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Analysis on Sources of Finance and Difficulties in Raising Finance for Small to Medium-Sized Companies

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Abstract
This paper tries to present what sources of finance are available for small to medium-sized companies and explain why they sometimes face difficulties in raising finance.

Key words: SMEs; Sources of finance; Raising finance; Small to medium-sized companies

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INTRODUCTION
In the past decades, small and medium enterprises (SMEs) have been paid increasing academic attention that resource limitations such as gaining finance, information, and management experience are more difficult to enter these SMEs than large companies. But SMEs play a basic role in the advancement of economy (EI-Said, AI-Said, & Zaki, 2015). To be more specific, SME could not only influence employment system and poverty alleviation, but is also an important factor to influence gross domestic product (Khan, 2015). Khan said that a great number of SMEs which started relatively late and were lack of experience would face some challenges that they could not raise funds at a cheaper cost (Khan, 2015). There are different kinds of sources of finance, so SMEs should choose these sources of finance which are suitable for the situation, but there would also be some obstacles on their developing ways.

This essay will firstly introduce SMEs and then focus on three different sources of finance. The last part is the reason why SMEs will face difficulties when raising finance. Bank loan and venture capital will be analyzed by comparing the differences of them. Leasing will be analyzed by presenting its function. This article will be divided into several parts: introduction, introduction of SMEs, different sources of finance for SMEs, the difficulties that SMEs face, and summary of this article.

1. DEFINITION OF SMES
With the development of economy, small and medium enterprises (SMEs) play an important role in different areas. They could enhance competition, increase technology and be beneficial to regional trade. The major function of SMEs is that they could decrease job crisis, and they has been tested to be very flexible in various economies (Kostovski & Poposka, 2014). SMEs are considered to be the core of the development for competitive markets. It is shown that SMEs occupy 95% of global business and make great contribution to GDP which account for 40% (Kumar & Sosnoski, 2011). For instance, SMEs take up the major share of 99.7% in the whole Romanian companies, and 65.7% of the total Romanian workers work in SMEs (Bărbulescu, Hapenciuc, Moroşan, & Costea, 2015).

2. DIFFERENT SOURCES OF FINANCE FOR SMES
As is shown in the previous section, SMEs have become an indispensible part of contemporary global economic world. Additionally, source of finance would be a defining and crucial factor for SMEs whether they could develop well in their future ways. With the increasing number of SMEs, more and more experts and scholars in some areas have paid much attention to SMEs (Cambra-

fierro & Centeno, 2012). So there are many different kinds of sources of finance. Financing is one of the most significant factors that every owner of the enterprises should focus on. In other word, the growth of SMEs would be in danger if they don't choose suitable source of finance (Kostovski & Poposka, 2014).

3. BANK LOAN AND VENTURE CAPITAL

Both bank loan and venture capital are very important sources of finance which are used in many SMEs. It is easy to understand these two sources of finance. Bank loan includes short-term bank loans, medium term bank loans and other kinds of bank loans. Bank loan is also an important part of bank operations, because loans occupy over two-thirds of bank assets (Stanhouse & Stock, 2008).

Venture capital could also be an optional source of finance during the developing period when SMEs fight against international financial crisis in international markets. To be specific, venture capital is a type of private venture. And it focuses on initial stage, and it would prefer to new products. The investor of venture capital is someone who has a large number of available assets (Vasilescu & Popa, 2011). Generally speaking, the venture capital for SMEs is that investor invests money to these enterprises.

Table 1
Bank Loan vs. Venture Capital

	Bank loan	VC
Form of financing	Loan	Investment
Reduction of the influence of the owner	No	Yes
Risk aversion	+	-
Demanded interest	Around 10%	More than 40%
Finance decisions based on	Guaranty for returning the loan	Opportunity for extra profit
Directly involved in the company's activities	No	Yes
Guaranty for returning the money	Yes	No
Direct interest for the company to be more successful	No	Yes

Note. Based on the empirical research.

There are also some differences between these two sources of finance. As can be seen from the Table 1, bank loan is one type of loan but venture capital is in the form of investment. It means that venture capital would decrease the influence of the initial owner, because when venture capital is invested in the enterprise, it would gain the profits of the company. On the other hand, when the money was invested in the company, venture capital could not return the invested money, the only thing they could do is to take part in the management of company in order to ensure the security of the invested money. Moreover, bank just focus on the collateral guaranty that company could show or offer, however venture capital has chance to gain more profits, so the investor would want the company to be successful. In other word, venture capital would like to invest more money, and expecting more money to return. From Table 1, we could clearly see the main difference is that bank would just ask for approximately 10% interest, but venture capital would like to obtain more than 40% interest (Kostovski & Poposka, 2014). So it would cause difficulties when SMEs try to develop during their growth period.

In general, these two sources of finance for SMEs are very different whether their forms or their purposes. However both of them would face difficulties when they try to enter SMEs. So there would be an increasing risk when venture capital enters SMEs because of the high transaction costs and low incomes. Another reason is that there is no regular venture capital system, for instance, a large number of venture capital is so fragmented that many SMEs could not receive capital supply timely in European (Popovici, 2014).

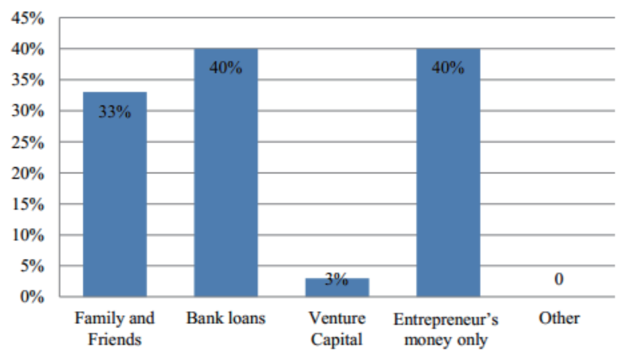

Figure 1
Source of Financing Used by SMEs
Note. Based on the empirical research.

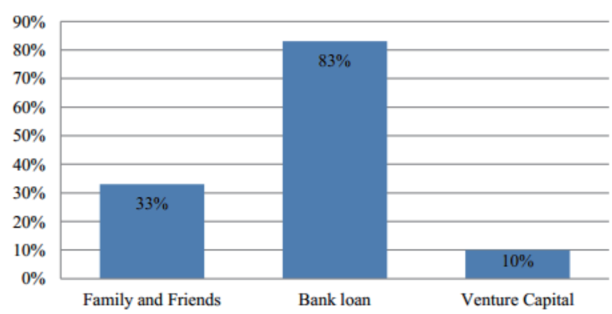

Figure 2
Sources of SMEs' Financing that are Likely to be Used in the Future
Note. Based on the empirical research.

These two graphs (Figure 1 and Figure 2), which indicate that different sources of finance used by SMEs. From Figure 1 we could see that bank loan and entrepreneurs' money only take up 40% and 40% respectively. On the other hand, venture capital occupies only 3% which is the lowest one among others. Moreover, SMEs would keep choosing bank loan as their source of finance, and only 10% of SMEs would choose venture capital in the future. Actually some companies would not choose these two sources of finance.

4. LEASING

Leasing is a very important source of finance which is used by many SMEs. Enterprise which use this source for financing show an increasing trend and the owners of enterprises could summarize the importance and development potential of leasing in Macedonian conditions (Boskovska, 2011). Some SMEs failed in the developing period because the owners of them spent much money on buying equipment or some projects were over their budget. In this situation, leasing is really a practicable source of finance which could relieve SMEs' fund shortage problems. These small companies could only lease equipment instead of purchasing it. So leasing could not only maintain cash flow but also improve technology. Furthermore, leasing would bring benefits in the last quarter of the year. During the whole year, leasing offers 100% finance support, and every month's payment and some "soft cost" are under control. Some SMEs could easily adapt to the changes in technology and business climate, because there would be more opportunities for SMEs to consider the useful life of equipment and more options for SMEs to replace equipment (Hoffman, 2006).

Leasing is really a suitable source of finance, and it is considered to be the symbol that economy is in good shape. If the increase of leasing market could be confirmed, we would consider that economic market is increasing at the same time. (Bărbulescu, Hapenciuc, Moroşan, & Costea, 2015).

5. THE DIFFICULTIES THAT SMES FACE WHEN USING THESE SOURCE OF FINANCE

5.1 There is No Related Law and Institution

Economic market is a huge and complex system, almost every country has their own laws and institutions to limit and manage it. If there is some serious problem appearing or some fatal danger hiding, it would bring great changes to the whole world, such as financial crisis, national bankrupt, or government deficits. SMEs are not strange to the world economy. Some regulations are constituted by the government to provide SMEs a more comfortable space. But many laws and institutions are not complete and mature, many SMEs would face many challenges and they would not be protected by policy and could not enjoy the rights they should have (Zhang & Gao, 2013). Therefore, it is difficult to raise finance.

5.2 The Different Attitude of SMEs and Bank

The reason why SMEs would face difficulties when raising money by bank loans is that these enterprises could not provide acceptable collateral. At the same time, banks show a reserved lending attitude and it forces SMEs to choose other source of finance. This reason is based on bank. And the second reason is argued from these SMEs themselves. The interest rates which is demanded by bank is very high cause many SMEs do not choose bank loan, and it is also the main factor. Another crucial reason is that the process of obtain bank loan is so difficult that many SMEs choose another method to raise finance. (Kostovski & Poposka, 2014)

5.3 Most SMEs Would Not Choose Venture Capital

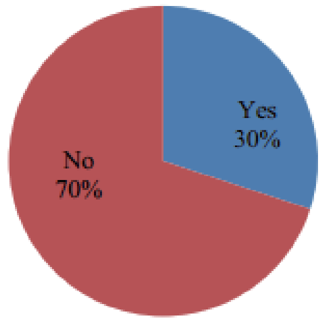

Figure 3
Would You Allow Entrance of VC in Your Company
Note. Based on the empirical research.

From the Figure 3, we could clearly see that most enterprises would not choose venture capital as their company funds. First of all, during the investment, venture capital is full of risk and nondeterminacy. Before investing start-up firms, many factors should be considered, such as the size of venture capital transaction, the size of venture capital and the size of venture capital market. The more aspects are considered, the more difficulties it would face. But all steps are essential because of the imperfectness of venture capital system (Vasilescu & Popa, 2011). As is explained before, most investors would join in the management of the enterprise in order to ensure the security of investment money (Kostovski & Poposka, 2014). Additionally, they would ask for more profits because of their substantial contribution to the company. It would bring hidden trouble to some start-up SMEs, especially some IT firms. Sometimes they would be bound to make changes for making money which is contrary to the original idea.

5.4 Some Internal Factors

In addition to these external factors, there are a lot of internal causes. The reason is that the scale of SMEs is so small that they are lack of experience and credit. For instance, most Chinese SMEs do not have accounting statement, and the survey shows that the credit rating of 60% Chinese SMEs is 3B or under 3B (Zhang & Gao, 2013). SMEs could not raise finance easily. In general, SMEs have many shortages, so they should improve their hard power as far as possible while making money.

CONCLUSION

With the expansion of the SMEs, they have become an indispensable part of financial markets. Because of the rapid development of SMEs, more institutions and individuals pay attention to them. Many different sources of finance which could help SMEs to grow up have been developed. SMEs should take their actual situation into consideration to choose suitable sources of finance to develop. In the future, there will be more kinds of sources appearing. SMEs could choose more than one sources and make reasonable use of them which would increase their competitiveness in finance markets.

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