
THE ROLE OF BANK LOANS FOR SMALL AND MEDIUM-SIZED ENTERPRISES

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Abstract: Small and medium-sized enterprises (SMEs) are a very important factor in solving most problems in national economies, so it can be safely said that they are stabilizers in the short term, and that they are generators for the development and success of the economy in the long term. Many analyzes and studies exist in order to provide recommendations that will be implemented by national authorities because SMEs are key in the overall operation of national economies as drivers of employment and participants in the creation of GDP and as such become a significant segment in modern economic flows. The main challenge of SMEs is access to finance, as well as determining the reasons for SME's limited access to finance. There is a great concern based on these challenges for SMEs due to the fact that such limited finances can limit the very operation and growth of companies, and consequently, create an obstacle in economic growth, so the concern is equal for businesses and for policy makers. The financial system in North Macedonia is solid, but still underdeveloped. Banks have the dominant participation in the system and have a high participation in the total assets of the financial sector, as well as in financial intermediation. Bank loans are the dominant form of financing for SMEs. Lending to the private sector as a percentage of GDP is over 50%, which is relatively low compared to developed EU countries. Through a survey on bank financing of SMEs, the main factor in the financing process was captured, as well as identifying institutional and political constraints. The findings indicate that banks consider the SME loan market large, competitive, underprotected and with positive aspirations for the future. From their side, a key premise is that the SME sector should be profitable, with good prospects, taking into account macroeconomic factors, the legislative environment and other factors that are specific to banks. All banks expect that SME is a segment that has aspiration for continuous growth and all banks agree that the existence of a credit bureau or credit register of the Central Bank of North Macedonia will facilitate the process of lending to SMEs in terms of a more transparent data structure, timely updating and improved display of credit exposure. Bank financing has aspirations to continue to be a key source of financing for SMEs, but it is still necessary to expand the financial instruments for SMEs in order to meet them and help them in maintain economic development at a satisfactory level in investment and innovation, in employment, especially in the part of innovative and fast-growing enterprises with a high risk profile in terms of yield. Despite the progress that has been visible in the past years, small and medium-sized enterprises continue to perceive access to finance as a challenge for their operations. However, there is a necessity in the implementation of further activities to support the SME sector in terms of strengthening the institutional, regulatory and operational environment in which it operates. Overall, the SME sector still has room to be supported and encouraged to increase their overall contribution to the economy.

Keywords: SMEs, banks, lending, growth

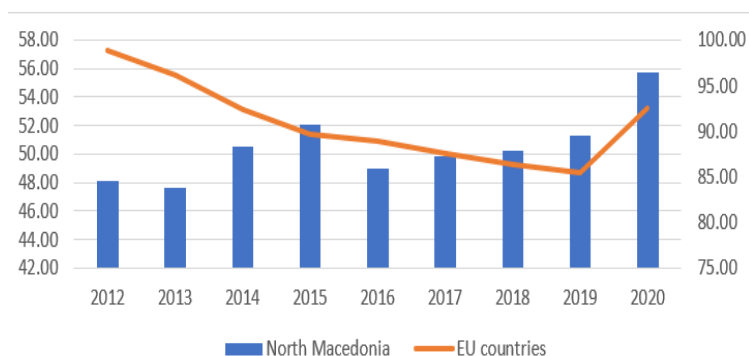
1. INTRODUCTION

One of the leading goals of any economy is the development of SMEs as a dynamic and productive sector that contributes to economic development. To grow and develop further, the SME sector needs stability in funding sources, so especially in developing countries, the only external channel for access to finance is through banks. (Moder & Bonifai,2020) The market for small and medium enterprises is becoming more competitive and as such banks see them as a strategic sector and strive to expand their operations much more aggressively in that segment by developing new business models, technologies and risk management systems. (De la Torre, Martinez & Schmukler, 2018). According to a survey conducted among four African countries Kenya, Tanzania, Uganda and Zambia (Calice, Chando & Sekioua,2021 the SME market is considered very large and competitive, while during the analysis period there were limitations that affected the involvement of banks in SMEs, namely: the general characteristics of SMEs, the interest rate, the volatility of the exchange rate, the business regulatory framework, legal norms, judicial inefficiency, the government's frivolous approach to this key segment in the economy, etc. As for the factors affecting access to finance, the changes in bank financing costs and the borrower's pledge that the bank requires as a guarantee are of particular importance. Increased financing costs and borrowers' debt-to-assets ratio are significantly negatively correlated with access to finance. . (Öztürk & Mrkaic, 2020).

The literature shows that SMEs are increasingly becoming a strategic sector for the economic and social development of any country. Accordingly, banks are beginning to understand the needs and preferences of SMEs, by developing different programs and approaches to financing, through reduced credit risk and financing costs. Support for the SME sector should be a continuous process and a part of the economic policy of every country that is reflected through the prism of adequate sources of financing and stability in the macroeconomic environment. (Yakimova T. & Popovska-Kamnar N, 2019).

Small and medium enterprises undoubtedly represent a vital segment of the economic structure of any country. The universal criteria used to define and classify SMEs are: the number of employees, the annual turnover and the company's assets.

Chart 1: Participation of MSMEs in the national number of active entities



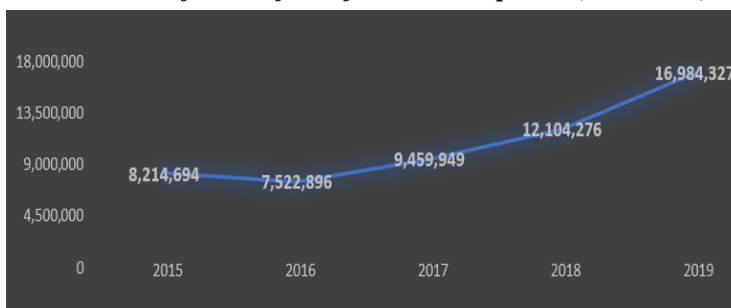
According to the graphs shown above, it can be seen how large the share of micro, small and medium enterprises is in relation to the total number of active business entities, so that in 2021 SMEs participate with as much as 99.68% in the total number of active business entities. In the period from 2015 to 2021, the actual share remains the same. This only confirms the benefits of their existence for the overall economic development. SMEs are characterized by the adaptability of market requirements, they deal more successfully with market disturbances, they can operate successfully with a relatively small invested capital, and thus the risk of business failure becomes small. As one of the most significant segments for encouraging the development of small and medium-sized enterprises is financing. The development of the banking system and all banking institutions is an important component in the lending process, but their role in the financing of small and medium enterprises is determined by the economic-financial, institutional and organizational performance of the macroeconomic and monetary system in national economies. Also, when it comes to credit activity to the non-financial sector in 2022, the accelerated growth of 8.5% compared to the previous year should be emphasized. Such growth results from the favorable environment created by the monetary measures and regulatory changes by the NBRM during 2020 due to the Covid 19 pandemic, as well as the package of state measures to support credit activity. In 2021, the banking sector has a dominant share of 79.1% in the structure of the total assets of the financial system of the Republic of North Macedonia, and 85.8% in 2015. And in terms of the share of the banking sector in GDP in 2021, it is 88.3%, and in 2015 it was 75.6%. Domestic lending to the private sector as a % of GDP and as an indirect indicator of the depth of the financial system in the Republic of North Macedonia has an upward trend, so according to the latest data from the World Bank, that % is 55.75% of GDP and is far below the level of the developed countries of the European Union. In some economies, lending to the private sector as a % of GDP is twice as high compared to Macedonia. Such a comparison gives a clear picture that there is a wide and large space for increasing the supply, that is, increasing the degree of availability of financial resources for SMEs in the Republic of North Macedonia.

Chart 2: Loans to the private sector as a % of GDP in the Republic of North Macedonia and the countries of the European Union in the period from 2012 to 2020



The survey conducted by the World Bank for 2019 is an excellent basis for understanding the attitudes of Macedonian companies regarding access to financial resources. The survey reveals that access to financial resources is the fourth biggest obstacle for companies in North Macedonia, after political instability, the informal sector and insufficient educational strength. According to the survey questionnaire for enterprises from the World Bank, a relatively high percentage of Macedonian firms use bank loans to finance their working capital, so compared to the countries of Europe and Central Asia, Macedonian firms rely more on financial support from banks.

Chart 3: Total amount of loans of non-financial companies (2015-2019) in MKD



Taking a loan from a bank for the normal development of the work process for small and medium-sized enterprises is the most common form of access to additional funds. Although in the last period there has been quite a significant decrease in interest rates, the interest spread is still relatively high and they themselves are a key factor in determining the credit demand in the overall banking competition. The graph shown above refers to the total amount of loans (principal) of non-financial companies based on project financing by activity and currency. That is, the table indicates the following: what amount of credit principal some banks gave to non-financial companies for financing projects in the period from 2015 to 2019. In general, the overall crediting of non-financial companies shows an upward trend, so that the total amount of loans granted since 2015 practically doubled in 2019, thus confirming the thesis that the non-financial sector considers banks as the biggest supporter of its projects.

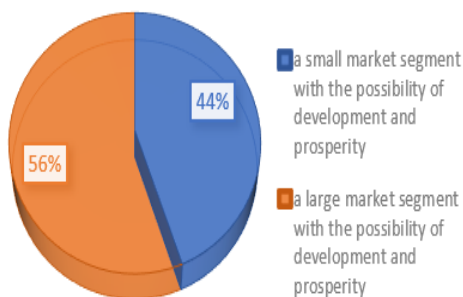
2. METHODOLOGY

For the purposes of the research concerning the significance of bank loans for small and medium-sized enterprises as a significant segment in every national economy, a methodology has been prepared for realization initially through a desk-research concerning the percentage of loans given to non-financial companies by banks.

Next is the preparation of a survey questionnaire, which consists of 27 questions and was directly asked to managers in banks, so that they were more thoroughly discussed through unstructured interviews.

The next step in the research procedure is the field visit to bank branches in the Municipality of Strumica, which was a direct visit in the period from 10.04.2023 to 20.04.2023.

After the completed survey questionnaires, the final processing of the received data was approached, regrouping and processing of the collected questionnaires and answers from the interviews, their logical check, tabulation and graphic presentation, ending with the preparation of a report with conclusions and recommendations according to the received answers.



3. RESULTS

The number of participating banks in the survey questionnaire is 69.2% of the total number of existing banks in the Republic of North Macedonia. All the employees who answered the questionnaire are in the department of lending to legal entities and

employees in the sector for lending to small and medium enterprises if they have a sector for lending to small and medium enterprises and all are in the low level of management of the bank itself.

More than half of the surveyed banks, ie 55.6%, have a separate organizational unit that refers to small and medium enterprises, while the rest do not, that is, small and medium enterprises are placed in a group of legal entities. All surveyed bankers answered that the share of loans for SMEs in the total loan portfolio of the Bank is more than 40%. To the question regarding the classification of enterprises according to size, 33.3% answered that their classification is in accordance with the Law on Commercial Companies, and the rest 66.7% have their own criteria

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What are the areas where the intervention of the state should be strengthened in the process of access to credits by SMEs	
Credit information systems (credit registers and bureaus)	15%
Legal and institutional framework through which the conditions in which the banking system functions will be improved	10%
A legal aspect through which creditor claims will be protected on the one hand and effective security on the other	37%
Securing credits	26%
Sources of financing through increased supply of credit lines	67%
Interest rates and other accompanying credit costs	56%
What is the current role of the state in supporting credit processes for SMEs?	
Interest subventions	31%
Guarantee funds	26%
Dedicated lines of credit	78%
Subventions of administrative costs	15%

What effects did the Covid 19 pandemic have on lending to the SME sector in your bank?	
Increased interest rate for SME loans	78%
Reduced deadlines for repaying loans for SMEs	0%
Increased risk due to volatility	89%
Redirected funds to other market segments	0%
Reduced number of credit requests	0%
Increased number of credit requests	45%
Reduced credit portfolio quality	0%

What are the most common problems in SMEs crediting ?	
Legislation	0.00%
Specificity in banking criteria	44.40%
Specificity in bank credit analysis	52.00%
Macroeconomic factors	0.00%
Competition in SMEs lending	65.00%
Political situation in the country	12.00%
Lack of acceptable credit requirements	24.00%
What are the internal factors in your bank that influence insufficient crediting of SMEs?	
No interest	0.00%
Lack of expertise in this segment	25.00%
The size of the bank	29.00%
Lack of information	0.00%
Problems in designing products for SMEs	15.00%
Difficult collection of overdue loans	45.00%
Weak ability to manage risks	25.00%
Lack of credit requirements	16.00%
Competition in the banking sector	100.00%

A criterion that is mandatory in credit processes?	
Security	77.80%
Financial situation	100.00%
Future projects	55.60%
Past credit portfolio	44.40%
Factors for starting a credit process for SMEs?	
Expected profitability	22.20%
Relationship of SMEs with large enterprises	0.00%
Competition in market segments	44.40%
Credit exposure	66.70%
Situations for rejected SME loan applications	
Insufficient profitability	66.70%
No acceptable pledge	44.40%
Inadequate history of the firm	88.90%
Incomplete application	11.10%

Investments and working capital are the purpose for which SME loans are approved in the largest percentage, and all banks answered that SME loans are financed from the bank's own funds. All banks agree that the impact of banking legislation has a positive impact on the participation of banks in the financing of small and medium enterprises. The bank's credit philosophy and culture is translated into its formal credit policy, which each bank independently determines, and yet is in accordance with the principles dictated by the NBRM. Each credit policy of the banks is in accordance with the long-term goals and strategic plan of the bank, while respecting regulatory provisions in the lending process, that is, to set the basic goals, principles and rules of the overall lending process. 55.6% say that their bank's credit policy is moderately restrictive, 22.2% believe that they have a restrictive credit policy, and the same 22.2% believe that their bank has an aggressive credit policy. 44.4% consider that small and medium-sized enterprises are a small market segment with the possibility of development and prosperity, and the remaining respondents 55.6% consider that small and medium-sized enterprises are still a large market segment.

As the most important criterion that the bank requires as mandatory and most important in the credit processes, they consider the company's financial condition, the second most important factor is the security, 55.6% consider the future projects of the companies as an important criterion in the credit processes, and 44.4 % believe that the past credit portfolio is a significant factor when applying for a loan. The relationship between small and medium-sized enterprises and large enterprises in none of the surveyed banks is a significant factor for starting a credit process. These factors that are of great importance are expected profitability, competitiveness in market segments, and above all credit exposure. Inadequate credit history of the company and insufficient profitability of the company are the

most common situations in which SME loan applications are rejected. As a reason, 44.4% stated that the lack of an acceptable pledge could also be the reason for a rejected credit application. From the point of view of banks, the most common problems they face in lending to small and medium-sized enterprises are: specificity in banking criteria, specificity in bank credit analysis, competition in lending to SMEs, political situation in the country and lack of acceptable credit requirements. According to the respondents, legal regulations and macroeconomic factors do not represent a problem in the process of lending to small and medium-sized enterprises. Internal factors influencing insufficient lending to small and medium enterprises, banks state the following: lack of expertise in this segment, the size of the bank, problems in designing products for SMEs, difficult collection of overdue loans, weak ability to manage risks, lack of credit requirements, and all banks agree that competition in the banking sector plays the biggest role in insufficient lending to SMEs in the surveyed banks. Regarding the areas in which they believe that the state should have an increased influence, 67% believe that the state should work more on sources of financing through an increased supply of credit lines, 56% believe that the influence of the state should be increased in relation to interest rates and other accompanying credit costs, and 37% believe that more attention should be paid to the legal aspect through which creditor claims will be protected on the one hand and efficient security on the other.

78% of respondents in Banks believe that dedicated credit lines are the segment in which the state has a strong role in supporting the credit processes of small and medium-sized enterprises. 31%, that is, 26% consider that the subsidization of interest and guarantee funds are the part in which the influence of the state in the support of SMEs can be seen.

88.9% believe that the Development Bank for Support of Development AD Skopje has a positive impact on the total credit portfolio for SMEs, so that the bank itself has increased loans, and 66.7% believe that through the effect that the Development Bank for Support of Development AD Skopje has on the commercial bank, the interest of SMEs in applying for a loan has increased, and they also believe that the influence of the Development Bank is positive in relation to the setting of credit conditions for SMEs, that is, on the interest rate, terms and security.

Taking into account that in recent years, the Covid-19 pandemic has had major consequences on the overall operation of the economy, the question about the consequences of that crisis was also asked in the survey questionnaire. 89% of those surveyed answered that the risk has increased due to market instability, the interest rate for SME loans has increased, as well as the fact that they have an increased number of credit requests.

4. CONSLUSION

Considering the fact that more than 99% of all companies are MSMEs and they provide more than 75% of the total jobs in the country and over 64% of the GDP value added, it is necessary for the Government to remain committed to improving the business environment for MSMEs in continuity, especially in the area of access to financial resources. The financial system in North Macedonia is solid, but there is still enough room for further development. It is dominated by banks, which have a high share in total assets and in general in total financial intermediation. Bank loans are the dominant form of financing for MSMEs. Lending to the private sector as a percentage of GDP is over 50%, which is relatively low compared to developed EU countries. Although the main source of financing for MSMEs is bank loans, small and medium-sized enterprises in the process of financing through bank loans encounter numerous obstacles such as insufficient financial literacy, poor corporate reporting, reluctance of companies to share business information, inadequate credit history, poor awareness of alternative instruments and financing options according to banks as a provider of funds for financing businesses. On the other hand, small and medium-sized enterprises are faced with high interest rates, high collateral requirements, complex administrative procedures, resistance to risks on the part of banks, lack of opportunity for education on alternative sources of financing, which greatly complicates the process of action. Bank financing has aspirations to continue to be a key source for financing MSMEs, but it is still necessary to expand the instruments for financing MSMEs in order to meet them and help them in maintaining economic development at a satisfactory level. In investment and innovation, in employment, especially in the part of innovative and fast-growing enterprises with a high risk profile in terms of yield. Through improved communication between banks and MSMEs, the lack of transparency for the operations of MSMEs will be compensated and financing directly from financial markets will be enabled and access to finance will be facilitated in general. Despite the obstacles faced by MSMEs in the Republic of North Macedonia, the financial market is large and competitive, and many banks are active and their target is MSMEs. All banks expect that MSME is a segment that has aspirations for continuous growth and all banks agree that the existence of a credit bureau or credit register of NBRSM will facilitate the process of lending to MSME in terms of a more transparent data structure, timely updating and improved display of credit exposure. Despite the progress that has been visible in the past years, small and medium-sized enterprises continue to perceive access to finance as a challenge for their operations.

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