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Financial support for the development of SMEs in the Slovak Republic

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Abstract

The healthy economics and functional business environment are inconceivable without the participation of small- and medium-sized companies. Their functioning is a basis of the economic and social development of country's regions because they influence a growth of the living standard of inhabitants and decrease the unemployment in Slovakia. The development of small- and medium-sized companies is affected by the European Union, especially from the aspect of the creation of the convenient business environment which is restricted by the legislature valid in Slovak conditions. However, the small- and medium-sized companies are faced by problems having impact on their development. The problem areas are pointed out and solved by authors of the paper who also analyse the present situation in the business environment in Slovakia.

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Keywords: business area; development of small- and medium-sized companies; instruments of the European Union; business alliance in Slovakia; risk capital.

Introduction

In every country, the stable and successful market economics is based on the segment of the business sphere represented by small- and medium-sized enterprises (SMEs). These companies are an essential component of the economic and social development of country's regions. They represent the main source of the living standard of inhabitants and principally influence the unemployment reduction in the country. The SMEs have an important role in the competitive ability and dynamics of the European economy.

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In the Slovak Republic, the above-mentioned companies started to develop actively at the beginning of 90s in the twentieth century in conditions of the deep market changes and social-economic transformations. The structure of the economic activity of SMEs in Slovakia comprises primarily the wholesale and retail trade, repair of motor cars (30 %) and industrial production (10%) aimed mainly at wood and paper products, printing, production of metals and metal constructions, foods and drinks, rubber and plastic products, textile, clothing, leather and leather products, repair and construction of machines and equipment's, and besides the listed branches also legal and accounting services (Statistical Office of the Slovak, Republic, 2013).

However, SMEs in Slovakia are faced in practice with many problems which negatively affect their activity and limit their sustainable development. The European Union (EU) makes every effort to support the business and suitable business environment for small companies in order they could realize their potential growth.

1. Analysis of the current state of company development in Slovakia

The state's ability to achieve a sustainable growth on the medium- and long-range horizon depends on many factors, one of which is the sustainable development of business subjects.

Both the economic crisis and the long-term economic recession, which affected also the Slovak Republic, have caused serious problems associated with a bankruptcy of a great number of companies. At present, in the Slovak Republic there exists a growing number of companies which have found themselves in the complicated financial situation leading to the inability to carry out their payment obligations in time. This is evident from the rising number of bankruptcies proclaimed by regional and district courts of the Slovak Republic and documented in the illustrated Fig. 1.

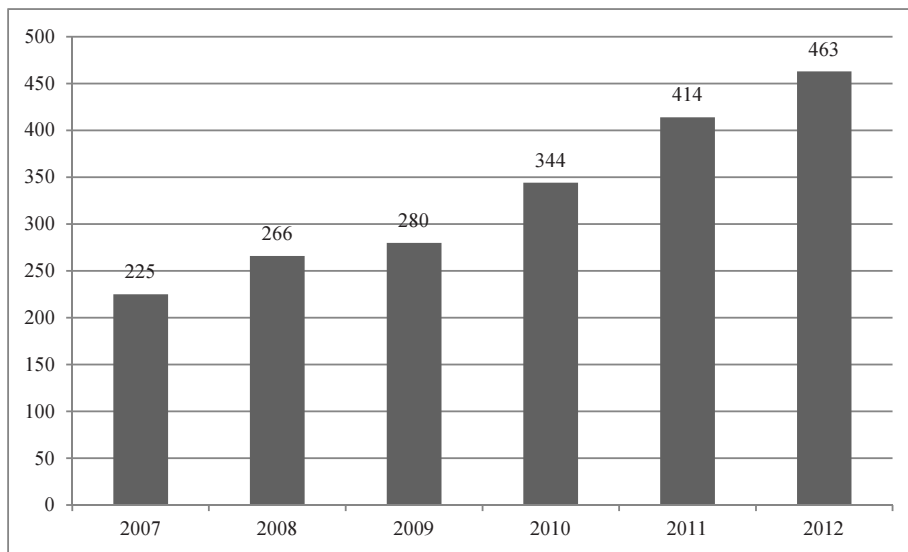


Fig. 1. The number of bankruptcies proclaimed by regional and district courts of the Slovak Republic for the period of 2007–2012

A growth of the number of insolvent companies results in the secondary, quickly spreading insolvency and represents a danger for a great number of companies.

The problem of insolvency has a great influence on the financial situation in companies and on the slowing down of their development, and finally on their existence. The main causes of the company insolvency in the Slovak Republic are mainly:

- decline of sales,
- enhancing and quickly spreading secondary insolvency,
- small reserves for unexpected events,

- pressure on the price reduction,
- lower accessibility of credits in bank institutions,
- high taxes and payroll deductions,
- insufficient level of the own management,
- insufficient level of the management of commitments and debts.

According to monitoring the business environment carried out by the Business Alliance of Slovakia (PAS, 2013) one of the main consequences of its deterioration resulting from the inhibited development of SMEs is the insufficient accessibility of financial sources, which is confirmed also by many Slovak entrepreneurs (55%).

The fundamental condition of the small and medium business development is the existence of the suitable business environment which stimulates the business activity and makes assumptions for the adoption of business decisions in conditions of the positive or negative risks favourable. The business environment is created by the legislative, tax, credit and customs policy, currency regulation, information system, financial services, education, qualification adaptability of the management and labour forces, and also by the functional system of development of SMEs.

The reason of the retarded development of the small and medium business activity in Slovakia are deteriorated business conditions which are regularly monitored by the Business Alliance of Slovakia (PAS, 2013) by means of the business environment index. The tendencies of changes which occurred in the business environment index in the years of 2007–2013 are shown in Fig. 2.

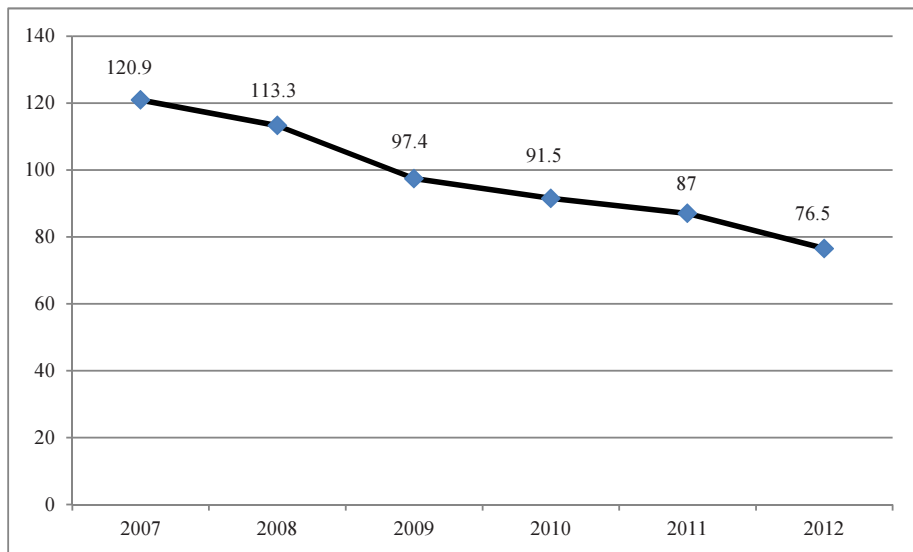


Fig. 2. Development trends in the business environment index in 2007–2012

The research carried out by BAS has shown that one of the main reasons of the deteriorated business environment slowing down the small and medium business development is, according to Slovak entrepreneurs, a worse access to financial sources. The question: “Why the access to financial sources has been worsened” was answered by respondents that it was caused by the following facts:

- costs for the acquisition of finances are higher (77% of respondents),
- credits have become inaccessible (16% of respondents),
- investment activities will have to be reduced owing to inaccessible credits (12 % of respondents).

In 2012, some law changes in the financial sector of Slovakia (e.g. an increase of the obligatory payments to the State Bank Stabilization Fund) came into force, which influenced, to a certain extent, the bank sector policy in the sphere of crediting. In that period the growth of crediting was considerably retarded in all companies, especially in small and medium ones. Although the bank products enjoy nowadays a great interest from the side of SMEs, the

bank sector is cautious and a lot of banks have made the requirements for the acquisition of new credits for SMEs stricter.

In the years of 2000–2011 the conditions for a provision of credits to SMEs operating in Slovakia were specified in greater detail. The dynamics of the development of the volume of crediting the SMEs is indicated in Fig. 3.

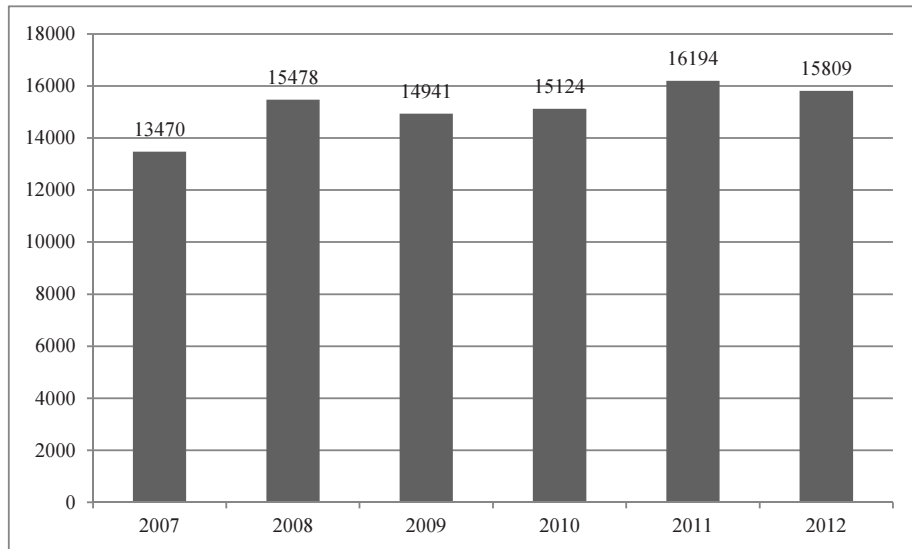


Fig. 3. The volume of loans to SMEs in 2007–2012, in million €

The unfulfilled requirements of SMCs for crediting their investment activity in 2011 achieved 25%, which is by 15 % more than an average in the EU. The increment of unfulfilled requirements was observed already in 2010 when their proportional share achieved 19%.

The monitoring of the situation in the sphere of financing the SMEs has shown an increased number of the Slovak companies reporting a lesser interest of banks to credit SMEs. It is worth of mentioning that in 2011 the price of credits for SMEs in Slovakia was on average by 25% higher than that for large companies; however, in 2010 this difference represented only 20%.

One of the serious problems of SMEs is a lack of the own sources necessary for financing their business, whether it is starting or already existing. In Slovakia, the risk capital is not sufficiently developed and arouses a certain mistrust of potential entrepreneurs considering their business activity limited.

The analysis of the European Venture Capital Association (EVCA, 2009) reveals that the problems concerned with a venture capital persist because of the low level of development, the small number of chances, and due to relatively low revenues. The research results have shown that there exist three basic problems in the European market of the risk capital, namely:

- 1) the non-existing homogeneity in languages, in culture and in consumer's preferences in all European markets which are limiting a large-scale business activity;
- 2) the small, although slightly improving possibilities allowing the output from the investment through IPO (Initial Public Offering) and direct sales;
- 3) the small number of institutional investors depositing their money in funds of the risk capital, and also the relatively weakly developed conditions for a rapid capital mobilization. In addition, the discussions revealed some problems associated with the potential chances (at a level of the preparation) of risk capitalists and entrepreneurs.

The public is not sufficiently informed about possibilities of the risk capital. Thus in 2011, the investor from the Club of Business Angels of Slovakia was shown interest by 118 clients and in 2012 by 71 clients. From among all

persons who had an interest in the investor in the years of 2011 and 2012 only 27 entrepreneurs negotiated with investors about the investment (Business Angels, 2013).

Investors render financial sources mainly by an exchange for a part of the proprietary share in the company. They enter the company not only with their money but often in the position of managers. They leave it after the backward sale of their share to the initial owner, after the sale to further investor, or to a buyer after completion of the targeted period of the investment representing in Slovakia approximately five to seven years.

However, not every company is suitable for the employment of the risk capital. This capital must have the proper structure and mainly the promising prospects. An object of interest are not only innovative companies as a potential of the significant growth in the future, but also starting SMEs having the unique ideas but, on the other hand, a lack of financial sources for the implementation of their business intentions.

The Slovak legal regulations do not enable one to normally employ all instruments of the risk investments. A barrier to the entry of such capital is also the insufficient enforcement of justified claims and the inconvenient capital or proprietary structure of companies. The companies do not often possess any property which could be invested in the project. Moreover, there still exist many entrepreneurs who have a negative attitude to the incorporation of a new partner or shareholder into the company, or they are against the future sale of their shares deposited in the company to a new, stronger investor. At present, in various countries of the world there are ongoing projects which are directed to a risk capital and used as an external source of financing the companies. For the Slovak SMEs they would be suitable mainly from the financial aspect and company management.

In this connection the function of other financial sources of SMEs is becoming more and more important along with the utilization of different financial instruments provided by the EU. The EU provides SMEs the numerous possibilities of financing the new business, ensures demanded grants and credits, financing of the particular projects, gives guaranties and another assistance.

2. Instruments of the European Union for a support of small- and medium-sized companies

EU funds are financial instruments through which blurred the differences between the Member States of the European Union. EU funds allow reallocation economically stronger partner for the development of weaker states and bring them closer to the developed European countries. The funds are used primarily to ensure increased performance of countries in various fields of sustainable economic growth, living standards and reducing regional disparities. The essential feature of EU funds help the weaker partner, thus profiting subsequently developed EU as a whole. At present, Slovakia is in the 2007–2013 period, for which the European Union approved Slovakia support nearly 11.5 billion. Eur.

In order to establish or extend the company it is necessary to have an access to finances. The EU gives small companies the possibilities of financing in various forms such as grants, loans, financing of the particular projects, guarantees, and other forms. Financial programmes and instruments include, for example, the European Portal for Small Entrepreneurs (2013).

Grants, funds and EU programmes (challenges for the submission of proposals), within which the European commission provides the direct financial contributions for projects in the form of grants, or provides contributions to organizations supporting the EU interests, or renders subsidies to organizations participating in the application of the EU programmes and policy. Of course, a direct access to all straight challenges for the submission of proposals published by the commission is possible. There exist many proposed programmes which are specific for SMCs.

European Progress Microfinance Facility (EPMF) is the instrument of micro-financing which has been functioning since 2010 and enables one to provide the micro-credits mainly to people who lost their jobs and want to found their own firm. The instrument permits the better accessibility of micro-credits, i.e. those representing the amount which is lower than 25 000 € determined for the establishment or development of the small company.

Risk Sharing Instrument (RSI) is a joint pilot guarantee programme of the European Investment Fund, European Investment Bank, and European Commission (General headquarters for research and innovation), the aim of which is to improve the approach of SMEs to the debt financing with a support of their projects in the sphere of research and innovations.

The programme *COSME* (Programme for the competitive ability of companies and SMEs for the years of 2014–2020) is designed to support the entrepreneurs and SMEs in the phase of the establishment of companies, when there is an access to finances, or in the case of their penetration into foreign markets. The support is given also to various bodies to improve the entrepreneurial environment and to facilitate the economic growth of EU.

Horizon 2020 is the frame programme for research and innovations (2014–2020), the role of which is to support the companies in their policy to invest in the research and innovations and thus to achieve a growth of the competitiveness.

The *Financial instrument of SME EU/EBOR* is applied in EU countries of the Central and Eastern Europe (Bulgaria, Czech Republic, Estonia, Hungary, Lithuania, Latvia, Poland, Romania, Slovakia, Slovenia) for the purpose of financing the small firms through loans to local banks, leasing companies and investments in the private (own) capital.

The *joint initiative for a support of micro-financial institutions in Europe – JASMINE* helps the small companies to start their business through micro-credits, and also supports the development of non-bank micro-financial institutions.

In the recent time, i.e. on the 30th of June, 2013 the company JEREMIE launched the third open competition, the so-called “Challenge for submitting the application” for a portfolio credit financial instrument of the borne risk. The challenge is valid for financial mediators who provide credits to SMEs. It will be the portfolio credit financial instrument, the allocation of which should enable one to create a new portfolio amounting to 26.6 mil. €.

Irrespective of the number of financial instruments allowing an access to external financial sources, the indicators characterizing the availability of the Slovak SMEs to financing reveal the worrying situation. In accordance with the monitoring of the Business Alliance of Slovakia (PAS, 2013) the question “in which manner has the availability of financial sources been deteriorated” was answered by respondents in the following way:

- expenses for their acquisition have increased – 77% of respondents,
- credits have become for us inaccessible – 16% of respondents,
- investment activity will have to be abolished due to inaccessible credits – 12% of respondents.

In 2012, a growth of the credit volumes of all companies, especially of SMEs slowed down. Although the demand for bank products increased, the banks became precautious in rendering credits and most of them even stricter in fulfilling the requirements for a provision of new credits.

In Slovakia, the market of risk (venture) capital is not well developed, which limits the capital accessibility for highly-innovative companies experiencing the early phase of their development. Since the risk capital represents a medium- and long-term external source of financing, this should be better comprehended by Slovak entrepreneurs and SMEs. The investment of this type of capital can be carried out either in the form of direct investments in the own assets of companies or in the form of various types of complementary credits, or in the form of their combination. Funding venture capital companies in Slovakia are illustrated in the Table 1.

Table 1. Venture capital in 2007–2011, in millions €. *Source:* www.cia.gov

Stage	2007	2008	2009	2010	2011
Seed Stage	0.22	3.84	2.1	1.99	0.87
Start-up Stage	0.11	0.45	3.86	8.95	4.8
Expansion stage	6.7	3.7	8.4	0.46	5.8
Spolu	7.03	7.99	14.36	11.4	11.47

In the existing companies the primary question is the capital enhancement and in the newly developing companies it is a joint foundation of the firm with a monetary deposit from the side of the company of the risk capital. The duration of a joint participation in the company is stipulated individually, within the range of one to five years. The companies of the risk capital can provide the operational or investment credits of the short- or medium-term character to SMEs, in which they have already taken a joint participation, the maximum time period of the maturity of credits being five years. In principle, investors provide financial sources mainly in the form of an exchange for a proprietary share of the company. They enter into it not only with their money, but in some cases also in the position of managers. They leave it by a return sale of their share to the original owner, by a sale to the

next investor, or to another person after finishing the target period of the investment, which is approximately five to seven years.

The Slovak legal regulations still do not enable the employment of all risk-capital investments. A barrier to the entry of such a capital is, besides others, the insufficient enforcement of justified claims and also the wrong capital or proprietary structure of companies. SMEs do not often have any property which could be put into a project. Nowadays many entrepreneurs still have a negative attitude to the entry of a new partner or shareholder into the company, or they are against the future sale of their share in the company to a new and stronger investor.

In this situation, the sustainable development of SMEs in Slovakia needs above all a support of the small and medium business given by a state.

3. State policy of supporting the development of the small and medium business

In Slovakia, the forms of the state financial support provided to small- and medium-sized companies can be divided into two groups:

1. direct forms – grants, additional charges, export premiums, grants and financial means from the European funds, and other forms,
2. indirect forms – advantageous credits, provision of financial guarantees, reduction of interests, tax allowances, consultations and a supply of information, state orders, and other forms.

At present there exists a wide network of organizations which help to develop the small business not only at a level of the state and regions but also at a level of individual towns. A guarantor for the coordination of programmes worked out to help the small and medium business is the Ministry of Economy of the Slovak Republic. In Slovakia, the most important institutions supporting the small business are: Ministry of Economy, Ministry of Finance, Slovak Guarantee and Development Bank, EXIM Bank, Ministry of Labour, Social Affairs and Family, National Agency for Development of the Small and Medium Business, Funds of the Risk Capital, National Website for the Small and Medium Business, etc. SME funding from the state shown in the Table 2.

Table 2 Financial support for SMEs from the state, in millions €. *Source:* www.cia.gov

	2007	2008	2009	2010	2011
The volume of government guarantees for loans to SMEs	82	99	81	70	84
Direct government loans to SMEs	117	160	139	147	168

The Ministry of Economy of the Slovak Republic is a central organ which coordinates a support of the small and medium business in Slovakia and realizes a series of programmes directed at the assistance to SMEs. In particular, in 2011 the financial support rendered within the programme dealing with “the competitive ability and economic growth” and associated with a development of the industrial production, energetic, tourism, etc. exceeded the value of 143 mil. € (Report, 2011). A support given to SMCs is implemented by the Ministry of Economy through funds and a great number of agencies as, for example, the Slovak Innovation and Energetic Agency, Slovak Agency for Development of Investments and Business (SARIO), and through other institutions.

The Ministry of Finance of the Slovak Republic provides a support via the Slovak Guarantee and Development Bank (SGDB) and the export-import EXIM Bank. For example, in 2011 a support was provided to SMEs realizing an export through the export-import bank when the export was on going through the bank and insurance operations in the value of 78 mil. €, and through the insurance operations in the value of 219.6 mil.€ (Report, 2011).

The Ministry of Labour, Social Affairs and Family of the Slovak Republic gives assistance to SMEs in conformity with a plan of the state support of employment rendered to the population. For example, in 2011 the support provided to SMEs represented the value of 10.52 mil. € within the joint financing from the European social fund (Report, 2011).

The National Agency for Development of the Small and Medium Business (NADSMB) was established to coordinate all types of the assistance given to small and medium entrepreneurs inclusive of the financial assistance provided at the international, intrastate and regional level. One of the forms of the assistance offered to small companies is the establishment of technological and commercial incubators which are an important part of the help

rendered to starting SMEs. Moreover, the NADSMB provides its help to small entrepreneurs through the regional consultation-information centres offering the whole complex of services for starting and other entrepreneurs. The help of this type includes: consultations before the elaboration of business plans, a supply of information on the business conditions in regions, legal, financial and tax consultations and also the provision of information about the labour market, etc. (NADSME, 2013).

The present system of the assistance provided to SMEs is not transparent. It is characterized by various interconnections and also by temporal and professional requirements for ensuring the documents necessary at the stage of the preparation and submission of an application for the financial support. The majority of SMCs cannot prepare the necessary documents and do not have the possibility to order the preparation of the respective documents in external firms. For this reason they do not often ask for this type of the financial support.

4. Conclusion

In 2011, the European Commission published the document entitled “Review of the Small Business Act for Europe” which reflects aims rooted in the EU strategy “Europe-2020”. In this review the central position in the formation of the European social market economics based on three priorities (EUROPE – 2020, 2013) is attributed to small- and medium-sized companies. The priorities involve:

- formation of the economics based on the utilization of knowledge and innovations;
- support of the ecological and competitive economics;
- insurance of the social and territorial solidarity of the population.

The creation of the business environment corresponding to the above-indicated priorities is an important factor in the development of SMEs. The simplification of laws, their transparency, reduction of the tax and administrative load, completion of building the infrastructure, support and improvement of the accessibility of financial sources are precautions which should help to sustain the development of SMEs in the Slovak Republic.

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