SMEs recovery in most of the countries.

The conditions of business finance availability from the supply side are re-evaluated in the paper, discussing the factors affecting finance availability for SMEs and the conditions of SMEs external financing with state intervention measures. Research results have revealed the easing general credit standards for Lithuanian businesses, but the demand is not yet met and is far from satisfactory. There have been various state intervention measures applied, but the promotion of mezzanine finance and equity or quasi equity guarantees are suggested.

Keywords: finance availability, small and medium business, state intervention, business support measures.

Introduction

Small and medium-sized businesses (SMEs) and entrepreneurs play a significant role in all economies as they are key generators of employment and income and drivers of innovation and growth. In the OECD area, SMEs employ more than half of the labour force in the private sector. In the European Union, they account for over 99% of all enterprises. Furthermore, 91% of these enterprises are micro-firms with less than 10 employees. Given their importance in all the economies, they are essential for economic recovery. The access to financing continues to be one of the most significant challenges for the creation, survival, and growth of SMEs, especially the innovative ones. As a result of 2008 financial crisis and the following economic downturn, there is still a tense situation in SMEs financing volumes and conditions. Moreover, there is insufficient financing not only for small but for all business entities. The access to finance is recognized as a key challenge for SMEs and a barrier for recovery in most countries (OECD, 2013).

The evaluation of business finance availability includes the factors of finance demand and supply, together with the influence of relationships and the level of trust, state intervention premises, and macroeconomic conditions (Railiene, 2007). Information asymmetry, risk-uncertainty, costs of transactions and monitoring, and insufficient collateral are defined as the main supply side factors limiting finance availability to certain businesses (considering size, business duration, and information availability, in particular). These factors are analysed in the studies of Kon and Storey (1993), Suzuki (1996), Zavatta (2008), Kundid and Eregovac (2011). Finance supply is limited because of moral hazard and adverse selection; therefore, in order to lower risk, credit rationing occurs; in order to measure risk, credit ratings are being set; in order to maintain venture capital (VC) returns, only highly profitable and ensured projects are financed (Stiglitz, Weiss, 1981; Schmidt, Tschach, 2001; Tschach, 2003; EC, 2004; Berger, Black, 2011). Thus, financing conditions for SMEs are tighter. In the case of risk capital investments, the costs of information gathering and evaluation are higher, therefore, this form of financing is more favourable for businesses having positive business experience, foreseeing rapid development and acting in perspective sectors (Berger, Schaeck, 2011; Puri, Zarutskie, 2012). In the case of small businesses finance availability, state intervention measures in the form of business support services (lowering moral hazard and adverse selection risk, and not disturbing market conditions) involving indirect support, microcrediting, guarantees (for promotion of risk capital investments and crediting) are used (Green, 2003; Railiene, 2007; Beck, Klapper and Mendoza, 2010; Honohan, 2010; Kreamer-Eis, Lang, 2012). Thus, the limited finance availability is widely analysed in scientific literature, but it requires to re-evaluating the factors and conditions of finance availability to SMEs in the light of a changing business environment, especially after the 2008 financial crisis and economic downturn.

The aim of this paper is to re-evaluate the conditions of business finance availability from supply-side, therefore, the attention is paid to the evaluation of factors affecting finance availability for SMEs, conditions of SMEs crediting and VC investments, and state intervention measures. Finance availability is analysed considering different theories explaining financing decisions and the interaction of finance market participants, assuming that finance markets act under the conditions of information asymmetry and uncertainty.
Finance Availability Factors

Finance availability valuation from the supply side covers the causes of limited financing supply, the factors determining the crediting and venture capital supply, and the features of business support measures.

Business financing problems, especially for SMEs, rise because of a limited supply of capital, thus, the conditions of financial services provision by banks and VC institutions are widely discussed. Financial services are recognised as the most important factor of business startup and development, and, finally, an overall economic development. The concerns related to limited capital supply and tight conditions applied when providing external financing resulted in different state initiatives across countries, as well as in Lithuania. As a result of the 2008 crisis and economic downturn, financing is insufficient not only for small but for all business entities. Thus, the problem of insufficient small business financing remains and, in most cases, small businesses must rely on internal financial sources. Such conditions are treated as economic development obstacles, causing long-term cash flow problems and the failure of newly developed businesses.

Studies related to finance supply are based on calculative capital logic, where the main criteria are risk and information asymmetry having effect on the return on investment. In this case, SMEs financing problems are explained by the following factors (Kon, Storey, 1993; Suzuki, 1996; Zavatta, 2008; Kundid, Ercegovac, 2011):

a) information asymmetry;
b) high risk (uncertainty);
c) high transaction and monitoring costs;
d) insufficient collateral.

The most important studies are concentrated on finance markets functioning, market imperfections and failures, factors determining financing decisions, and the role of information asymmetry in financial markets and in SMEs financing decisions (Stiglitz, Weiss, 1981; Holmes, Kent, 1991; Black, de Meza and Jeffrey, 1996; Cressy, 1996; Zavatta, 2008; Irwin, Scott, 2010; Hashi, Toci, 2010; Kundid, Ercegovac, 2011). A situation with limited capital supply means imperfect market position conditioning in supply-demand imbalance (EC, 2001).

From the supply side, financing decisions are made under the conditions of information asymmetry and uncertainty. Finance risk management tools are applied in order to manage credit or default risk. Finance institutions face problems as moral hazard (when a person has low motivation to avoid failure) and adverse selection (the risk of bad decisions when selecting a customer). It would be too difficult for a finance institution, in the light of procedures and costs and especially in the SMEs case, to solve the moral hazard problem in each transaction, thus, more attention is paid to mitigating adverse selection risks.

Here different strategies and procedures are applied in the form of criteria and requirements for business experience, certain level of financial ratios, entrepreneurial skills, and collateral. The impact of information asymmetry on bank lending amounts and credit rationing has been disclosed in the Stiglitz-Weiss model (Stiglitz, Weiss, 1981). Under market equilibrium conditions loans are provided to projects that are larger in amount and have lower risk. The interest rate defined by a bank can influence the demand for more risky projects: when selecting potential investors (risk of adverse selection) and influencing the borrowers’ behaviour (moral hazard). Prices act as a selection mechanism (Stiglitz, Weiss, 1981). If the equilibrium settles near higher interest rates, compared to a marginal level, banks will apply credit rationing and will lend at lower interests, compared to the market, but not to all requesting a loan. Contrary to the neoclassical theory, where lending is analysed without any concern to risk and transaction costs, the Stiglitz-Weiss model emphasises the influence of risk valuation on the supply of lending amounts and interest rate. Having in mind information asymmetry, the model explains that (Schmidt, Tschach, 2001; Tschach, 2003):

- in the case of rising interest rates, projects with low risk will not be realized;
- borrowers seeking to realise such projects in any way are motivated to choose more risky ones.

Schmidt and Tschach (2001) and Tschach (2003) have modified the Stiglitz-Weiss model and explained the differences in a large and small lending provision and rationing. Credit rationing is mostly applied to small loans, i.e. in the case of SMEs lending. Moreover, small businesses may be discouraged from applying for a loan believing that they will be refused by the bank. In this case, credit rationing occurs from the demand-side. Hashi and Toci (2010) argue this phenomenon as borrowers’ self-selection.

As stated by Kundid and Ercegovac (2011), the exclusion of SMEs in bank lending is even more wary in financial distress periods, where credit rationing occurs in tighter conditions with increased selection costs, reduced collateral values, rising uncertainty and interest rates, and SMEs general specificities.

Finance risk management is related not only to credit rationing, but also to the evaluation of creditworthiness of a credit applicant, i.e. credit ratings. The reserve requirement for banks depends not only on the size of the loan, but on loan risk as well. Thus, more risky lending is associated with higher costs. With the valuation of credit risk the ratings are calculated, the possibilities to repay the loan are evaluated and lending conditions and prices are determined. By setting internal ratings, the likelihood that the borrower will return the debt is calculated. Quantitative and qualitative information is used for valuation. Quantitative information is obtained from financial statements, business plans, and declaration of taxes. This information is used for calculating financial ratios, the most important of them being liquidity, profitability, equity, and debt level, asset turnover (efficient use of assets), coverage of financial debt (ECB, 2004; Savickaitė, Valvonis, 2007). Qualitative information is used when obtaining the information on business management quality, business, production, clients and market, and prognoses of business activities. Quantitative indicators are distinguished as more important ones and, in the case of small business valuation, correspond to two thirds of evaluation weight (EC, 2005). The exception would be in the case of start-ups, when evaluation is made by experts
In the venture capital market, groups of investors can be separated: venture capital funds (VCF), individual investors – business angels, informal VC investments, investments of large enterprises, state share capital initiatives. Thus, there are three interested parties: investors (as persons, investment funds, enterprises, insurance companies, banks, and the like), VCF as intermediaries, and businesses. Investors and investment intermediaries face information asymmetry risk and information selection and valuation costs, that are much higher, compared to crediting. The margin of risk capital investments is 20-30%, but with risk valuation only projects with about 40% margin are selected (EC, 2001; EC, 2004).

VC investments enhance opportunities to get bank financing, as well as transfer knowledge, experience, information, relationships. VC financed businesses grow larger in share value, number of employees, and in sales volumes (but their payroll expenses increase, so they are more or less even in profitability, compared to non-VC financed businesses), invest in R&D more intensively, have lower failure rates, higher acquisition rates, and more often go public (Berger, Schaeck, 2011; Puri, Zarutskie, 2012).

The criteria used for VC investments may be grouped into two categories (Ge, Mahoney and Mahoney, 2005): resources and abilities (as management quality, product features, business development level) and market structure (as market size, growth rates, competition, entry barriers). These categories correspond to the main strategic management theories: the resource based theory and the paradigm of industry structure-behaviour-performance, where the importance of industry structure for enterprise behaviour, strategy, and performance is emphasized. The joining part for these two theories would be the theory of external relations establishment and maintenance. Besides that, a macroeconomic environment should be considered as it defines market features and opportunities and has influence on VC decisions (Engel, Heger, 2005).

Financing sources in different SMEs growth stages

The availability of finance from the supply side is analysed on the basis of Keynesian and later theories, assuming that finance markets act under the conditions of information lack, asymmetry, and uncertainty. The attempt to emphasize the availability of finance for enterprises depending on their size rises from the theories of business development. Theories explaining enterprise development through the business cycle or lifecycle describe the growth as a process through a number of stages (Bhaird, Luckey, 2011). An in-depth analysis of the life-cycle paradigm and literature is presented by Hanks et al., (1993) and the definition of stages proposed is below: start-up with young and small enterprises, expansion with older and larger enterprises, maturity with larger enterprises than in previous stage, and diversification with experienced large enterprises and highest level of entrepreneurship. Although the lifecycle theory is analysed from a managerial point of view, the use of financial sources in different stages of
enterprise development is also analysed. The most complete, cited and researched model is the financial growth cycle model developed by Berger and Udell (1998). Financing needs and measures used (and available) change depending on enterprise size, age, and information, i.e., in time, enterprises become more experienced and information-wise opaque and use different financing options. These factors would be compatible with additional ones as asset structure, profitability, and growth (Hall, Hutchinson and Michaelas, 2004).

In the early studies of Holmes and Kent (1991), Freear, Sohl, and Wetzel (1995) and Cardullo (1999) it has been proven that in the stages of business start-up and early activities the most important financing sources are personal finance, loans from friends and relatives. At the beginning, especially in the case of innovative business, the risk is high, activities are unprofitable, or profits are uncertain; in the case of services, tangible assets are in low value. In the early development stage enterprises are not large enough to attract VCF, thus, business angels become important, as besides direct financing they share experience, knowledge, and contacts (Thompson, Choi, 2002). In the start-up and early development stage the state intervention measures, such as guarantees, microcrediting, provision of seed capital are important (Suzuki, 1996; OECD, 2004; Irwin, Scott, 2010). External financing, such as trade credit or short-term loans in this stage are accessible with business growth and a proof of return. At the early development stage small businesses are more dependent on debt financing than larger enterprises and face the problem of external capital deficiency. Changes in credit markets, such as decreased lending rates, rising margins, or tightened collateral requirements affect vulnerable SMEs as they have typically less alternatives for external financing. Although the use of financing instruments alternative to straight debt (e.g. factoring, leasing, mezzanine finance) has increased also among SMEs in recent years (IIF, 2013; OECD, 2013). As Kreamer-Eis and Lang (2012) report, bank loans and overdrafts are the most widespread debt financing methods for SMEs, but alternative sources, such as leasing and factoring have also high relevance.

The use of external finance by SMEs in the middle-development stages has been proved as uneven comparing to the prepositions of Berger and Udell (1998), explaining it by differences in perceptions, economic conditions, cultural and ethnical aspects, and a lack of adequate growth in large companies compared to smaller ones (Gregory et al., 2005; Irwin, Scott, 2010; Bhair, Luckey, 2011). Gregory et al. (2005) argue that the growth cycle of SMEs cannot be placed in one universal model. They have found differences from the Berger and Udell (1998) model, as size and experience have not been proven to be indicators when choosing the financing of VC and medium-term loans instead of public offerings and long-term loans.

As studies suggest, VCF are concentrated on the expansion or any later phase and the availability for seed, or early-stage phases, is very limited (Heimer, Holscher and Werner, 2008). There are only small part of businesses that use VC as seed capital (Puri, Zarutskie, 2012); moreover, VC is used more likely by younger and larger firms, whereas SMEs are less likely to use VC (Berger, Schaeck, 2011).

The assumptions of lifecycle theories and financial growth cycle models are presented in Figure 1.

Financing sources are presented according business characteristics – size, activity duration, and information availability – and lifecycle stages (Figure 1). The model presented should be treated as general assumptions of finance availability, as previous literature analysis suggests. The difference would be in presenting state support forms available for SMEs in their start-up and early development stages, and mezzanine finance in maturity stage. Bank lending is provided starting from the early stages and not limited to the highest development level. The distinction among the availability of finance by short-term, middle-term, or long-term loans is not made as studies in different countries do not reveal the same results. Moreover, the forms of bank lending are interpreted not only as typical loans, but also as overdrafts and credit lines. In the case of share capital investments, it is assumed that public offerings are possible in later development stages as regulations apply, and VCF are more common in the early to mid-term development stages, compared to single investors as business angels.

<table>
<thead>
<tr>
<th>Lifecycle</th>
<th>Start-up</th>
<th>Expansion</th>
<th>Maturity</th>
<th>Diversification</th>
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<tr>
<td>Financial growth cycle</td>
<td>Pre Start-up</td>
<td>Micro</td>
<td>Small</td>
<td>Information / Size / Age</td>
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<td></td>
<td>State subsidies</td>
<td>Microcredits</td>
<td>Guarantees</td>
<td>Leases</td>
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**Figure 1.** Financing sources in business lifecycle and/or growth cycle stages
State intervention conditions and measures

State intervention is necessary under certain conditions and for a limited period of time. Theoretical views defending different state intervention levels may be separated into three groups: hands-off policy, forming market conditions, and active intervention (Railiene, 2007). The view of forming market conditions is supported by the authors of this article. The main principles are: the application of measures through market mechanism and promotion of motivation for appropriate activities, ensuring macroeconomic stability, forming legal conditions for financial transactions, forming an information system and ensuring finance acceptability. These principles should be applied in the case of business support in order to increase entrepreneurship level in the economy, applying them for activating both supply (favourable conditions for entrepreneurial activities, widening funds, and easing conditions) and demand (development of skills and abilities, refreshing qualifications, forming a positive view, ensuring the availability of services, herewith financial). Financial support services should be provided through private finance institutions (using the existent infrastructure), in some cases (as indirect support) through public specialized institutions (lowering service provision costs), and applying the main principles of sustainable development of microfinance institutions – independent, stable, market-oriented, supplementing the development of overall finance system. The measures imply financial support services that should be provided in the cases of weak supply or demand when market failures occur, following a market-oriented strategy and applied temporarily to business service providers or users (businesses).

From the supply-side perspective, financial support measures would be the ones that help alleviate financing constraints by influencing the provision of external financing and easing financing conditions: funds for crediting, leasing, and share capital investments; single loan or loan, lease and investment portfolio guarantees; covering costs of debt or investment servicing.

Guarantee schemes are the most common government support measures for SMEs financing. Guarantees are treated as an incomplete form of both collateral and insurance, as are provided by third party and do not insure the borrower who loses the assets he has pledged (Green, 2003). In different countries the guarantee schemes applied differ, depending on economic conditions, a legal system, and historical factors. Guarantee schemes may be (EC, 2003; EC, 2006): guarantee funds, established and funded by regional or national authorities; public guarantee schemes, established by public policy, funded at least initially by state subsidies, managed by private organizations; international schemes, initiated by at least two NGOs, as ILO, UNIDO or EIF; mutual guarantee associations (schemes, societies or funds), established by SMEs, business federations or Chambers of Commerce, sometimes in partnership with banks, funded from membership fees and government support; corporate guarantee schemes, funded and operated by private banks, chambers of commerce. Guarantee schemes may be different, some guarantee individual loans and others – portfolios. Guarantee schemes are usually provided for loans, but are applied for leasing portfolios as well (Kreamer-Eis, Lang, 2012). When implementing the government guarantee schemes, the interest rate subsidies are also applied. The difference in guarantee schemes is also related with ownership, management, and funding structures.

Beck, Demirguc–Kunt and Peria (2008) prove that banks value government guarantee schemes as the most effective, compared to direct crediting, interest rate or regulatory subsidies. As presented in Green (2003), Beck, Klapper and Mendoza’s (2010) studies, a wide application of guarantee schemes exists because they are more effective and less costly (compared to direct lending); initial costs are low, instruments are market-friendly as a lending decision is mostly made by a private lender. However, while there is no direct influence on lending decisions, the problem of moral hazard rises, as incentives to aggressive risk taking by banks rises. According to Beck, Klapper and Mendoza (2010), it is important to note that government is usually involved in funding and management of schemes, but less - in risk assessment and recovery, and only rarely are schemes are applied which reduce risk through risk-adjusted and performance based pricing and pay-out only after the lender starts legal action against a defaulting borrower. Higher default rates are in schemes where government is involved in risk assessment function (not banks), where risk management tools are not used and in older schemes. Most investigations argue in favour of guarantee schemes, although the dangers or shortcomings are mentioned as well (Beck, Klapper and Mendoza, 2010; Honohan, 2010): it is dangerous that schemes are introduced because of politically, not economically reasoned welfare reasons; schemes can be costly, benefits are often vague and little studied, schemes do not provide promising incentives.

Positive effects are evident, as banks are encouraged to provide loans for profitable (but riskier) projects, usually associated with new technologies which help increase operational efficiency for innovative businesses, and, in the case of success, have positive effects on overall economic development. Most of guarantee schemes are restricted to SMEs, less - to some sectors or regions, technology development level, financing objectives, and a guaranteed part of loan. According to Douette (2006), guarantees are provided after the evaluation of business and requests to finance stable and, at the same time, not viable and not innovative businesses are rejected. Priority is given to start-up and risky businesses, investing into innovative technologies and having insufficient collateral. Orientation into such business entities, competitive and market-friendly instruments, competitive partners (banks as risk assessors) help reach the main objective: to lower the moral hazard and adverse selection risks, increase the availability of financial resources to viable SMEs without disturbing market conditions.

Direct lending programs are launched for SMEs and are targeted towards tangible and intangible investments and working capital in the start-up or expansion cycle (EC, 2003). The instrument is less market-friendly compared to guarantee schemes, but supports this view as loans are
provided through intermediaries: commercial banks, non-bank microfinance institutions, and not-for-profit microcredit providers (EC, 2012). Such conditions as loan amount, duration, interest rates and fees, repayment schedule usually depend on a loan provider as well as risk assessment and monitoring. Direct lending programs are usually related to microcredit initiatives. Microcredit is one of the forms of microfinance services, usually provided through specialised microfinance institutions or specialised government funds and programs (Robinson, 2001). In EU programs, microcredits are treated as loans of €25000 in value, and are usually provided to micro and small enterprises in their early development cycles (EC, 2012). The benefits of direct lending schemes are related to expansion of SMEs financing sources, but have lots of critics as usually the programs are costly and do not have tight and clear monitoring conditions.

Support measures for share/VC investments are direct investments through VCF, individual or VC portfolio guarantees, fiscal incentives (EC, 2004). As in case of lending support measures, VC guarantees are the most market-friendly and cost-saving instruments that help lower risk for investments into small, start-up, or highly innovative businesses. VC support measures are applied in order to mitigate the information asymmetry problem in lowering transaction and agency costs and dealing with risk aversion (OJ, 2006). VC investments are not equally treated in different countries because of the effects of (Heimer, Holscher and Werner, 2008): financing of retirements, cultural aspects, national accounting standards, and the opportunity costs. For example, in bank system driven countries, cultural aspects lead to low acceptance of private equity, thus, the VC support measures should be individually designed, firstly applying demand side initiatives.

In summary, the main financing measures and supply-side factors influencing SMEs finance availability are presented in Figure 2. Financing measures are crediting as the major and commonly used source, venture capital as a complementary source of funding for rapid development of innovative small businesses. As discussed in the paper, state intervention measures would be appropriate only if market-friendly crediting or VC investment instruments are applied. Support measures are applicable in order to activate financial services that face high transaction and monitoring costs and high risks, to encourage the financing of innovative, thus risky, but perspective projects applying the competitive procedure of support services provision (lowering moral hazard and adverse selection risk and not destroying market conditions).

![Figure 2. The main financing measures and supply-side factors influencing SMEs finance availability (adopted from Railiene, 2007)](image-url)
In general, such business characteristics as size, business nature, activity duration, business forecasts, and financial state would be important for both types of external fundraising.

**Conditions of Lithuanian SMEs finance availability**

Following a severe crisis in 2008–2009 and an uneven recovery in 2010, conditions to access finance in 2011 remained tight for SMEs and entrepreneurs in most countries. In Hempell and Sorensen (2010) Euro area research, it has been concluded that both price effects (e.g. higher margins on riskier loans) and restrictions on the size of loans negatively affect the growth of corporate loans. In OECD (2013) research, only one country in the OECD Scoreboard had positive developments in 2011 for the most of the core indicators (OECD, 2013). In Canada, SME loans increased while the SME loan share in total business loans remained stable. Credit conditions improved, venture capital recovered, and bankruptcies continued to decline. Eleven other countries experienced improvements in SME lending, but deterioration in credit conditions (Chile, France, Korea, the Netherlands, New Zealand, Norway, Russia, Sweden, Switzerland, Thailand, and Turkey). For the rest of the countries that experienced modest or no recovery, most, but not all, of their core indicators deteriorated (Czech Republic, Denmark, Finland, Italy, Ireland, Portugal, Serbia, the Slovak Republic, Slovenia, Spain, United Kingdom and the United States) (OECD, 2013).

SME Access to Finance (SMAF) index. The European Commission developed the SMAF index to monitor developments in SMEs’ access to financial resources and to analyse differences between Member States. The SMAF index provides an indication of the development of SMEs’ access to finance over the time for the EU and its Member States. The index is calculated using EU 2007=100, and so allows comparison between countries and across time. Figure 3 presents the main elements of SMAF index.

![Figure 3. SMAF index](image)

Figure 3. SMAF index (prepared by the authors, according to SMAF calculation principles; EC, 2013)

![Figure 4. Comparison of SMAF index values](image)

Figure 4. Comparison of SMAF index values in 2007–2011 (EC, 2013)
As Figure 4 shows, Lithuania SMAF index was higher than the average of European Union and Euro Area in 2007 and 2008 (EC, 2013). But the affect of crisis has impacted the downgrading of index in 2009. In 2010 the SMAF index was not far away from the average of European Union and Euro Area countries, and in 2011 it was higher than average, together with Latvia, as the debt sub-index was the higher, compared with other EU countries.

**Financing conditions.** As concluded from OECD (2013) research, despite continuous monetary easing, financial institutions had difficulties in translating the flow of funds into credit to the private sector. It would be true in the case of Lithuania, as lending values to non-finance institutions stopped to decrease in 2012, but still remain low (LCB, 2013).

The loan portfolio of banks in Lithuania has been increasing (more than three times) from the period of 2004 through 2008 (Figure 5). But the financial crisis of 2008 had a negative impact on the loan portfolio during the period of 2008 through 2011, as total loans have decreased more than 2535 mln. EUR. Only in 2012 the growth of total loans can be found as 175 mln. EUR.

Crediting conditions for SMEs over the 2007-2011 period in most countries were severe, compared to large enterprises in the form of higher interest rates, shortened maturities, and increased request for collateral (ECB, April 2013; OECD, 2012). Interest rate spread between loans for SMEs and large firms suggests a tightened perception by lenders of risk for SME loans, but it wasn’t the case of all the Euro area (EA) countries, although a high level of collateral requirements increasing the costs of lending was common (OECD, 2013). Having such a situation the payment delays remain high or even grows.

By analyzing total credit conditions for SMEs in Lithuania, it’s important to approach the dynamics of loan and deposit interest rates. As presented in Figure 6, interest rates for loans and deposits had the same increasing tendency at period from 2006 to 2008. During the same period, the 6 month VILIBOR (Vilnius Interbank Offered...
Rate - the average interbank offered rate at which banks are willing (prepared) to lend funds in Litas to other banks) had a larger increase and showed a higher credit risk. Starting from 2009, the interest rate for loans and deposits started to decrease, but the loan interest rate slipped from 8.79 to 5.35, as the deposit interest diminish from 7.16 to 1.37. It shows that banks’ lending strategy remains very conservative and banks’ intend to get a big credit risk margin.

As the Lithuanian Central bank (LCB) has reported (LCB, 2013), in the second half of 2012, almost two-thirds of enterprises surveyed satisfied all their business financial needs using internal financing sources. The decision to refrain from borrowing was mostly influenced by sufficient internal resources. Almost half of the enterprises surveyed indicated the needed borrowing from credit institutions. As a matter of fact, industrial and construction companies are likely to be the most active borrowers. Almost half of the enterprises use the borrowed funds for the repair or acquisition of equipment, machinery, and vehicles. In the same survey, two-thirds of borrowing enterprises believed that borrowing conditions remained the same; however, there were more enterprises that indicated that the borrowing conditions had eased, compared to those that claimed that conditions had become tighter (LCB, 2013).

The latest ECB survey on the access of finance of SMEs in the European Union (EC, November 2012) has indicated the percentage of Euro area SMEs using bank loans (33% of Euro area SMEs, down from 35% in H2 2011) and bank overdrafts or credit lines (41%, down from 42%) which declined slightly when compared to the previous round, with bank financing remaining the most important source of external financing. More SMEs reported an increase (18%, compared to 19% in H2 2011) in their need (i.e. demand) for bank loans rather than a decrease (12% compared to 11%). SMEs perceived further deterioration in the supply of bank loans between April through September 2012 (-22% in net terms, compared to -20% in H2 2011), but not as bad as the levels of 2009 following the bankruptcy of Lehman Brothers (EC, November 2012). SMEs have also reported further deterioration in the availability of bank overdrafts and trade credit. Reasons for the deterioration in external financing include demand-driven factors: general economic outlook and firm-specific outlook. These may reflect higher risks related to weakening economic activity, which banks account for in their lending policy. But Bank loan rejections have increased slightly to 15%, up from 13% in H2 2011. This represents the highest percentage since the peak of 18% in H2 2009. This is more pronounced for micro firms (1-9 employees) which report a much higher rejection rate (24%, up from 20% in H2 2011). At the same time, 60% SMEs reported receiving a full loan amount applied for (EC, November 2012).

The latest bank lending survey in Lithuania (LCB, April 2013), executed by Lithuanian Central Bank indicates that banks have eased their general credit standards as applied to enterprises for a second consecutive half-year. The access to bank loans for business should be easier due to improved perception of risk, driven by better prospects for the Lithuanian economy and business, the improvement in the quality of collateral, and bank competition in the market. Enterprises sensed this in declining margins, easing collateral requirements or declining other loan covenants. Over the next half-year banks intend to ease their credit standards as applied SME and it could increase bank’s loan portfolios of 1 per cent to 5 per cent in 2013 (LCB, April 2013).

Equity financing was severely affected by financial crisis and economic slowdown as well. Despite an overall positive economic trend of EA, venture capital and growth capital declined and equity funding had not recovered to the level of 2007 (IMF, 2012; IMF, 2013; OECD, 2012). Sweden has the most venture capital (as % of GDP) of any EU member; since a relatively high proportion is invested in earlier-stage deals - which tend to be smaller - the number of beneficiaries is also high. Venture capital is difficult to analyse in Lithuania, as just one larger deal can cause volatility; but as VC association reports, there were 5.02 million EUR VC investments in 2007 and 2.73 million EUR in 2011 (EC, 2011).

SME support measures. By the initiative of the Lithuanian government, SME crediting instruments for investment projects and working capital financing have been developed. Creditoring instruments and programs are implemented by a JSC ‘Investments and Business Guarantees’ (INVEGA). The purpose of INVEGA activities is to promote the development of SMEs in Lithuania, facilitating their access to the sources of financing (INVEGA, 2013a). There are some developed instruments for the risk reduction for credit institutions and thus encourage commercial banks in Lithuania for credit granting for SMEs:

- state guarantees for the SME loans and SME financial leasing contracts;
- portfolio guarantees.

In addition, INVEGA administrates the financing of loan interests and provides partial compensation of SMEs credit interest payment and subsidies form wage compensations. A detailed information about SME support instruments are summarised in Table 1.

Risk capital instruments. For the first time, the Lithuanian Government funding was made available to encourage risk capital investments into companies. On January 21, 2010, the EIF signed an agreement with a selected jointly investing fund manager UAB Mes invest (INVEGA, 2013a; 2013b). The value under the agreement constitutes EUR 9.45 million; the joint investments to the SME entities are expected to make about EUR 16.8 million. The Business Angels Fund I, together with the business angels (private investors), will invest in small and medium-sized enterprises of Lithuania (LTL 1.38 million - EUR 0.4 million - for one enterprise). The investors will share their know-how and experience and help enterprises to improve their business management skills and successfully behave in the long-term perspective.
On April 23, 2010, under the Risk Capital Funds measure, an agreement with BaltCap was concluded, and on June 1, 2010 – an agreement with LitCapital Asset Management (INVEGA, 2013b). Based on these agreements, two risk capital funds were established. Two funds amounting to LTL 138 million (EUR 40 million) have been earmarked LTL 96 million (EUR 28 million). It has been set that the investment amount invested by the Fund in one targeted enterprise may reach up to EUR 3 million (LTL 0.35 million) and EUR 1.5 million (LTL 5.18 million) within any period of twelve months. On 11 April 2011, LitCapital Asset Management signed an agreement for an LTL 3 million investment with UAB Lignoterma which is a bioenergy company of the Lithuanian origin (Invega, 2013b).

Furthermore, INVEGA is starting implementing a new program ‘Creative Innovation Development’. Two risk capital funds will make investment in start-up high or average high tech companies.

In the 1st Q of 2013 INVEGA started managing an agreement with Baltic Innovation Fund (BIF). BIF is a Fund-of-Fund initiative, launched by the EIF, in close cooperation with the Governments of Lithuania, Latvia, and Estonia in 2012 to boost equity investments made into Baltic SMEs with a high growth potential. BIF will invest EUR 100 million into private equity and venture capital funds focusing on the Baltic States over the next four years through a ‘fund of funds’ process to attract additional private finance and implement the best market standards for equity investing in businesses. BIF represents a EUR 40 million investment by EIF with each Baltic Government committing EUR 20 million through national agencies (INVEGA in Lithuania, KredEx in Estonia and LGA in Latvia) (EIF; 2013; INVEGA, 2013b).

Impact of financial crisis on SMEs access to finance. The problem of access to financing sources is strongly exacerbated by the financial and economic crisis, as SMEs and entrepreneurs have been suffered by shocks since SMEs are generally more vulnerable in times of crisis for many reasons (Figure 7). Even under ‘normal’ economic conditions governments have recognized that, to survive and grow, SMEs need specific policies and programs.

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### Table 1

**SME support instruments implemented in Lithuania**

<table>
<thead>
<tr>
<th>Instruments</th>
<th>TOTAL, million Lt</th>
<th>Implementing institutions</th>
<th>Conditions</th>
<th>Source of Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CREDITING</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shared Risk Credits</td>
<td>379,8</td>
<td>3 banks</td>
<td>Credit amount up to 16,5 mln. Lt.</td>
<td>EIF Jeremie</td>
</tr>
<tr>
<td>Open Credit Fund</td>
<td>150</td>
<td>6 banks</td>
<td>Credit amount up to 1,5 mln. Lt, term – 72 months, until 31st of December, 2018. Not more than 2 credits.</td>
<td>75% EU Structural Funds, 25% bank’s own recourses</td>
</tr>
<tr>
<td>Small Credit Granting</td>
<td>95</td>
<td>4 banks</td>
<td>Credit amount up to 350 thous. Lt, term – until 31st of December, 2014.</td>
<td>EU Structural Funds</td>
</tr>
<tr>
<td>Entrepreneurship Promotion Fund</td>
<td>23,4 (380 units)*</td>
<td>57 credit unions (CU)</td>
<td>Credit amount up to 86 thous. Lt, INVEGA credit guarantee, 95% interest compensation, wage compensation.</td>
<td>EU Structural Funds</td>
</tr>
<tr>
<td><strong>GUARANTEES</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit (INVEGA) (2348 units); Guaranteed credit: 984,2 million Lt**</td>
<td>667,5 million Lt</td>
<td>11 banks, CU</td>
<td>30-80% of loan (not more than 3 million Lt)</td>
<td>Structural Funds – National sources of finance</td>
</tr>
<tr>
<td>Lease (INVEGA) 984,2 million Lt**</td>
<td>7 leasing companies</td>
<td>70% of assets (not more than 5 million. Lt)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit Portfolio 99,4</td>
<td>2 banks</td>
<td>80% of loan, max. 11,28 million EUR</td>
<td>EIF Jeremie</td>
<td></td>
</tr>
<tr>
<td>Lease Portfolio 99,4</td>
<td>1 leasing co.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>INTEREST COMPENSATION</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>INVEGA 40,6 (3176 SMEs)</td>
<td>11 banks, 7 leasing comp., CU</td>
<td>Working capital financing - not longer than 24 months, investment credit – up to 36 months, till 30th of September 2015. Up to – 50% of interest.</td>
<td>EU structural Funds</td>
<td></td>
</tr>
<tr>
<td><strong>SUBSIDIES: WAGE COMPENSATION</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Entrepreneurship promotion Fund 10</td>
<td>SMEs</td>
<td>Total not more than 25 thous. Lt, priority group: SMEs (personnel: young people to 29 years old, unemployed, disabled, older than 50 years) or 20 thous. Lt to other SMEs, but not more than 1311,80 Lt per employee.</td>
<td>EU structural Funds</td>
<td></td>
</tr>
<tr>
<td>First Job Support 32</td>
<td>SMEs</td>
<td>Period not exceeding 12 months, for a young person, 16 to 29 years of age, employed for the first time, with no previous work experience under employment contract.</td>
<td>EU structural Funds</td>
<td></td>
</tr>
</tbody>
</table>

* period from 2010 till December 31st, 2012; ** period from 2007 till September 30, 2013. Data from (INVEGA, 2013b; INVEGA, May 2013)
However, at present, SMEs have been especially hard hit by a global crisis. SMEs are more vulnerable now for many reasons: not only has the traditional challenge of accessing finance continued to apply, but new, particularly supply-side, difficulties are currently apparent.

Also it has to be mentioned that the stagnation in lending is true even of banks in countries where governments have deliberately strengthened banks’ balance sheets to allow them to grant additional credit to SMEs and/or where credit guarantee schemes exist. The fact is that large banks have evolved into very complex institutions where loan decision making is centralized and based on automated credit assessment systems. Thus, SMEs often lack face-to-face contact with bank managers who understand their specificities. Inappropriate and indiscriminate use of credit scoring mechanisms can lead even deserving SMEs to be denied credit. To some extent, a proper use of individual assessment through relationship banking can counteract this, and it has survived in some countries because the banking sector is composed of many local or regional banks which have been less affected by the crisis, are liquid, and continue to lend to SMEs.

The government impact and support could be noticeable by preparing and implementing specific and active SME’s programs and policies that include supporting SME’s sales, preventing the reduction of SME’s working capital, helping SME’s to maintain their investments, enhancing SME’s access to liquidity and promoting the mezzanine development in SME’s sectors or providing equity or quasi equity guarantees.

Conclusions

In summary, the main supply-side factors influencing a limited SMEs access to external finance are information asymmetry, high risk – uncertainty, high transaction and monitoring costs, and insufficient collateral.

Finance availability in different SMEs growth stages is valued by entity size, experience and information availability. As information asymmetry and uncertainty exists, the supply of external financing is limited because of moral hazard and adverse selection risks. Thus in order to lower the risk, finance institutions apply rationing, in order to measure the risk, credit ratings are calculated. In this case SMEs face tighter valuation criteria and crediting conditions. In the case of venture capital investments, the information and valuation costs are much higher; the return requirements are higher too. This financing measure is available and acceptable for businesses having the experience of successful activities and insights of perspective development, foreseeing high growth rates, acting in perspective sectors.

The application of state intervention measures is vital for SMEs, but state intervention is justified only in the case of finance supply or demand failure and only if measures that least disturb market conditions are applied. The most popular and widely used measures are guarantee schemes, but microcredits, interest rate subsidies, venture capital investments are non the less important under certain conditions.

Following the financial crisis of 2008, conditions to access finance still remain tight for SMEs and entrepreneurs in most countries. SME Access to Finance (SMAF) index, developed by the European Commission, provides the indication of the development of SMEs’ access to finance in EUR by analysing access to debt finance, access to equity finance and survey perceptions. Lithuanian SMAF index was higher than average in 2011 as the debt sub-index was higher compared to other EU countries.

The analysis of SMEs financing conditions has disclosed the growing loan portfolio, decreasing interest rates and VILIBOR in Lithuanian commercial banks. As the LCB has reported (LCB, 2013), almost two-thirds of

Figure 7. Impact of crisis on SME (prepared by authors, based on OECD (2009, 2012, 2013), ECB (April 2013), EC (November 2012, 2013), LCB (April 2013)
enterprises surveyed satisfy all their business financial needs using internal financing sources. But almost half of the enterprises surveyed have indicated the need for borrowing from credit institutions for investments in equipment, machinery and vehicles.

In spite of the fact that EC has reported the deterioration in external financing because of demand-driven factors (general economic outlook and firm-specific outlook), Lithuanian Central Bank indicates that banks in Lithuania have eased their general credit standards. The access to bank loans should be easier for business due to the improved perception of risk, driven by better prospects for the Lithuanian economy and business, the improvement in the quality of collateral, and bank competition in the market.

The analysis of SME support instruments implemented in Lithuania has shown the spectrum of measures: 4 crediting programs, state (INVEGA) credit repayment or portfolio guarantees for financial institutions (commercial banks, leasing companies, and credit unions). Also, SMEs can get partial (up to 50%) financing of interest of loans issued by credit institutions or financial lease companies. Besides, SMEs can receive subsidies for wage compensation from the Entrepreneurship Promotion Fund and measure ‘Fist Job Support’. Risk capital instrument implementations are just making first steps in Lithuania. EIF with the help of INVEGA implement new programs which could help stimulate the risk capital investments in Lithuanian SMEs.

A drastic drop in demand of SME’s goods and services, the shortage of cash flow (tightening in credit terms, increased payment delays), and growing defaulted and bankrupted SMEs were just the main after-effects of the financial crisis of 2008. As SMEs are very important for each country’s economy, government has to implement a stable and proceeding policy and programs for supporting SMEs sales, preventing the reduction of working capital, helping SMEs to maintain their investments, enhancing the access to liquidity and to working capital, helping SMEs to maintain their supporti

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G. Railiene, L. Išakvičiūtė

Finansų prieinamumo Lietuvos smulkaus ir vidutinio verslo subjektams vertinimas pasiūlos požiūriu

Santrauka

Smulkaus ir vidutinio verslo (SVV) subjektas ir verslininkai yra ypatingi svarbūs: jie dažnai veikia mažų verslo sektoriaus sritimose, kurios turi didelę įtaką įvairioms verslo srityms. Dėl to jie gali turėti didelę įtaką bet kuriam verslo sėkmės aspektui. Tai taip pat gali turėti įtaką didžių finansų institucijų verslo atsivesimo strategijoms. Tai yra svarbu įvertinti finansų prieinamumo požiūriu, nes tai gali turėti didelę įtaką mažų verslo sėkmės atžvilgiu.

Šis straipsnis tikslas yra įvertinti finansų prieinamumo požiūriu Lietuvos SVV subjektų ir verslininkų reikšmes. Tai galėtų padėti suprasti, kaip mokėtis ir finansavimas veikia mažų verslo sėkmėje, taip pat galėtų turėti įtakos didžių finansų institucijų verslo atsivesimo strategijoms.

Finansų prieinamumas Lietuvos SVV subjektams vertinimas finansų prieinamumo požiūriu

Finansų prieinamumas vertinamas finansų prieinamumo požiūriu, nes tai gali turėti didelę įtaką mažų verslo sėkmės atžvilgiu.

Finansų prieinamumo požiūriu vertinamas finansų prieinamumo požiūriu, nes tai gali turėti didelę įtaką mažų verslo sėkmės atžvilgiu.

Finansų prieinamumo požiūriu vertinamas finansų prieinamumo požiūriu, nes tai gali turėti didelę įtaką mažų verslo sėkmės atžvilgiu.

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