



Lending to small and medium businesses: problems and solutions

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Abstract

The development of small and medium businesses becomes one of the priorities on economic state policy in today's difficult economic situation. The need for effective use of the potential opportunities of small and medium business as the most widespread form of entrepreneurship, which provides socio-economic stability of development, the implementation of a diversification and an economic modernization, improving its efficiency, import substitution, the solution of complicated social problems is increasing. At the present time, conditions for the development of small business in Russia are deteriorating because of the action of a number of adverse factors. One of these adverse factors is lending to small and medium businesses. Financial position reflects the ability of the company to finance its current activity on an extended basis, always maintain their solvency and investment attractiveness. The company should have sufficient capital, optimal structure of assets and sources of its financing to do it. It is also important to use the funds in such way that the revenues consistently exceed expenses, it provides the stable solvency and the growth of profitability.

Keywords: lending, small and medium business, loan, lending conditions, banks, small and medium business financing, financial stability of the company.

1. Introduction

The development of small and medium businesses (further SMB) becomes one of the priorities on economic state policy in today's difficult economic situation. The need for effective use of the potential opportunities of SMB as the most widespread form of entrepreneurship, which provides socio-economic stability of development, the implementation of a diversification and an economic modernization, improving its efficiency, import substitution, the solution of complicated social problems is increasing [4].

2. Lending problems for small and medium businesses

At the present time, conditions for the development of small business in Russia are deteriorating because of the action of a number of adverse factors. One of these adverse factors is lending to SMBs. The problems of lending to SMBs are shown in the Table 1.

There are predominantly negative trends for SMBs in the period of 2013-2015. Although the common number of SMBs (organizations) increased by 12.2% in 2012-2013 (this amounted to 2.08 million organizations), this growth was in the segment of micro-enterprise. Unfortunately, this trend did not change for the better in 2014. The number of registered individual entrepreneurs decreased by almost 15% in 2013 in comparison with 2011. Then this number increased by 1.6% in 2014, but it happened due to the growth of micro-enterprises. As far as an employment in SMBs is concerned, it has decreased by 0.4% (this amounted to 66.000 man) [1].

Senior staff from 450 companies including 150 medium-sized companies and 300 small (including micro) enterprises participated in interview for SMBs, arranged by the Analytical Center of "SME Bank" in cooperation with the National Agency for Financial Studies (NAFS) in April of 2016. There were questions related needs for bank loans. According to results of this interview, only 10.4% of entrepreneurs noted an increase in the availability of credits in the first quarter of 2016. Percentage of these assessments decreased by 0.9% on this period (it was 11.3% in the 4th quarter of 2015). 40% of interviewed entrepreneurs told about a

decrease in the availability of credits (it was 38.5% in the 4th quarter of 2015). Nearly half (49.6%) of respondents found it difficult to give a definitive assessment. Thus, respondents' assessments changed insignificantly in comparison with the 1st quarter. The results of this interview are on the Figure 1 [3].

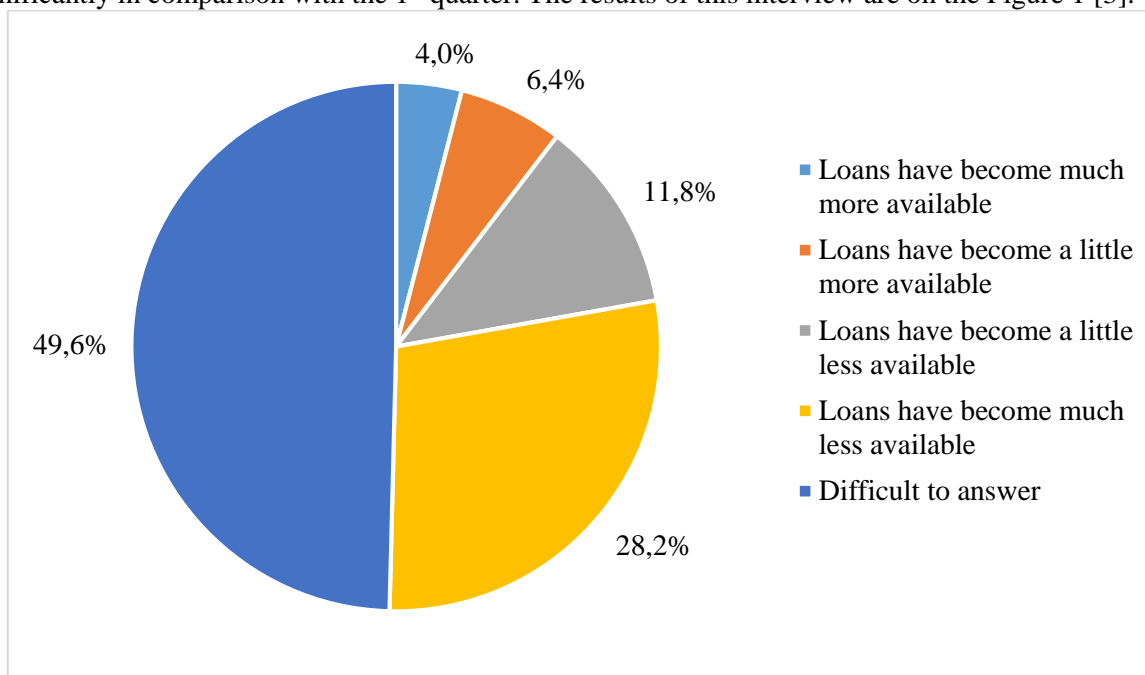


Figure 1. The results of the interview for SMBs

Table 1. The problems of lending to SMBs [4]

The problems of lending to SMBs from the perspective of creditors	The problems of lending to SMBs from the perspective of borrowers
<ul style="list-style-type: none"> • ‘Opacity’ of borrowers; • Lack or poor quality of the pledge; • Undeveloped system of state subsidy of loans; • Lack of the sufficient resource base in banks to give long-term loans; • High risks (because of the ‘opacity’ of SMBs); • Unwillingness of banks to work with small businesses, particularly with those who have just started a business, because of the lack of the credit history, imperfection of business plans of small businesses, the high cost of operating expenses for the consideration of applications from small businesses, the lack of efficient commercial risks insurance and etc. 	<ul style="list-style-type: none"> • Discommodity of conditions which banks offer for small businesses (requirement of 200% of pledge collateral, dominance of short-term loans (one year), interest on loans are more than these one abroad in 2-3 times, duration of the consideration of applications is large unacceptably; ‘shady’ organizations can not provide an accurate documentation and etc.); • The lack of tax incentives for small businesses to increase an amount of money which are for re-equipment of production and innovations development; • A lot of documents which are requested by banks.

According to the Index ‘SME Bank Financial crossroads’, the number of rejected applications from small businesses for the loan has been increased by 33% (it was 27.7% in the 2nd half-year of 2015). The number of rejected applications from medium businesses has been also increased. It was 13.6% in the 2nd half-year of 2015 and it increased by 22.4% in the 1st half-year of 2016. There are the most common reasons for rejection loans to SMBs on the Figure 2 [2].

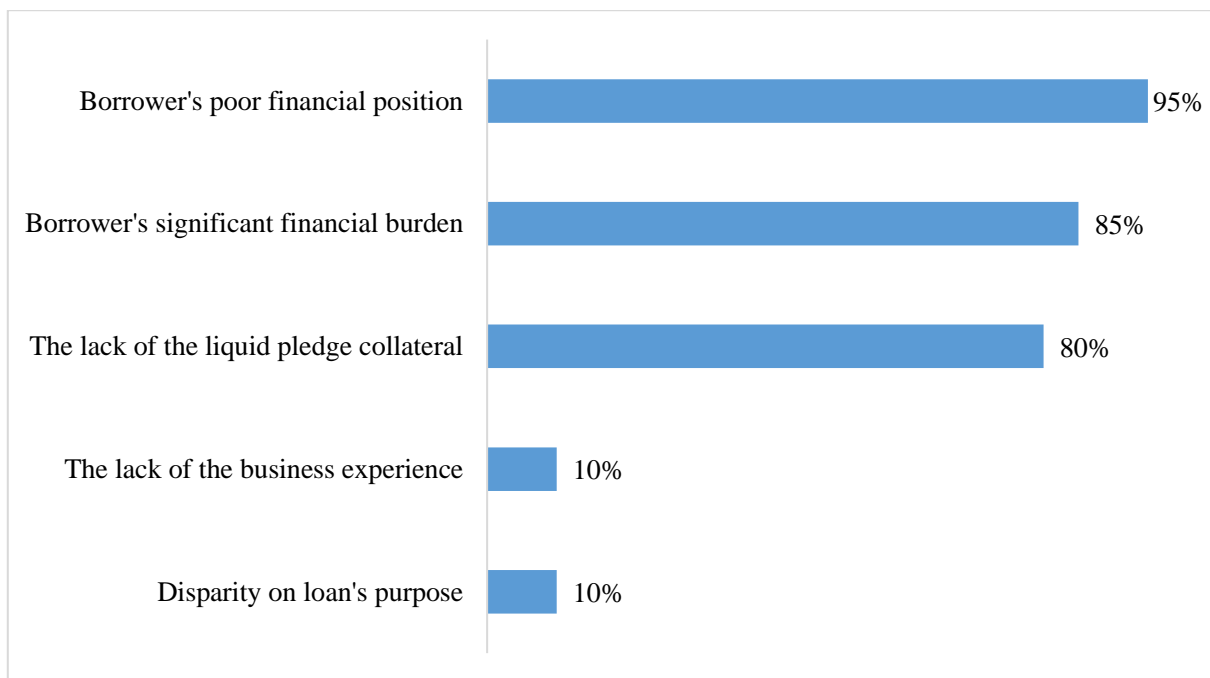


Figure 2. The most common reasons for rejection loans to SMBs

The most frequent reason for rejection remains borrower's poor financial position. Borrower's significant financial burden moved from the 3rd on the 2nd place on the "popularity" of failures and displaced the lack of the liquid pledge collateral down one place.

Economic crisis influenced the quality of debt service by small and medium entrepreneurs a lot. Retailers occupy the leading positions on overdue loans in the banks' balance in comparison with 5.2% of overdue debts in total in the banking sector. One of the reasons, which restrain lending to SMBs in Russia can be the lack of information for SMBs credit risks assessment, which banks and microfinance institutions need in. Banks can not assess adequately the credit risk of small and medium entrepreneurs because of the lack of transparent reporting and low level of centralized borrowers' credit histories monitoring or information exchange between financial institutions on credit histories. It forces banks to rely on their own credit analysis and credit history of the borrower in this bank. But this in conditions of disparity on management (real) reporting to official one, as well as gray schemes lead to the increase of the risk in the interest rate for the credit and the growth of pledge requirements. With considering all the above, and also the deteriorating of an economic situation and increasing of the risks banks have raised the requirements for borrowers. First of all, these measures have influenced the SMBs [8].

Chairman of the Board of directors of the 'Bank VTB' Andrey Kostin during the one of the press conference expressed the opinion that lending to SMBs is very risky: the number of non-performing loans has increased a lot in recent years. 'If SMBs products are not in demand, then the lending of this sector may lead to the bankruptcy,' – noted Kostin.

Representatives of relevant business organizations interviewed by the RBC consider that Andrey Kostin is not right. 'Perhaps, there are a little benefit for major banks to lend small business, but it does not mean economy need not it,' – declared to the RBC the vice-president of SMB public organization 'Support of Russia' Vladislav Korochkin [7].

The good alternative for SMBs who were rejected in banks' loans is leasing. The object of leasing is in the property of lessor, so the need in pledge disappears. It allows to give less attention to financial indicators of the organization.

But even though all of the above and other problems, Russian banks continue to lend to this niche and do it willingly. Due to the fact that this will help them to increase their competitiveness.

3. Solutions

There are some ways, which can help to improve lending conditions for SMBs:

- To decrease a tax burden to banks which deal with the lending to small businesses;
- To set a fix fee for pledge agreement registration [5];

- The policy of supporting SMBs should be a part of the economic development strategy;
- Measures for supporting SMBs with the involvement of suretyship guarantee companies at reasonable interest rates can influence well the lending market for SMBs. These programs will stimulate the SMBs' activity and provide the stability of banks' loan portfolios [6].

It is reasonable to decrease funding costs and capital burden to make banks are interesting in financing SMBs. The mechanism of loans refinancing in the Bank of Russia and the securitization of SMBs' credit portfolios will be claimed by the market. In particular, the Bank of Russia can decrease credit costs for SMBs through the using such mechanism of banks refinancing when cash may be obtained against SMBs' credit collateral which were given under the guarantee of the SMB Corporation. The risk indicator for credit requirements for small businesses have been decreased by 75% from the 1st of January, 2016 in Russia. The use of such tool in the Russian practice and, also, the additional reducing of capital burden because of the guarantees of development institutions will allow to increase an interest of banks in SMBs financing and provide a stable market recovery [6].

4. Features of the financial stability of the company

To carry out its main current activities in the given scale companies must have sufficient capital and its optimal structure from point of view, firstly, placing funds in assets and, secondly, rationality of business funding. Continuous circulation of funds and the formation of cash flows and financial results are in the results of economic and financial activities implementation. It should provide:

- The company's ability to self-financing its activities not only in the previous volume, but also on an extended basis;
- Stable solvency of the creditors for the payment of bills, budget for taxes, staff for salary payments, banks for timely repayment of loans;
- The attractiveness of the company for investors and other business partners.

These is the features of the financial stability of the company.

5. Conclusion

Financial position reflects the ability of the company to finance its current activity on an extended basis, always maintain their solvency and investment attractiveness. The company should have sufficient capital, optimal structure of assets and sources of its financing to do it. It is also important to use the funds in such way that the revenues consistently exceed expenses; it provides the stable solvency and the growth of profitability.

The common goals of an analysis:

- Assessment of the financial position of the company;
- Identifying the causes and factors of occurred changes during the period;
- Development of recommendations to strengthen financial stability, provide solvency and increase profitability.

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