European Journal of Business and Social Sciences, Vol. 2, No.11 , pp 155-164, **February 2014.** **P.P. 155 - 164**
URL: *http://www.ejbss.com/recent.aspx*
ISSN: 2235 -767X

SMES' ACCESS TO FINANCE: AN OVERVIEW FROM SOUTHERN ITALY

Matteo Rossi
Assistant Professor of Corporate Finance
University of Sannio
Via delle Puglie 82 – 82100 Benevento (ITALY)
Telephone: +39.0824.305780

ABSTRACT

In EU, despite Small and Medium Enterprises (SMEs) have a significant impact to the economy, they haven't adequate attention. Particularly, various researchers have focused their attention on larger and listed firms. This study aims to investigate the access to finance of SME. Access to finance is a key for business start-up, development and growth for SMEs, and they have very different needs and face different challenges with regard to financing compared to large businesses. The lack of equity invested in small firms makes these enterprise more dependent on other sources such as bank lending and other types of financial products. This paper describe the different ways to finance SMEs. The limitations of the paper are the result of its very nature: it is a largely conceptual paper. Empirical research is therefore needed to test and validate the essentially preliminary framework.

Keywords: Financial Choices, Internal Source, External Source, Bank loans, SMEs

1. INTRODUCTION

Small and Medium Enterprises (SMEs) represent a huge portion of the firm tissue of developed countries. Particularly, the 20 million European SMEs play an important role in the European economy. In 2012, they have represented 99.8% of total number of firms, and 66.5% of all European jobs for that year (European Commission, 2013). During 2012, the SME sector as a whole delivered 57.6% of the Gross Value Added (Table 1) generated by the private, non-financial economy in Europe 2012 (Eurostat, 2013). All these data show the importance of these firms, but not always receiving the just attention. <<Empirically, the emphasis on large companies has led us to ignore (or study less than necessary) the rest of the universe: the young and small firms, who do not have access to public markets>> (Zingales, 2000: 1629).

	Micro	Small	Medium	SMEs	Large	Total
Number of Enterprise						
Number	18,783,480	1,349,730	222,628	20,355,839	43,454	20,399,291
%	92.1%	6.6%	1.1%	99.8%	0.2%	100%
Employment						
Number	37,494,458	26,704,352	22,651,906	86,814,717	43,787,013	130,601,730
%	28.7%	20.5%	17.3%	66.5%	33.5%	100%
Value Added at Factor Costs						
Million Euros	1,242,724	1,076,388	1,076,270	3,395,383	2,495,926	5,891,309
%	21.1%	18.3%	18.3%	57.6%	42.4%	100%

Table 1. Firms, Employment and Gross Value Added of SMEs in the EU-27, 2012
Source: Eurostat, 2013

2. FINANCIAL SOURCES FOR FIMRS

The lack of capital is one of the most important obstacle to growth. The management of the capital factor, since the acquisition to the time of its use, will require a decision-making focused on quantitatively and qualitatively capital resources observed both in their origin - sources - and in their destination – uses (Rossi, 2014). Funds can be differ in the different stages in a company's life cycle (Figure 1).

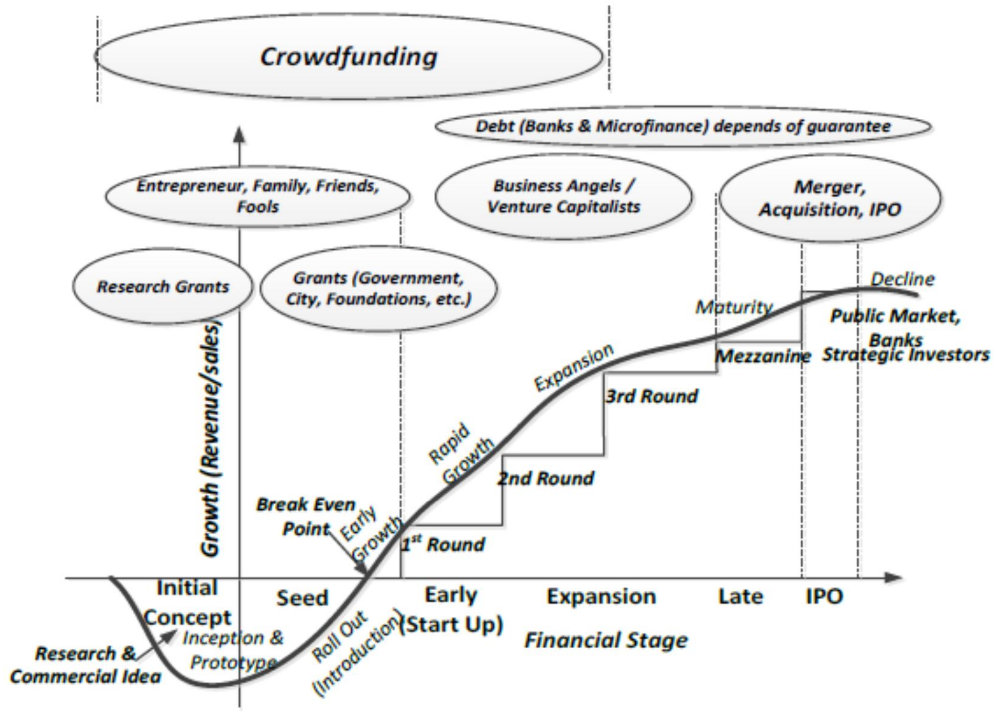

Figure 1. Financing lifecycle
Source: Lasrado, 2013

Seed financing is important to design and develop a business idea before a company has realized the start-up phase. At this phase, family of owner and/or business angels are the main investors of new firm. Start-up financing is used for product development and initial marketing activities. Enterprises may still be in the creation phase or have just started operations and haven't sold their product. At this stage, money are important to realize R&D activities. When the product has taken form, a certain number of Venture Capitalists will join the firm: they want to setting up the firm[98]. In Post-created stage, firm has developed its product and it require more financial resources to begin making and selling it. Firm has not yet generated profits. The step of Expansion-Development is a period of high progression. In this stage capital is used to increase production, to develop new services/products, to finance acquisitions and/or to increase the working capital of the business (Rossi, 2014).

Firms need different capital in different stages of their life. Financial resources can be classified into external sources and internal sources. The internal sources are all financial resource from inside the business, external sources are all financial tools from outside the business (Figure 2).

Internal finance tends to be the cheapest form of finance since a business does not need to pay interest on the money. However, it may not be able to generate the money that firm is looking for, especially for larger uses of finance. There are three internal sources of finance:

- Retained profits,
- Sale of existing assets, and
- Cut down stock levels.

[98] Venture capitalists and business angels have interest to invest firms where growth is expected to be significantly higher than others (Rossi et al., 2011)

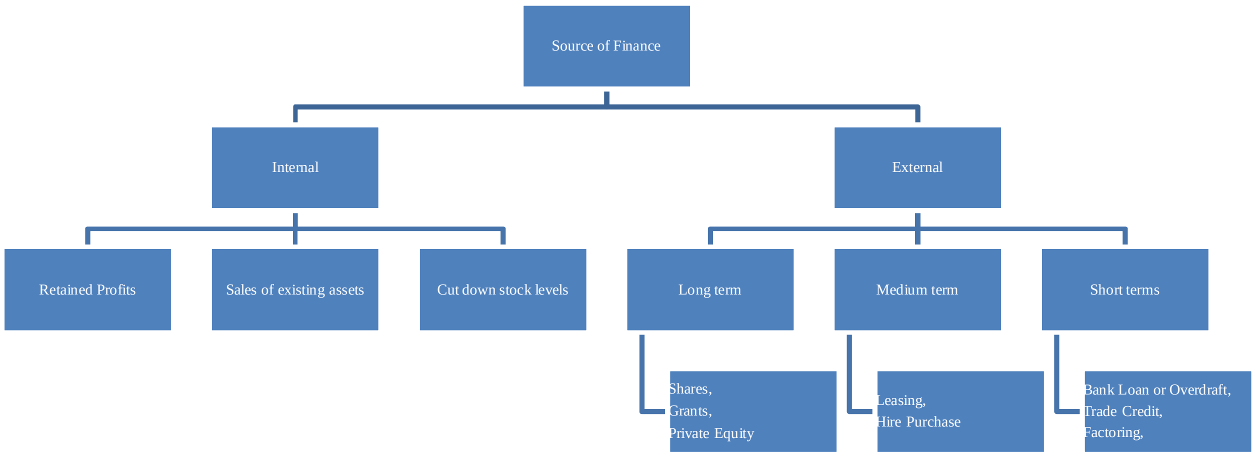

Figure 2. Sources of Finance
Source: authors' calculation

External sources can be divided in long term, medium term, and short term. Short-term financing have a repayments periods of less than one year. Medium-term financing are those with a maturity period of more than one-year but less than 5 years. Long-term financing are those with maturity periods of 5 years and more.

There are a lot external sources of finance:

- Bank Loan or Overdraft,
- Trade Credit,
- Factoring,
- Leasing,
- Hire Purchase,
- Shares,
- Long Term Bank Loans,
- Grants, and
- Private Equity, Venture Capital, Business Angels.

The use of external financial resource is linked to principal disadvantage of internal resource (Table 2).

ADVANTAGE	DISADVANTAGE
Capital available	Expensive: is not tax-deductible
No interest	No increase of capital
Spares credit line	Not as flexible as external financing
No control procedures regarding creditworthiness	Losses are not tax-deductible
No influence of third parties	Limited in volume

Table 2. Advantage and Disadvantage of Internal Sources
Source: author's calculation

In fact, internal resources are limited in volume, and this require external investors. External financing can help jump-start of business, but it also has drawbacks (Table 3).

ADVANTAGE	DISADVANTAGE
Faster Growth	Loss of Ownership
Greater Economies of Scale	Loss of Control
Leveraged Return	Cost
	Cash Flow

Table 3. Advantage and Disadvantage of External Sources
Source: author's calculation

Starting from the seminal papers of Modigliani and Miller (1958, 1963), a lot of financial researches have focus their attention on optimal capital structure. One of the most important researches was conducted by Myers and Majluf (1984). They argue that it exists a hierarchy in the financing funds of firms. Due to informational asymmetries, firms will prefer internal to external capital sources. The limitation of internal resources conduct owners of SMEs to select external capital sources. In this cases, they choose short term debt, because it doesn't reduce managers' operability.

3. ACCESS TO FINANCE FOR ITALIAN SMEs

Starting from the European Commission SME definition, this paper consider a sample of small and medium firms, located in Southern of Italy[99]. This sample has been extracted from AIDA a datebase of Bureau van Dijk, which is a database that contains economic and financial information with up to eight years of history over more than 200,000 Italian firms. Before this analysis, paper analyses the main problem in access to finance for Italian small and medium firms.

3.1 MAIN PROBLEMS IN ACCESS TO FINANCE OF ITALIAN SMEs

Access to finance is one of the most important problem for Italian SMEs. Italy performs well below the EU average, with signs of increasing deterioration (Figure 3).

<<Banks are less willing to provide loans to SMEs, and this, together with higher rejection and unacceptable loan rates, signals a drying up of private-sector financial support, compounded by diminished access to public sector financial support, either national or European. In line with the long payment times for public authorities, the total invoice payments time remains one of the longest in Europe (117 days), double the EU average (53 days)>> (European Commission, 2013: 11).

[99] In this researcher South Italy encompasses eight of the country's 20 regions: Abruzzo, Apulia, Basilicata, Calabria, Campania, Molise, and the two islands Sicily and Sardinia.

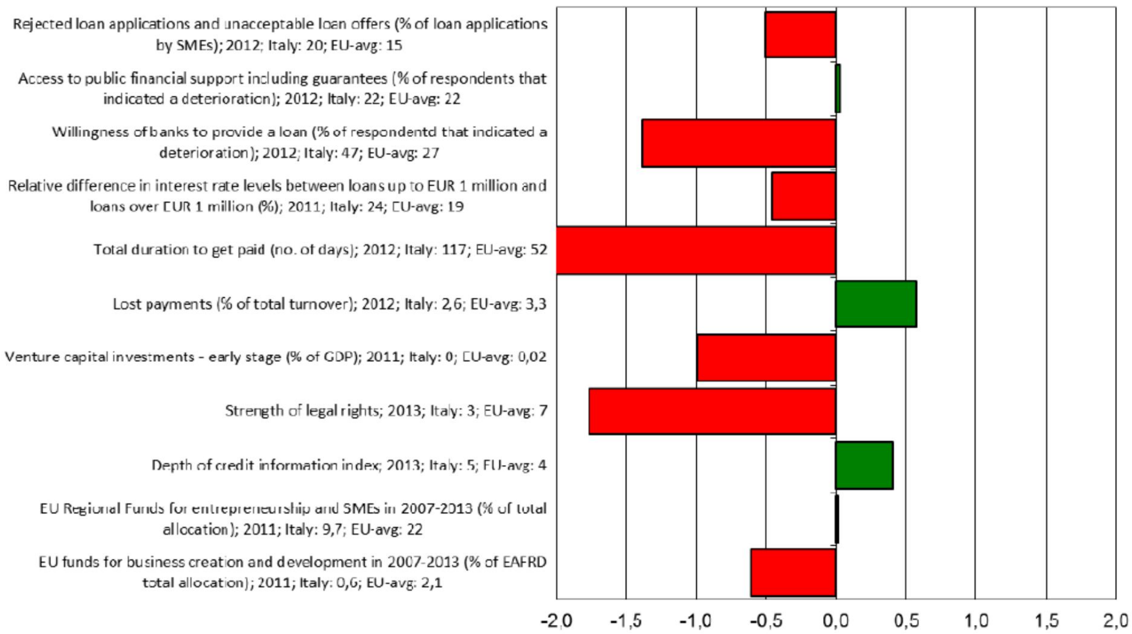

Figure 3: Distance from the EU-average (measured in standard deviation, EU-average=0)
Source: European Commission, 2013

Problems continue in the wider interest rate spreads between small and large loans and the absence of private equity and venture capital investor, particularly for early-stage investments. Despite the efforts realized from Government to sustain new and traditional forms of financial instruments, Italian SMEs still suffer from a chronic and structurally difficult access to finance. The main problems are:

- the increased administrative rigidity of banks in providing loans,
- the higher differential rates between Large firms and small and medium firms.

3.2 RESEARCH METHODS

The analysis of the principal weakness in financing SMEs is the basis for the research. Data was obtained through a survey of business firms. The research was realized with CFOs, responsible for capital budgeting decisions. In order to achieve this goal, a total of 240 entrepreneurs-managers from the different types of firms were targeted as potential respondents. Due to the nature of research, the study focused primarily on CFOs and managers who are involved in the capital budgeting decisions.

A pilot testing of the survey interview schedule was first administered to eight managers (one for each Regions of South Italy). The aim of pilot testing was to check the relevance of questions before interviewing. Out of the 240-targeted interviews, a total of 71 interviews were successfully conducted. This gives a response rate of about 30%.

3.3 MAIN RESULTS

The following section discusses the main findings and results of the survey on capital budgeting techniques used by Southern Italy firms. The first classification has regarded the business size and sector of firms involved. From the total 71 respondents 11.26% qualified as large firms, while 40.85% were medium enterprises, and the remainder 47.89% were categorized as small businesses (Figure 4).

The respondents were further categorized according to industry. From the survey, a total of 52.11% represented the service sector while 29.58% were in retail, and the remaining 18.31% were involved in manufacturing activities.

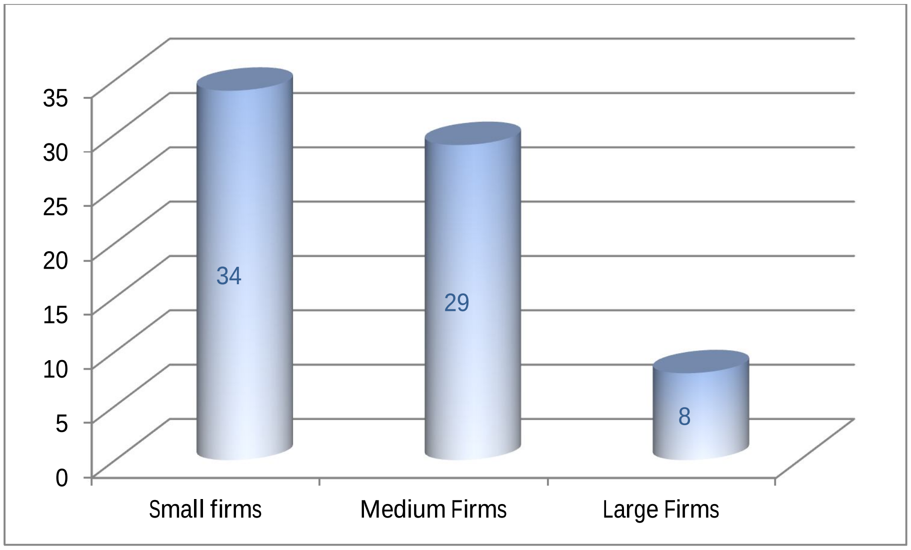

Figure 4: Firms size
Source: author's calculation

The survey sought to find out whether there was any relationship between financial decision maker and their level of qualification. In fact, there is a different involvement of respondents to the survey. Figure 5 shows the formal educational qualifications of the decision makers of the respondents.

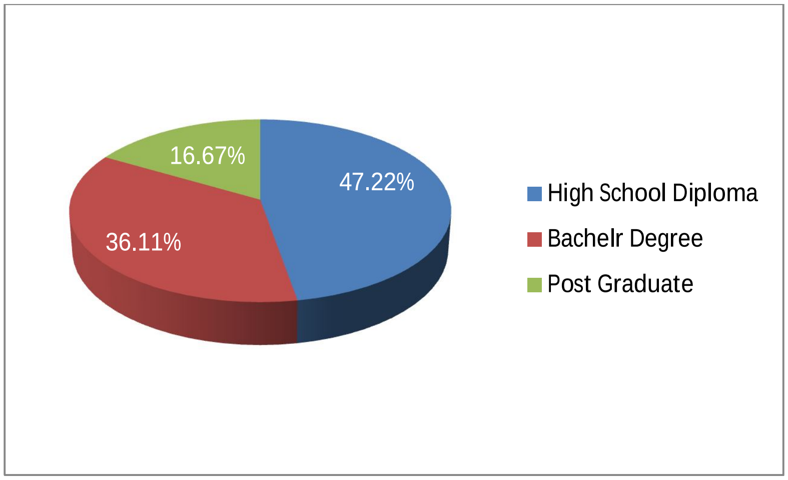

Figure 5: Qualifications of Personnel Responsible
Source: author's calculation

The research highlights that those decision makers that did have an High School Diploma mainly used Bank Loan or Overdraft as compared to those that received formal training. However, a deep analysis revealed that the use of financial instrument more sophisticated (Factoring, Leasing, etc.) was more used by those that received formal accounting-finance training. A closer look at those firms that used more than one source of finance indicate that the majority of them belonged to the post graduate category.

Table 4, shows the percentage usage of the different types of methods by business sector.

Financial Sources	Manufacturing (%)	Retail (%)	Service (%)
Bank loans	23	28	34
Factoring, Leasing	22	34	43
Other sources	12	21	11

Table 4: Financial sources by Sector
Source: author's calculation

Another important step of the research was the analysis of responses given per category of firms (Table 5). The results confirm the theory that SMEs have a preferred financial sources: bank loans. In fact, about 60% used bank loans or Overdraft and says as firms increase in size they begin to use more financial sources.

Financial Source	Small (%)	Medium (%)	Large (%)
Bank loans	58	41	37
Factoring, Leasing	22	33	55
Other sources	9	15	22

Table 5: Firm size and Financial Sources
Source: author's calculation

External financial sources present an important cost: interests. In our interviews we asked to CFOs which is the interest rate. This aspect is fundamental because is a signal of entrepreneurial awareness in financial choices. The research highlights that SMEs decision makers don't have a specific awareness of interest rates on loans. They consider interest rate as a constant, but this is e is at least a crude approximation to reality.

In financial choices is very important the decision maker. Different organizations use different decision makers to realize their financial choices. Table 6 shows decision makers responsible for the selection of better financial source in terms of the size of the firms.

Decision Makers	Small (%)	Medium (%)	Large (%)
Owner	83	71	35
Chief Financial Officer	4	11	41
Team Decision	13	18	24

Table 6: Decision Makers
Source: author's calculation

The above results show that at least a sixty-five percent of business owners in the South of Italy are directly responsible for choices of financial sources. Furthermore, the results suggest that different business level managers have limited influence on this decision-making. However, the influence increases with the increase in the firms' size. It would seem that - where there is - finance section had a significant influence in all decisions making scenarios.

A similar view can be expressed as regards the role played by teams. A possible explanation is linked to the nature of small businesses. The majority of the interviewees in the small firms had limited operational structures, generally associated with larger corporations. This may be a reason why owners defined financial choices in small firms. However, the same reason cannot be attributed to larger enterprises. In fact, they have more formalized structures and large work forces.

4. CONCLUSIONS AND RESEARCH LIMITATIONS

This research has revealed the nature of choices of financial sources in Southern Italy. Particularly, in this research were considered two different variables: the impact of the business size and the level of education of decision makers.

This research has demonstrated that financial choice is a complex process, but it's under evaluate from SMEs. In fact, in these firms business owners are directly responsible. In most cases of the firms in the sample, the decisions makers taken choices without appropriate training (Rossi et al. 2012).

The limitations of the paper are the result of its very nature: it is a largely conceptual paper. Empirical research is therefore needed to test and validate the essentially preliminary framework developed and the (well-based) assumptions made towards its development. Particularly, the most important limit is the definition of company sized was based only the on the number of employees. Other indicators of business size such as capital employed and turnover were not considered.

This research is in effect exploratory and its findings are far from final. They rather represent a starting point, a base for further research and analysis. For this reason the empirical results should be interpreted in view of some limitations: the sample of firms is random and does not fully conform to the criteria of statistical representation; the sample of companies could be expanded both numerically, but also geographically.

REFERENCES

1. European Commission (2013), 2013 SBA Fact Sheet – ITALY, available at http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2013/italy_en.pdf
2. European Commission (2013), "A RECOVERY ON THE HORIZON? ANNUAL REPORT ON EUROPEAN SMEs 2012/2013", available at http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2013/annual-report-smes-2013_en.pdf
3. European Commission (2013), "2013 SMEs' Access to Finance survey", available at http://ec.europa.eu/enterprise/policies/finance/files/2013-safe-analytical-report_en.pdf
4. Lasrado L.A. (2013), "Crowdfunding in Finland – A new Alterantive Disruptive Funding Instrument for Business", TAMPERE UNIVERSITY OF TECHNOLOGY, Master's Degree Programme in Industrial Engineering and Management, available at: http://dspace.cc.tut.fi/dpub/bitstream/handle/123456789/21784/Lasrado.pdf?sequence=3
5. Modigliani, Franco and Miller, Merton H. (1963), "Corporate income taxes and the cost of capital: a correction", *The American Economic Review*, Vol. 53, No. 2, pp. 433-443.
6. Modigliani, Franco and Miller, Merton H. (1958), "The cost of capital, corporation finance and the theory of investment", T*he American Economic Review*, Vol. 68, No. 3, pp. 261-297.
7. Myers S. C., and Majluf N. S. (1984), "Corporate financing and investment decisions when firms have information that investors do not have", *Journal of Financial Economics*, Vol. 13, pp. 187-221.
8. Rossi, M., Thrassou, A. and Vrontis, D. (2011) "Financing innovation: venture capital investments in biotechnology firms", *International Journal of Technology Marketing*, Vol. 6, No. 4, pp.355–377.
9. Rossi, M., Vrontis, D. and Thrassou, A. (2012) 'Wine business in a changing competitve environment – strategic and financial choices of Campania wine firms', *Int. J. Business and Globalisation*, Vol. 8, No. 1, pp.112–130.
10. Rossi M. (2014), "The New Ways to Raise Capital: an Exploratory Study of Crowdfunding ", *International Journal of Financial Research*, Vol. 5, No. 2 (forthcoming)
11. Zingales L. (2000), "In search of new foundations", *The Journal of Finance*, Vol. LV, No. 4, pp. 1623-1653.