ROLE OF ALTERNATIVE SOURCES OF FINANCING IN ATTRACTING INVESTMENTS BY SMALL AND MEDIUM-SIZED ENTERPRISES: EXPERIENCE OF EUROPEAN UNION COUNTRIES AND PROSPECTS FOR THE REPUBLIC OF MOLDOVA

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ABSTRACT

This article examines the peculiarities of attracting investments by SMEs of the European Union countries, as well as in the Republic of Moldova and prospects for applying new alternative sources of financing. The actuality of this study is determined by the fact that in most countries with a market economy, SMEs play a dominant role in ensuring employment and the formation of a national budget. For the Republic of Moldova, where SMEs, like in most EU countries, make up about 98% of all companies, their financing is one of the determining factors for economic development and improvement of the population's well-being. Taking into account that in the Republic of Moldova, unlike the EU countries, during the last few years there has been a negative dynamics of attracting investments in long-term tangible assets of companies, in order to apply the best international experience, in this study, based on such research methods as: documentary method, analogy and grouping of quantitative and qualitative data; graphical method, method of synthesis, comparison, etc., are analysed possibilities on expanding the range of instruments of attracting capital used by the SMEs of the Republic of Moldova, taking into account modern financial technologies.

KEY WORDS: *SMEs, source of financing, alternative finance*
JEL: *G23, O16, O33*

1. INTRODUCTION

The financial crisis of 2007 – 2008 has had a significant negative impact on the pace of economic development of the EU countries, greatly complicating the task of attracting investments by companies that are needed to meet the challenges of sustainable development. The most negative impact of the crisis was that it affected the SMEs, which represent about 99% of all European Union non-financial enterprises, that face different challenges when accessing finance to large scale enterprises. However, numerous initiatives that were developed and successfully implemented within the framework of the European Union, including the *Entrepreneurship 2020 Action Plan*, *the Small Business Act*, *the European Commission's Investment Plan for Europe*, with its components: *the Capital Markets Union Action Plan*, *Digital Single Market Strategies* etc. have made possible to attract over Euro 116 billion in investments over the last few years, finance about 202,000 SMEs, create 100,000 new jobs, and have been approved by the European Fund for Strategic Investments till 2017 infrastructure projects and for more than 400,000 SMEs and mid-caps, supported by the European

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Investment Fund, and more than 3,000 startups in Europe, as it is co-investment with leading venture capital funds (PODIM (2017)), which allowed to solve the financing problems for most EU SMEs.

In the Republic of Moldova, as in EU countries, SMEs account for about 98% of the total number of registered companies; at the end of 2016, 61.2% of the total working population were employed and 41,5% of the total volume of goods and services produced. However, despite the growth in SME sales revenues observed since 2012, concern about the prospects for their further development causes an annual significant reduction in investments in these companies, a particularly significant drop is observed in terms of investment in fixed assets, which is explained by the limited capacity of the SMEs of the Republic of Moldova in attracting capital, both on domestic and foreign financial markets.

Taking into account the successful experience of the EU financial market regulators in stimulating the development of SMEs and ensuring that these companies attract substantial inflows of investment capital through the modernization of the EU financial infrastructure, the expansion of the range of financial instruments, the use of modern methods and technologies for raising capital, the ***purpose of this study*** is to compare the features of financing SMEs in the EU and in the Republic of Moldova and to identificate of prospects for expanding the spectrum of the instruments of financing companies used in the national market, in particular, through the implementation of modern methods of attracting capital, based on modern digital technologies.

2.1. RESEARCH THEORETICAL ASPECTS

Modern capital structure theories, based on Modigliani and Miller capital structure theory, which affirms that under the conditions of perfect capital markets the capital structure of the firm is independent of its cost of capital and, therefore, of firm value, considering the acknowledgment of imperfections of financial market, investigate a number of determinants that are responsible for various impacts on capital structure. The literature highlights the importance of taxation and corporate control, asymmetric information, agency problem, firm's lifecycle in determining the choice between equity and debt and the tradeoffs of costs and benefits provided by each financial instrument (Xhaferi S. & Xhaferi B. (2015)). As a result of these theories systematization, the following directions of the scientific ideas development can be highlighted: *trade-off theory*, that analyses tax advantages of debt and optimization of capital structure, balancing the costs and benefits of debt and equity finance*; agency theory* which investigates companies agency costs and their influence on capital structure and growth; *pecking order theory* that analyses information asymmetry between firm's management and its shareholders, resulted in companies financing by an order from safer to riskier, with advantage of internal financing compared to external financing, preferring debt to equity (Briozzo A. & Vigier H. (2007)).

The rationale for the SMEs is very different from those of larger companies. In their wish to control, most SMEs owners prefer the internal finance and the aversion to external finance, that determines the relevance of the pecking order theory to SMEs. But, in order to extend and attract external financing, SMEs usually prefer the debt to equity, because they are much more familiar with banks and other sources of debt finance providing a wide variety of debt products available for SMEs (Uchida H. et al. (2006)). As indicated in the investigation of *Organization for Economic Co-operation* *and Development* (OECD (2015)), bank lending is the most common source of external finance for many SMEs and entrepreneurs, which are often heavily reliant on traditional debt to meet their start-up , cash flow and investment needs. However, bank financing is often difficult for SMEs, especially for those who are just starting a business and do not have enough assets, as well as for innovative, fast-growing and high-risk companies. The study notes that while alternatives to traditional debt finance are particularly important for start-ups, high-growth and innovative SMEs, the development of affordable financing techniques may be relevant to the broader population of SMEs and micro-enterprises. That is why, as indicated in the study, it is necessary to steadily expand the range of financial instruments available for SMEs that will help them fulfill their role in ensuring economic growth, providing employment and introducing innovations, for which the study proposes to use SMEs to attract capital such financial tools like: various forms of loans, asset-backed companies, securitized forms of debt, hybrid financial instruments and crowdfunding (OECD (2015)). Alternative finance is an umbrella, term capturing a variety of financing sources that have developed outside traditional financing channels (EIF (2017)). The *European Bank for Reconstruction and Development* (EBRD (2016)) announced the need to diversify the financial products offered to the business in the *Financial sector strategy 2016-2020,* in which are identified three strategic objectives: 1) *development of a sound banking sector* through improvement of business standards, restructuring and consolidation, and increased competition; 2) *strengthening the financial sector* by achieving better diversification (including the development of the non-banking sector) and integration into global financial markets; 3) f*ostering deeper and broader financial intermediation* in the countries of operation through innovative financial products to reach under-served market segments and strengthen competition and market effectiveness in the financial sector.

2.2. PROPOSED RESEARCH METHODS

Presented in this article investigation was implemented based on such research methods as: documentary method, analogy and grouping of quantitative and qualitative data method, graphical method, method of synthesis and comparative analysis method. Analyses is found on the data obtained from European Commission, Cambridge Centre for Alternative Finance, KPMG investigations, Reports elaborated by the Organization for SMEs Sector Development (ODIMM), National Bank of Moldova (NBM), National Bureau of Statistics of the Republic of Moldova (NBS), National Commission for Financial Markets of the Republic of Moldova (NCFM) etc.

2.3. RESEARCH OF EMPIRICAL ASPECTS

In the Europe Union SMEs form the backbone of the economy. In 2015, more than 23 million SMEs, about 98% of all European non-financial enterprises, employed 90 million people, created around 85% of new jobs and generated USD 3.9 trillion in value added that is three fifths of EU value added in the non-financial sector and is almost 9% higher than in 2008 (European Commission (2016)). Such high SMEs rate of development in the EU in contrast to the worldwide practice can be mainly explained by the introduction of the numerous initiatives aimed at ensuring of SMEs possibility to attract enough capital for their expanding and growth, which were made by the EU public authorities and financial market regulators, as result EU SMEs, have received the opportunity to attract capital through a broad spectrum of financial instruments, using several of them at a time and at a low level of cost (Figure 1).

Bank financing (overdrafts and loans) is traditional external source of finance for EU SMEs, that consists 75-80%, compared to 25% in the USA. But, at the same time, specific challenges limit traditional bank lending to SMEs. These are largely related to the greater difficulties that lenders encounter in assessing and monitoring SMEs relative to large firms, due to the asymmetric information as a more serious problem in SMEs than in larger firms (OECD (2016)).

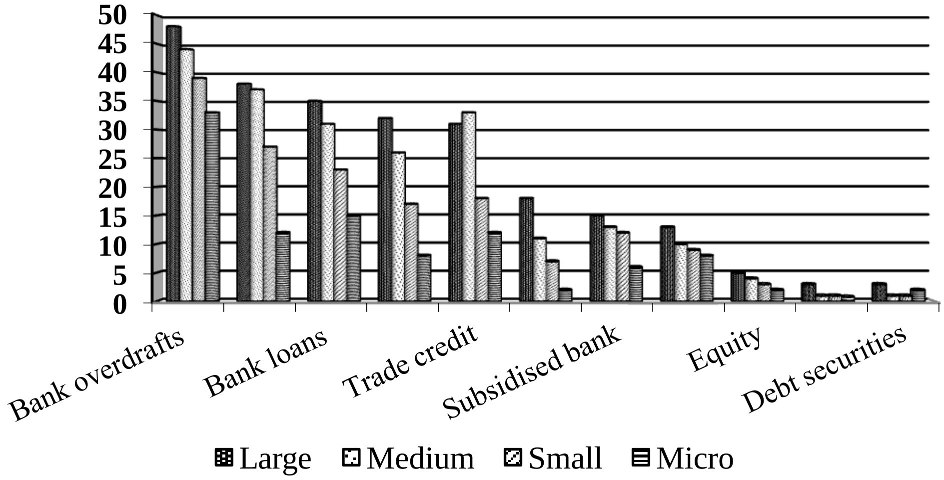

Figure no 1. The share of firms, used particular sources of finance in the EU28, %
(*Source*: elaborated by the author based on EBA, 2016)

Analysis demonstrates, that there are some cross-country differences in the financing of EU SMEs (table 1).

Table 1
The share of SMEs used in EU countries particular sources of financing, %

Country	Bank loan	Credit lines	Leasing	Trade credit	Other loans	Grants	Equity capital	Internal funds	SMEs, with problems in financing
Germany	48	52	59	14	27	30	13	25	6
France	66	54	52	26	15	30	21	32	11
Italy	55	26	8	52	13	52	2	28	11
Hungary	31	35	38	14	18	39	2	26	8
Czech Republic	42	49	48	16	18	34	2	23	8
Poland	43	57	59	44	17	31	4	22	8
Romania	35	59	51	35	35	27	14	31	9
Bulgaria	44	61	45	25	27	26	3	36	10
Latvia	39	43	45	18	31	21	44	20	11
Estonia	41	30	55	20	25	20	18	40	6
Lithuania	43	44	50	27	31	21	13	34	12

(Source: elaborated by the author based on https://ec.europa.eu/docsroom/documents/24481)

The cross-country features may be explained by the availability of financing sources for SMEs in each country, but also and by peculiarities of domestic firms business, SMEs life cycle and their financing needs (figure 2).

Analyses of the alternative to *banking loans* and *overdrafts* sources of financing has reveiled, that at the best risk/return proportions are asset-based finance, such as *leasing*, whereby a firm obtains cash, based not on its own credit standing, but on the value that a particular asset generates in the course of its business (OECD (2016)). *Leasing* and *hire-purchase* together are the third most relevant source of finance for SMEs in the Euro Area, used by the 11.6% of micro, 27.1% of small, and 37% of medium enterprises, growing with the firm size.

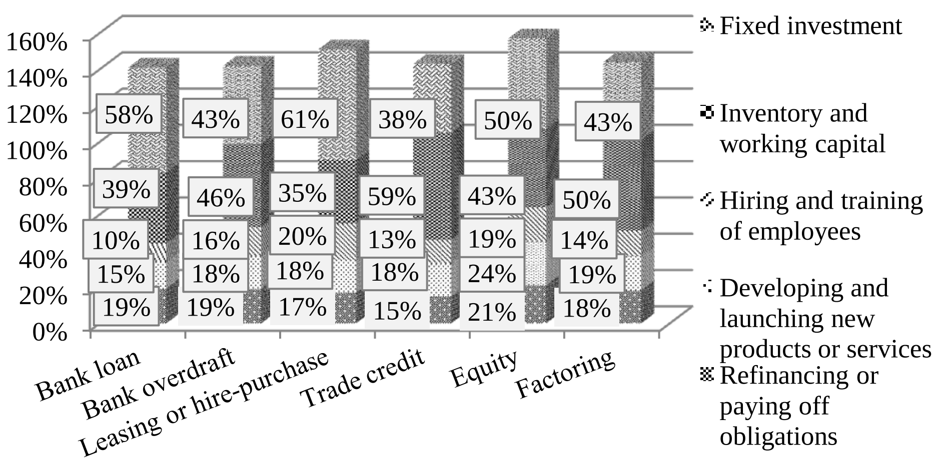

Figure no 2. Purpose of financing by type of finance used, EU area SMEs, %
(*Source*: elaborated by the author based on EIF, 2017)

Austria, Germany are the countries with the highest proportion of SMEs using leasing or hire-purchase, followed by the France, Poland and Romania. Leasing users are characterised by a high degree of investment activities. Leasing are mainly used for investments in property, plant or equipment, the percentage of SMEs who used leasing for fixed investment is higher than the percentage of SMEs who used other types of financing (EIF (2017)). Providers of leasing include commercial banks, but also other credit non-bank organizations or leasing companies. According to the *European Federation of Leasing Company Associations*, in 2016, the leasing firms helped European businesses invest in assets worth more than 273.2 billion EUR. Leasing is also extremely popular amongst EU larger corporates and useful to support the public sector (e.g. leasing to hospitals, schools, etc.).

The next important source for EU SMEs financing is *factoring* that is similar to asset-based lending,depending on the value of an underlying asset rather than on the creditworthiness of the firm, but factoring has some features: it involves exclusively the financing of accounts receivable, rather than a broader range of assets; the underlying asset is sold to the factor at a discount, rather than collateralised; it is a bundle of three financial services, i.e. a financing component, a credit component, and a collections component, as in most cases the borrower outsources to the factor its credit and collection activities (OECD (2016)). The total factoring and commercial finance turnover for EU countries in 2016 reached 1,5 trln. EUR, with an increase of 6,2%. The amount of funds available exceeds 200 bn. EUR, secured by assets valued at 260 bn. EUR, with growth of 20% over 2015. Factoring transactions are high coveraged, with low risks. Across the EU28, the average GDP penetration ratio of the industry is over 10%. The main type of EU factoring is domestic, it amount is 78% of total turnover in 2016. The majority of factoring users are SMEs, which represent 87% of the users (EUF (2017)).

Trade credit is other important source of finance for many SMEs and start-ups, which can substitute or supplement short-term bank lending. This mainly consists of the extension of traditional credit instruments and credit-mitigation tools, such as loans and guarantees, to sustain import and export activities (OECD (2016)). Trade credit is used by 21% of EU SMEs (across all SME size groups).

Securitisation is an instrument for the refinancing of banks and for their portfolio risk management. In the case of SME loan securitisation, a bank extends loans to its SME customers, bundles them in a pool and sells this portfolio to capital market investors through the issuance of notes, backed by the SMEs loan portfolio. Debt securitisation presents some advantages for banks SME lending, due to reducing the bank's exposure to credit risk, which is transferred to the capital market, resulted in allowing banks to transform SMEs loans in their balance sheets into liquidity assets, which can be used to increase banks lending capacity (OECD (2016)). The pre-crisis (before 2008) SME securitisation market was dominated by Spain and Germany, and represented by synthetic securitisations. In 2016 the overall EU securitization market activity is 238 bn. EUR that 10% higher than in 2015. At the same time, SMEs issuance is still remains at low post crisis levels. The overall issued volume of SMEs deals is 19.8 bn. EUR, that by 26% less than in 2015 and by 75% less than in 2007. It resulted in decrease of share of SMEs in overall securitization from 12,6% in 2015 till 8.3% in 2016. The highest share of SMEs deals in overall EU securatisation – 18%, was inregistred in 2012 (EIF (2017)). The main actual impediments to the development of SME securitisation market are: the availability of large volumes of "extraordinary" central banks liquidity assistance, leading institutions in Europe to have less recourse to market funding; the subdued demand for finance from SME borrowers, due to the overall weak macroeconomic scenario in Europe; the relatively negative performance of SME loans in some countries where SME securitisation has taken place. On the other hand, the current condition of persistently low interest rates in the market may facilitate SME securitisation (EBA (2016)).

Covered bonds work similarly to securitised debt, as they are debt securities backed by the cash flows from mortgages or loans. Almost all EU countries have developed specific national regulatory frameworks governing the issuance of covered bonds, based on Capital Requirements Directives (CRD), actual Capital Requirements Regulation 2013 (CRR) etc., limited the range of accepted collateral to debts (OECD (2016)). Outside the national regulatory framework for covered bonds compliant with the UCITS Directive, certain national financial markets have seen the introduction of *structured bonds/notes* issued by credit institutions and backed by SME loans (EBA (2016)).

In 2016, located in Europe investments decreased compared to the 2015 by 2% to 52.5 bn. EUR and number of European companies financed through PE decreased by 7.9% to 5,899. In 2016, total funds raised by Private Equity funds located in Europe increased by 38%, to 73.8 bn. EUR, which demonstrates the highest value since 2008. The 71% of Private Equity funds growth, or 56.3 bn. EUR have raised by funds focused on buyouts. *Business Angels* investment in 2015 increased by 5%, compared to the 2014, to 6.1 bn. EUR, the average amount invested per company increased by 6% to EUR 184k. In the *venture capital* segment, fundraising increased by 17% to 6.4 bn. EUR, it is the highest amount since 2008, the most remarkable increase to 4.7 bn. EUR

(65%) was recorded for venture funds with a focus on both early and later stage investments. The share of ICT companies in total *venture capital* investment activity increased from 33% in the 2007 to 45% in 2016 (EIF (2017)).

During recent years significant increase demonstrate the volume of capital attracted on Fintech alternative sources market, through *crowdfinding equity-*, *debt-*, *reward-* and *donation-based platforms,* which is actively used by the SMEs. Appearance and spreading of *Equity-based* and *Debt-based securities crowdfunding* significantly contribute to the development of the EU capital market and to attracting on it SMEs (figure 3).

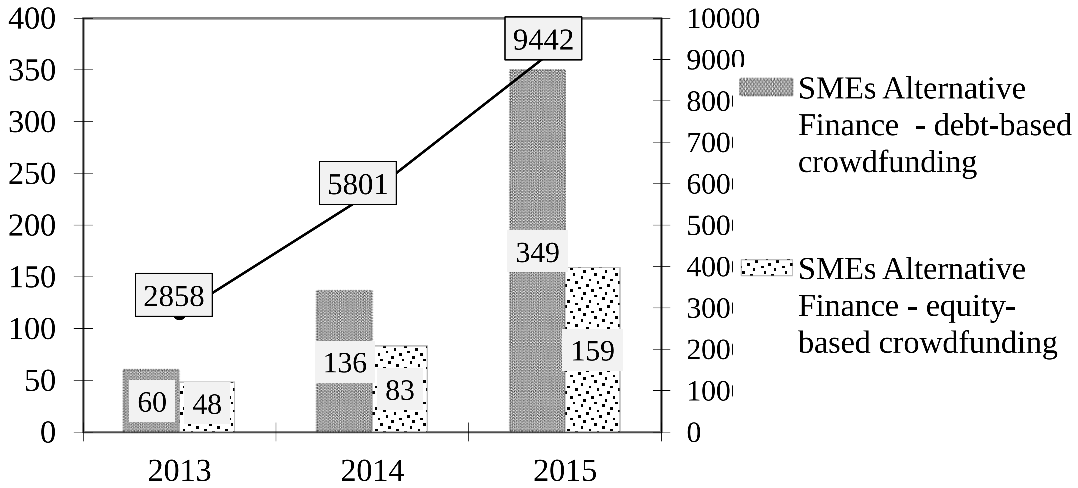

Figure no 3. The volume of attracted by the SMEs capital, using Alternative Finance, and amount of SMEs benefit from Alternative Finance (excl. UK), 2013-2015
(*Source:* elaborated by the author based on Cambridge Centre for Alternative Finance, 2016)

A particular role in this effect is executed by *Debt-based securities crowdfunding*, because it allows to attract capital through allocation of SMEs debt obligations even in countries, where the market of corporate debt securities is not developed.

In the Republic of Moldova, at the end of 2016, 51.6 thousand SMEs, represented about 98% of the total number of registered enterprises, were employed by 31.6 thousand people, or 61.2% of all employees. Due to significant SMEs impact on the national economy and the level of employment, Government of the Republic of Moldova pays much attention to the supporting of the national SMEs development and promotion of the provisions of the *Small Business Act* in Moldova. Thus, in 2012, based on the key points of the OECD report *Republic of Moldova 2011: Fostering SME Development* (OECD (2016)), was elaborated a policy document – *SME Sector Development Strategy 2012-2020*, in which as one of the priority directions was indicated *improvement of access to financing for SMEs;* in 2016 was approved *Law* on *small and medium-sized enterprises*; established the *State programs for SMEs development,* policies facilitating access to finance and attracting capital investment. In 2007 was created the *Organization for SMEs Sector Development* (ODIMM), which coordinates and implements such projects as: *Program on attracting remittances into economy "PARE 1 + 1", National program of Economic Empowerment of Youth, Women in Business Programme, Lifelong Learning Programme*, also ODIMM manages the *Business Consulting and Business Support Center* and the *Loan Guarantee Fund* created and capitalized from State Budget, etc.

Above mentioned measures provided significant positive influence on the gross value added of the Moldovan SMEs, however, in contrast to the practice of EU countries, the evolution of this indicator does not correlate with such indicators as level of employment and national GDP and, it means that in the Republic of Moldova, SMEs do not yet have a decisive influence on economic growth (figure 4). This assumption is confirmed by ODIMM investigation, where is indicated, that the share of Moldovan SMEs in national GDP in 2015 was 30,8%, while in EU countries it was 57% (ODIMM (2017)).

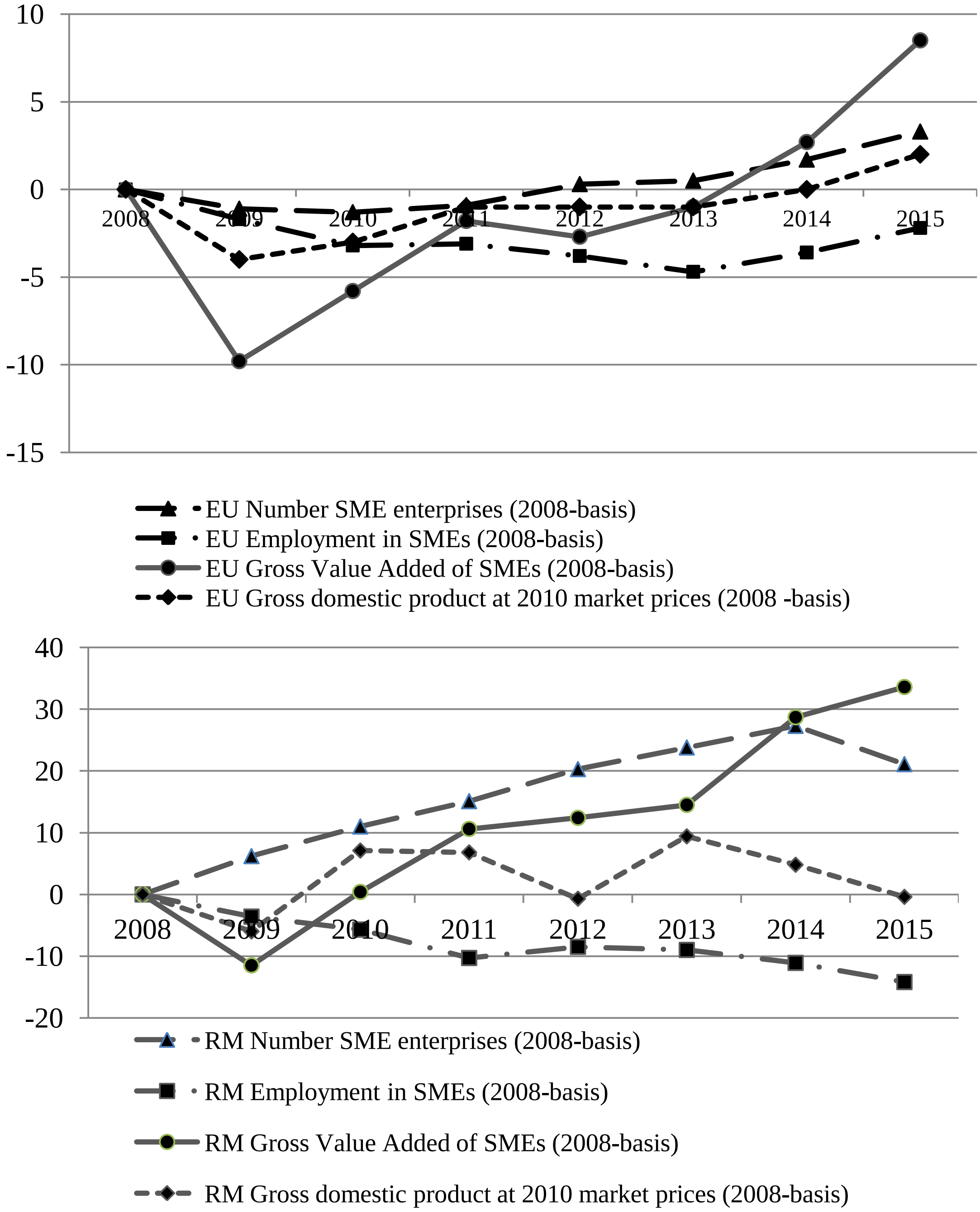

Figure no 4. The evolution of SMEs indicators in EU and Republic of Moldova, %
(*Source:* elaborated by the author based on EU, 2016, ODIMM, 2016)

At the same time, analysis of the data, presented in Annual Report of the National Bank of Moldova, demonstrates that, the positive dynamics of the gross value added of SMEs, as well as SMEs profit increase can be of a short-term nature, due to decline in investment in fixed assets of companies. Thus, investments in long-term tangible assets of companies, in 2015, compared to 2014 decreased by 1%, and, in 2016, compared to 2015 decrease by 6.9% (NBM (2017)). Another concern is the capital structure of SMEs, where the main share (65%) account internal sources, which do not correspond to international practice and significantly limits the development of SMEs (figure 5).

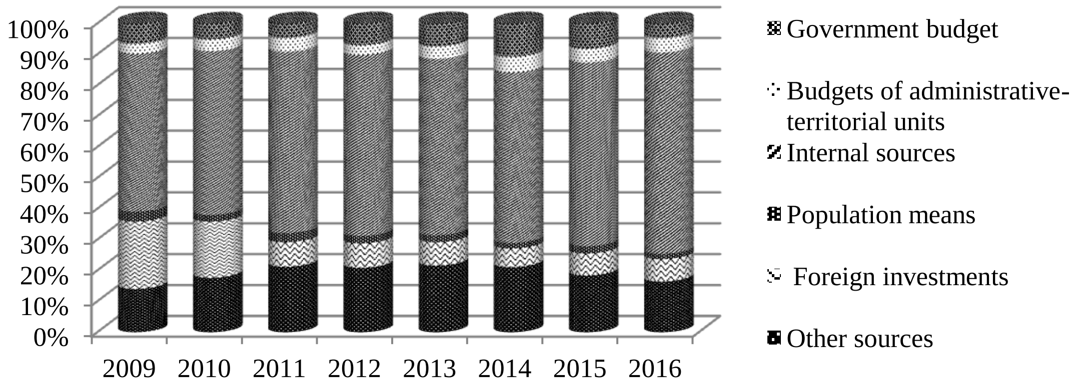

Figure no 5. Sources of SMEs financing in the Republic of Moldova, %
(*Source:* elaborated by the author based on statistica.md)

Analysis demonstrates that despite a decrease in the amount of loans issued by banks by 11.6% in 2016, the significant part of *other sources* of SMEs financing in the Republic of Moldova is represented by *banking loans.* In total, in 2016 economic agents were granted loans in MDL amounting EUR 412 million and in foreign currency loans in the amount of EUR 18 million. It should be noted, however, that some SMEs have difficulties in obtaining a bank loan due to lack of sufficient assets that could serve as collateral, the absence of a favourable credit history, high volatility of the loan interest rate, which only during 2015 – 2016 varied between 6.2 % - 19.5%, etc. (NBM (2017)). To simplify attraction of the borrowed capital by the SMEs may be applied such financial instruments as *overdraft* and *trading credit*, but Moldovan commercial banks do not offer to SMEs these types of credits on available conditions.

Microfinance is the second most important external source of finance for national SMEs. In recent years, in the Republic of Moldova microfinance sector indicators demonstrate stable growth, for example, microfinance organizations' loan portfolio in 2016 increased by 31% compared with 2015 and amounted about EUR 183 mln. (NCFM (2017)), at the same time, the volume of attracted by the SMEs finance using microfinanc*e* is still significantly less than in the EU countries.

Leasing, which is one of the main sources of financing for the EU SMEs, is also used in the Republic of Moldova, but in a much smaller amount. Since 2013, national leasing market has started gradually to recover after the crisis of the branch in 2009 and in 2014, its fixed assets for enterprises and organizations, tripled to EUR 30.5 million, and are slightly less than in 2008 (NBS, 2017).

The *securitization market* in the Republic of Moldova has not been created yet. Actually, in the Republic of Moldova there are no *corporate bond* issues, the *equity capital*, as a source of finance, is used mainly by the large companies. The *venture capital* segment is practically absent, *Business Angels' culture* is not developed.

In general, national SMEs are less familiar with alternative sources of financing, which have in Moldova a great potential. For example, in the Republic of Moldova, *factoring market,* after decreasing in 2014, in 2015 returned to growth, increasing turnover by 23.9% to EUR 16.9 mln., and in 2016 by 0.2% to EUR 17 mln. Taking into consideration that the Republic of Moldova is an importing country, for the national SMEs international trading support *import factoring* would be quite convenient, *reverse factoring* also has perspectives (FCI (2017)).

Crowdfinding, as a source of finance for SMEs practically is not applied. The only functioning crowdfunding platform in the Republic of Moldova is https://guvern24.md/, which is used mostly for attracting financing in charitable and social projects. Through international crowdfunding platform INDIGOGO, beneficiares attract financing for production of some cartoons and movies and largely, for charitable and social projects.

3. CONCLUSIONS

Insufficient financial resources, due to the absence on the financial market of the Republic of Moldova of the most of alternative financial instruments facilitated to the attraction of capital by the EU SMEs is one of the important problems, preventing the development of SMEs in the Republic of Moldova and giving them the same significant influence on national economic growth, as EU SMEs. In order to eliminate this problem, the main directions for the financial market regulators activity should be: modernization of the national leasing, microfinance and other nonbanking credit instruments legislation; support the appearance on the national financial market of broad range of institutional investors e.g. investment funds, private pension funds etc.; stimulation of providing by the banks such financial services as *overdraft, trading crediting* and creation of *securitization market;* development of the *leasing, microfinance* and *factoring* markets; perfection of the credit organizations credit risk management, taking into consideration the peculiarities of national SMEs activities, ensuring market transparency, in particular, the creation of a single database, available for all its participants on the services offered by banking and non-banking institutions for lending, including: credit conditions, commission fees, interest rates etc.; increase the financial literacy of entrepreneurs; modernization of *crowdfunding* platform, encourage *P2P business lending* and *Equity-based crowdfunding* with perspectives of Moldavian SMEs attraction on the capital market.

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