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Theme: Financial Barriers of Small and Medium-Sized Enterprises in Emerging Markets

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Executive Summary

The first section is going to be dedicated to the initial information about the reason why this topic had been chosen for the dissertation topic. SMEs, or in its full name, Small and Medium-sized Enterprises have an important role in modern business, even not only in modern business, but they have also been important for all times before as now. As far as their importance in terms of their noticeable contribution to the economic growth of countries, employment and entrepreneurship, they are considered one of the main drivers of socio-economic development of almost all societies. Throughout this report, some notable facts and the statistical report will be discussed in order to prove our initial hypothesis that how this type of businesses plays an important role in nations economy.

When it comes to the central question of my dissertation topic, one of the most fundamental issues for SMEs is considered financial challenges. Especially those competing in the emerging markets suffer from a lack of sufficient funds to expand their business activities.

In developing countries, the lack of enough number of venture capital and private equity investors existing makes the process of finding external sources of financing more difficult. Notwithstanding those, options including banking lending and the private equity investment funds do not have enough power to satisfy the need for domestic small businesses for some reasons. Moreover, SMEs are considered riskier assets than other options for many investors to invest their money. As well as financial reasons, there may be some other non-financial obstacles that have a negative direct effect on the development of small businesses.

A number of various reasons that may lead to financial challenges for Small and Medium-Sized Enterprises in the developing markets will be identified in more detailed in this paper. As well as the main obstacles, some most preferable remedies for tackling those issues will be defined and discussed.

Introduction

During this section, meaning and definition of the notion of Small and Medium-sized Enterprises will be clarified. The central question is about the benchmarks that are used to measure the size of enterprises. Which indicators are measured so as to define the business size of entities?

To begin with, there are three main keywords that may give initial expression about the nature of SMEs:

- Small- This type of business is small in nature. They are considered small because of the relative size of their capital, their asset, or the number of employees is less than large institutions.
- Single- In terms of its owner. There is only one manager, in some cases, he could be the only employee. But there are some organizations, especially Limited Liability Companies are considered SMEs, because of their relative size. However, LLC may have more than one owner, which are called shareholders.
- Local- Due to capital and financial insufficiency, small and medium business are obliged to operate in only one geographical market. As well as financial reasons, there are some other factors that may impede the process of geographical diversification for SMEs. These are the reasons why; especially micro and small enterprises are characterized as the local businesses. Despite that fact, there are some SMEs that have international business affairs with some foreign companies.

Having considered these three keywords above, what are the exact benchmarks and which standards regarding these benchmarks which are utilized to measure the size of businesses. Suppose two businesses: Apple and barber-shop on the corner of the street. You are asked that which one is to be considered “SMEs”. You will answer barber-shop immediately, it is actually obvious. (Actually, it is considered micro-sized, but we take it as small sized). So, it is easy to distinguish them. On the other hand, suppose two different companies which do not have obvious difference and operate in the same industry, one is characterized by large enterprise, but another is a medium one. But where is the border? What is the upper limit for SMEs, and the minimum limit for large enterprises? And if any, based on which criteria do we distinguish them?Basically, following indicators are taken into account:

1. *Total Assets*
2. *Turnover*
3. *Employment*

Total assets: Amount of total assets that business has is one of the most important variables that are taken into account when you decide the size of this enterprise. Because what you have in your hands would be a sign of how big you are. But for this type of determination has some drawbacks:

- Rational Valuation of long-term assets: In most of the cases, SMEs don’t have an exact estimate of the value of their fixed assets. It is also possible to underestimate the value of fixed assets because of substantial asset taxes. Moreover, the market price cannot be easily determined in such imperfect markets in some cases.
- Governments’ behavior. In most of the countries, this indicator is ignored by official authorities, because of the possible biased knowledge. For example, fixed assets and land are considered as a total asset in some countries, while for others, it is only fixed assets. So, it is defined by governments and makes a differentiation between different countries.
- İnflation. Different currencies have different values in term of one another. It becomes more obvious when there is a fact of inflation. Local currency understates the real values of many fixed assets.
- Depreciation. Real values of fixed assets are declined over time because of depreciation. Management of the company may use depreciation as a way to underestimate their net profit, so paying less profit tax. Different methods

may be employed in order to measure depreciation, expected useful life and residual value. Managers can utilize unfair depreciation method for their own purposes and it may give misleading information regarding the real value of long-term assets.

Annual Turnover: Think that you are not tax inspector and you ask the owner of the enterprise: “How big you are?” In most cases, you will not be answered like how many employees they have, or how much revenue they earned. Most probably, he will talk about his business’s sales last year, or last month, etc. Turnover basically means sales. Obviously, the annual turnover is one of the rational measures that define the size of the entity.

For most of the researches and analyses, experts don’t consider turnover factor, because selling more product may not be a perfect notion in all cases. The seller can set the lower price, even price below than its cost, so they probably run for a loss. Another scenario would be an example of credit sales. An extended number of sales is not a rational benchmark for the company, as it may lead to a liquidity problem.

Employment: According to this determination, any business that is growing needs more employees. So, if you have more workers, it means you are large enterprises or vice versa. What else, if you have more employees that means your turnover and liquidity are strong enough to cover expenses regarding hiring these employees.

In addition to this, if a particular company is engaged in business activities in an international environment, it should have more employees to conduct business operations in different locations. However, this may not give perfect knowledge about the size of the business. One large institution may have 250 employees and operate as a multinational company. On the other hand, another company which is categorized as a medium entity may have 1000 or more registered workers.

Thus, in the previous paragraphs, some basic benchmarks have been discussed so as to measure business size. At that point, we have some initial information about benchmarks. What’s left is, based on which numbers, or standards we determine this dimension. Suppose you have 500 employees, which size should your business be categorized in? That is an issue for definition. This issue is the reason why there is no universal definition for SMEs.

So, if there is no universal definition for SMEs, how could we define those businesses? In the Investopedia, Small and Midsize Enterprises are defined like that: SMEs are those businesses that maintain revenues, assets or a number of employees below a certain limit. That is the exactly same with what I’ve just explained in the previous paragraphs. But again, what are these limits?

Standards for these limits are different in different countries. In different countries, this standard has different limits. That may be related to the economy of a particular country. Take an example of inflation factor. Assets may be valued according to the different price levels. To put it simply, the price of a particular fixed asset in one country is different from that of another country. That is an obvious fact. As far as employment is regarded, different societies have unemployment level, or total population may vary across different countries. All those factors make the process of standardization of accepted standards for measuring the size of business difficult, or impossible.

For instance, in USA, businesses that have 500 employees or less, are considered SMEs. In the European Union, this number is 250 as in UK. So, different countries use different numbers to determine these limits. We’ll look all of them separately in the next sections, also numbers in total revenues, assets and other key indicators.

SMEs in Different Countries

As we discussed in the previous paragraph, size of enterprises is defined by various standards in different countries. In some countries, the limit of number of employees is 250, while it is just 50 for other one. Also, different institutions use different standards in order to define size of enterprises. It causes some difficulties when officials from different institutions discuss important issues about SMEs.

In the following table, we will find out standards implied by different institutions.

Different Institutions	Max. Number of employees	Max. Revenue, Or Turnover($)	Max. Assets ($)
World Bank	300	$15,000,000	**$15,000,000**
MIF – IADB*	100	$3,000,000	-
African Development Bank	50	-	-
UNDP**	200	-	-
MIGA and IFC***	300	$15,000,000	**$15,000,000**
APEC****	100	-	-
UNIDO*****	**Not specified standards, takes how countries define for Themselves**		
Asian Development Bank	**Not specified standards, takes how countries define for Themselves**		

*MIF – IADB: Multilateral Investment Fund- Inter-American Development Bank

**UNDP: United Nations Development Programme

*** MIGA and IFC: Multilateral Investment Guarantee Agency and International Finance Cooperation

****APEC: Asia-Pacific Economic Cooperation

*****UNIDO: United Nations Industrial Development Organization

European Union: SMEs are considered the backbone of the European economy. 99% of all businesses in the EU are supposed to be small-medium enterprises. There are approximately 23 million SMEs registered in the EU. The total number of employees working for these entities is approximately 90 million workers. On average, a share of SMEs in new job openings are estimated at 85%. For the European Commission, SMEs and entrepreneurship are key to ensure high economic growth, solve the unemployment problem, and social integration in Europe.

In Europe, the size of enterprises is defined by the European Commission, according to Commission Recommendation of 6 May.

For this purpose, these factors are taken into account:

- staff headcount
- either turnover or balance sheet total

Enterprise Type	Staff Headcount	Turnover	Balance Sheet Total
Medium	< 250	≤ € 50 m	≤ € 43 m
Small	< 50	≤ € 10 m	≤ € 10 m
Micro	< 10	≤ € 2 m	≤ € 2 m

Hence, according to European standards, those business entities whose total number of employees is less than 250, annual turnover less than ≤ € 50 m, and balance sheet total less than ≤ € 43 m are considered Small and Medium-Sized Enterprises.

Establishing a better business environment for small businesses is one of the main purposes of the EU. According to the Commission Recommendation of 6 May, development of private ownership, especially Small and Medium-sized Enterprises should be prioritized and European Union and all regulatory bodies should be responsible for the improvement of the private ownership and business climate.

United States. SMEs play an active role in different industries within US economy, like tourism sector, including the hotel and restaurant businesses, service sector especially communication and business services, and more importantly, wholesale and retail trade. In the global world, new areas like computer software and information processing, research and development are the key sectors for SMEs to expand their business operations in the US, as well as other parts of the world.

Standards for the size of enterprises are defined by the North American Industry Classification System (NAICS) in the three big states in North America: Canada, US, and Mexico. Enterprises which have less than 500 employees are considered small and Medium-sized Enterprises in the North American countries. SMEs are very important for the US economy in terms of employment, innovation, also exporting. Shares of SMEs in some areas, like manufacturing, agricultural, and service sectors have to be mentioned.

According to the statistical reports, SMEs make up 99% of all US firms. Approximately 50% of private sector employees are working for those sized enterprises. In addition to these, 65% of net new private sector jobs are generated by SMEs. 98% of the export of one of the largest exporters in the world market, the United States are the products of small and medium-sized enterprises. To put it another way, the share of SMEs in US export Revenue equal to 35%. These numbers are crucial for a country that has giant companies like Apple, McDonald's, GM, etc.

In the US, because of taxation issues, the Internal Revenue Service does not divide enterprises in terms of their size like Europe. Small Enterprises and self-employed individuals are considered as one group, Medium and Large sized for another group. Limit between two those groups are assets of $10 million. (Investopedia)

Canada: Like in the US, those standards are determined by the North American Industry Classification System (NAICS) in Canada. The same definition is true for this country: businesses that have 500 or fewer employees are Small and Medium-

Sized Enterprises. Businesses that have 5 and fewer employees are micro-sized ones. In the official site of the Canadian Government, there are important facts about enterprises operating in Canada. For the report of December 2015, there were 1.17 million employer businesses in Canada, which consist of 1.14 million (97.9 %) businesses were small businesses, 21,415 (1.8 percent) were medium-sized businesses and 2,933 (0.3 percent) were large enterprises. Small businesses are those businesses that have less than 100 employees (for businesses which are goods-producers) or less than 50 employees (for service-based businesses). From these numbers, up to 500 employees are considered medium-sized enterprises.

According to reports of 2015, there were 11.6 million people who work for private businesses. 8.2 million (70.5%) of these employees are working for small-sized, while 2.3million (19.8%) for medium-sized and 1.1 (9.7 percent) million people for large businesses. Note that percentages were calculated based on the private sector workforce. That means, totally SMEs have 10.5 million employees which are equal to 90.3% of the private sector workforce.

Russia: In the Federal Republic of Russia, size of enterprises is determined based on the Federal Law of July 24, 2007, № 209-FZ "On the development of small and medium entrepreneurship in the Russian Federation" and by the Government Decree of February 9, 2013 N 101 " On the thresholds of sales revenues for each SME category"

According to statistical reports, in 2017, registered micro and Small Medium-Sized enterprises' total number is 4.5 million. Approximately more than 18 million people are working for those enterprises which are 25% of total employment in Russia's economy.

On the following table, it is shown how enterprises are measured in terms of size based on two important indicators:

	Staff headcount	Sales Revenue
Micro	< 15 employees	< 60 mln. RUR
Small	16 - 100 employees	< 400 mln. RUR
Medium	101 - 250 employees	< 1 bln. RUR

Source: Russian Federal Statistical Service (Rosstat)

A total number of individual entrepreneurs is 2.4mln. (53.3% of all SMEs) Microenterprises are 41% with the total number of 1.9mln. Small enterprises' percentage is 5.2%, while 0.3% for medium-sized enterprises. 55% of all jobs are on the hands of Microenterprises and individual entrepreneurs in the SME sector.

Asia: According to the Asian Development Bank Working Paper, on average, 98% of all business entities in Asia are considered SMEs, while the total labor force contribution is equal to 66% of total employment. As most parts of Asia, especially South Asia and Southeast Asia are considered two of the most populated areas of the world, employment is one of the key issues for societies. In terms of this challenge, the existence of those entities and their contribution to total employment are crucial notions for countries.

Japan: Like that of China, business entities according to their size are categorized differently for various industries. Like most the other countries, main benchmarks; the number of employees, annual turnover and stated capitals are utilized in order to determine business size. In terms of taxation, the Corporation Tax Act uses only state capital for this purpose.

In this following table, main statistical standards are described to measure entity size: (Note that these standards are adopted according to the Small and Medium-sized Enterprise Basic Act.)

	SMEs		Small Businesses
Business Sector	Stated Capital	Employees	Stated Capital
Manufacturing industry and others	¥300 million or less	300 or fewer	20 or fewer
Wholesale Trade Industry	¥100 million or less	100 or fewer	5 or fewer
Service Industry	¥50 million or less	100 or fewer	5 or fewer
Retail Trade Industry	¥50 million or less	50 or fewer	5 or fewer

China: Economic Reforms have changed the economic situation in China. More democratic and more market-based economy allows businesses to improve themselves. It also can be considered a favorable situation for Small and Medium-Sized Enterprises. In the 1980s, economic reforms held by Chinese leader Deng Xiaoping began to establish a market-based economy in China. At the beginning of the 21st century, the number of SMEs in China was more than that of Europe and the US combined. According to the China Statistical Yearbook, now about 97.9% of all registered companies are small and medium-sized enterprises in China. Total assets on those enterprises' hand are equal to 53.4% of the total asset of PRC. Their profit is equal to 4.26 Billion Yuan, which is equal to 64,3% of the total profit of the Chinese economy. SMEs' revenue is approximately 62% of the total revenues in China. Approximately 60% of the GDP and 69% of exports are the stakes of Small and Medium-sized Enterprises. Also, those enterprises' role in employment is significant. Thus, 82% of total employees are working for SMEs in China. It means, 96, 8% of workers who work for private business. They are an estimated 77% of new jobs in the next year.

Size of enterprises is determined based on China's Regulations on the Standards for Classification of Small and Medium-sized Enterprises (the "Regulations" on

June 18, 2011) which were made and introduced jointly by the Ministry of Industry and Information Technology, the National Bureau of Statistics, the National Development and Reform Commission, and the Ministry of Commerce.

According to this regulation, those enterprises are divided into three categories: Mini, Small and Medium sized Enterprises. But, in Chine, size of enterprises is defined differently by the industries they are operating. (you may find online version on following link: http://www.china-briefing.com/news/2011/07/07/china-issues-classification-standards-for-smes.html)

According to Chinese standards, in Construction Sector maximum number of employees of small businesses is 300 employees, while this number is 100 on wholesale and retailer businesses, for hotel & restaurants it is 400 employees.

In another example, retailer businesses whose revenue between 10million-150million RMB is considered medium-sized enterprises, while this number is between 30million-300million RMB for wholesale businesses.

India: In the Indian economy, small and medium-sized enterprises have a significant role because of its importance in domestic production, exporting, low investment requirements, operational flexibility, location wise mobility, low intensive imports, capacities to develop appropriate indigenous technology, import substitution, contribution towards defense production, technology-oriented industries, competitiveness in domestic and export markets thereby generating new entrepreneurs by providing knowledge, training and skill development .(source: SME Chamber of India)

Moreover, those enterprises could be an effective solution for one of the most Indian economical problem: inequality between regions. Competition between those enterprises in the non-modern parts of India pushes businesses to develop and to adopt modern trends of global businesses.

According to a report by Europe-India SME business council, there are approximately 30 million SMEs operating in India. They employ 60 million people while each year they are contributing 1.3 million jobs every year. They are responsible for 40% of the export of India.

Size of enterprises is defined by different way in India. In most other countries, main indicators are the number of employees, value of total assets, etc. However, in India, this definition is based on investment in plant and machinery for manufacturing businesses and in equipment for service-based businesses. The main logic behind that is, unfair distribution among the regions is one of the key problems for the whole economy. The revenue stream of businesses in some parts of the country is not capable enough to compete with those entities in modern cities. Government of India utilizes this indicator so as to encourage investment in less-developed sectors of the economy. Standards for defining the size of enterprises in India are as following two tables:

Table 1: Manufacturing Enterprises - Investment in Plant & Machinery

Enterprises	Investment ($)
Micro-Sized	< $ 62,500
Small	< $ 1.25 million
Medium	< $ 2.5 million

Table 2: Service Enterprises – Investment in Equipment

Enterprises	Investment ($)
Micro-Sized	< $ 25,000
Small	< $ 0.5 million
Medium	< $ 1.5 million

Turkey. 99.9% of the total number of businesses is Small and Medium-Sized Enterprises in Turkey. They are contributing 77.3% of employment which means 53% of total wages and salaries. 63% of total turnover is on the shoulder of SMEs. (Source: “Türkiye istatistik Kurumu” Turkish Statistical Institute turkstat.gov.tr)

Indicators to define the size of enterprises are standardized by KOSGEB, Republic of Turkey Small and Medium Enterprises Development Organization. These standards are as shown in the following table:

Enterprise	Staff Headcount	Annual Turnover (TL)	Balance Sheet Total (TL*)
Micro	< 10	≤ 1 Million	≤ 1 Million
Small	< 50	≤ 5 Million	≤ 5 Million
Medium	<250	≤ 25 Million	≤ 25 Million

Azerbaijan: İn Azerbaijan, standards for evaluating business are dictated by Azerbaijan Parliament’s (National Council) act on June 9, 2015. According to these standards, indicators are allocating as shown in following table:

Enterprise	Staff Headcount	Annual Turnover (manat)
Small	<50	<120,000
Medium	<125	120,000-1.125 million manats
Large	>125	>1.125 million manats

Non-Financial Challenges

Countries are categorized into developed and developing classes in terms of their economic development. Countries those have high results of different economic indicators, like GDP, GDP per capita, Gross National Income (GNI) per capita are considered Developed Countries, rather than Developing Countries. Besides those economic indicators, there are some other factors, like living standards, industrialization, literacy rate of population, expansion, and diversification of their export industries, regulatory systems are critical on this classification. Developed countries' economies are more based on industrial sectors which get more profitable because of technological innovation that affects directly. In developing countries, the main driver in the economy is agriculture sectors, in most of the cases.

This classification may be not accepted for some cases. Some developing countries have more GNI per capita than in most developed countries. For example, in Saudi Arabia this number is 55,760 PPP dollars, as opposed to 42,380 PPP dollars in France, 49,530 PPP dollars in Germany, 43,420 PPP dollars in Canada, 42,100 PPP dollars in the United Kingdom, 45,970 PPP dollars in Australia. (Source: World Bank, note that data is available only for 2016) According to the United Nations Statistics Division, there is no established convention for the designation of "developed" and "developing" countries or areas in the United Nations system. The designations "developed" and "developing" are intended for statistical convenience and do not necessarily express a judgment about the stage reached by a particular country or area in the development process.

Sometimes it could be considered unethical to diminish some countries from the class of "developed countries" That is the reason why most of the new literature, for example, Wikipedia, use "developed" and "more developed" classes.

But for some purposes, it is more efficient to define countries based on this classification, because countries have not been classified based on one or two of these indicators. Indicators were taken into account as a whole. It is obvious that in developed countries, better results are observed on those factors, in most of the cases. As Kofi Annan, former Secretary General of the United Nations said: "A developed country is one that allows all its citizens to enjoy a free and healthy life in a safe environment." Because of the aim of this report, it is better to get this classification. Because not only SMEs but also nearly all businesses have difficulties in finding efficient financing source on those types of countries.

But financing does not only challenge for Small and Medium-Sized Enterprises in developing markets, more preciously emerging markets. There are some other issues which are basically sourced by lack of sufficient environment especially for businesses in such countries. Before going to financing problems more detailed, this paragraph is more focused on some other issues:

Political instability: Political stability is one of the key problems for the business environment. It doesn’t matter how big businesses are, political instability is a big challenge for operating your business. In developed countries, doing business is less difficult in terms of stability in political regimes. They have well-established governmental regimes and allow an open market economy. Better level of open market economies means fewer government interventions which make a more effective environment for doing business. But in developed countries, it is a bit different. Most of the developed countries got their independence in the near history. Those nations don’t have government tradition and experience. This causes great problems, especially in terms of decision-making. Most of the developed countries were under control of colonial (African and American countries) and socialist regimes (former Soviet Union countries, China, etc.) in the even last century. Actually, it makes ineffective ground for the market economy. Most of those countries are adopting some rules that allow a market-based economy. But those sometimes are not enough getting the ideal open market economy. This process could take a long time and during this time, doing business is more difficult, especially for Small and Medium-Sized Enterprises.

Government Interventions: Also, government interventions are typical of these economies. Some of the developing countries, especially those were under control of Soviet Socialist regime are suffering this problem the most. Their experience in terms of market control was different than others. Government intervention was always the main problem for them. They might not think their economy without government. Highly-privatization of main business sectors by the government had been putting a very important hindrance on economic development. But even today, within the process of establishing a market-based economy, they need government intervention. In another word, they need government intervention to interrupt government intervention. Laws of governments play a crucial role in making a new world and new opportunities for those countries after the socialist regime.

Political Regime: Also changing of political regimes is essential stuff to follow. This is not the only a case for Emerging Markets, but also for Developed Markets. The policy of new elected regimes, parties or president is a potential issue for business, also could be an opportunity for many cases.

Possibility of War is also main question. Without any discussion, war is a problem for everyone, every business. And this possibility is bigger in emerging markets, especially in hot areas like Africa, Near East and Middle East. Civil war is also an important to subject especially in the parts of the world where many ethnic groups are living together.

Taxation: Taxation could also be considered the main problem in emerging markets. Most of developing countries there is an ineffective level of taxation for business. That makes discouragement for business to develop, also could be the reason for a business owner to leave the country and operate their business in other countries that offer more favorable tax rate.

The Rise of Protectionism: That is a big problem especially in terms of foreign investment. In this report, we are analyzing the financing difficulties of SMEs in emerging markets. In terms of financing, foreign investment is one of the best options, especially in the case of a lack of domestic financing source. But the rise of protectionism could be the reason for this problem. United Kingdom's leaving European Union and the election of Donald Trump for the president of the United States has shown that this is also a problem for developed countries. In the 2010s protest in Turkey began against globalization and foreign investment. Their slogan was: "Turkey is one and it belongs to its citizens". The same protests were observed in different parts of Russia and other Soviet countries by socialist powers.

Social/cultural environment: Basically, it is not very though a problem for small and medium-sized enterprises, because they know their market, the behavior of their customers and other external parties. This could be a problem when they decide to expand new markets. But it is a problem in some countries where different ethnical groups of minorities are living together, like India or Russia. You also take into consideration people's behavior in your marketing campaigns, which these considerations could be incurred many costs.

Competition: If you are doing business, competition is always a crucial point that you have to take into account. It is not just enough to supply high-quality products at a reasonable price for consumers. You have to consider external parties' behavior, especially competitors. Because there is one stable market, and you are sharing this market with your competitors which have different amounts of market share. Especially, today's open market economy, it is getting more difficult to deal with this problem, because you are not only competing with local competitors, also global actors. Emerging markets are one of the most attractive markets in the world. As we know, in those countries there is a highly-growing market. Every multinational company is trying to get a role in this new world by expanding its business into those markets. On the one hand, it is good for domestic consumers, but the problem for producers. Suppose the market of Turkey, which is one of the most important emerging markets. It is really hard for domestic businesses, especially for small and medium-sized enterprises to compete with foreign companies which are more well-established and can offer products with more quality. In fact, local consumers prefer American companies, rather than small enterprises of Turkey.

Another factor which is worth to consider is, there is a growing number of domestic enterprises in emerging markets. This is also could be a threat to each other. In fact, it is common practice in every market. So, it is a less important problem than overseas competitors.

Research and Development: It is impossible to even describe today's economy without R&D. They are considered main driver of innovation and economic growth in nearly every business sector. In fact, successful investment on R&D could be translated as more successful business. But in reality, most of SMEs do not pay too much attention on this type of investments. These expenditures are typically characterized by large business in most cases. This scenario is even worse in emerging markets. In the OECD report of "Innovation in Firms" (2017, part 1: Business R&D) shares of SMEs in different markets are shown according to Research and Development Statistics Database (http://oe.cd/rds, June 2017). In this table, it is shown that SMEs share in Business R&D reaches its maximum result in Iceland, where this number is 90%, in New Zealand it is approximately 65%, in Norway 50%. But in most of Asian countries this number is 5-10%. In Japan highly-developed country, SMEs' share in BERD (Business enterprise expenditure on R&D) is less than 5%. But it is considered one of the most important reasons behind the slowed economic growth in Japan.

Adoptation of Advanced Technology: We can't imagine world without technology. Technology has changed all our lifestyles, also business style. Today, you can purchase anything that you want, or get some information about products with your phone, tablets, computers etc. That made different point of view for business that business can increase their sales with online- shopping, or in other word, e-commerce. But, for Small and Medium-Sized Enterprises, it is not common practice. But China could be considered only exception that Chinese enterprises make e-commerce and they have important stake on it. In the Turkey, approximately 95% of Small and Medium-Sized Enterprises do not have online site. This is not only missing chance of increasing sales, also losing potential communication tool with your customers. According to survey of Russian Public Opinion Research Center (Всероссийский центр изучения общественного мнения), 89% of customers do not rely on online shopping, because of cheating, delay in delivery and other reasons. That is the new point of view to online shopping. One of the reasons why SMEs in emerging markets are not busy with e-commerce is that. People don't trust online shopping and instead of investing and paying attention to e-commerce, they prefer to increase their effectiveness on face-to-face sales.

Lack of a successful plan: Planning is the essential part of each business; it does not matter how big your business is. If your business has effective business plan, it is getting better to deal with problems, and to be ready for unexpected errors. Also, it could be advantage if you want to borrow money from banks.

When you apply for a bank loan, credit officers of banks are interested in what they invest their money. Unprofessional business plan and unreliable estimations of future profitability are the key problem for businesses in the loan application process.

Managerial Issues: That is the problem basically sourced by professionalization. In the most cases, business owner and manager is the same person in Small and Medium-Sized Enterprises, especially for small ones. In the most of Large-Sized Enterprises, especially corporations those are two different actors; business owners are shareholders who have some stakes on company, and management is implemented by managers, directors, CEOs etc. Being controlled only one person could be tough problems for SMEs especially on decision-making. Someone who has enough money could be business owners, but at the same time, he has to have enough managerial ability. And someone who could be good in management has to have money, or ability to get enough money.

Human capital: Human capital is one of the basic problems in emerging markets. In developed countries education level of population is higher than emerging countries. It makes difficult to deal with employees in emerging markets. At least university-graded people's percentage is not high, so chance of getting educated employees is less than that in developed markets. Also, training employees, putting some bonuses and promotions is highly-costly for SMEs. In emerging markets, most of SMEs belong to only one person, or one family. That owner is trying to hire persons whom he knew it before or suggested by any closed person. This is one kind of obstacle on improvement, because by doing this, you might ignore the opportunity of getting better employee.

Another fact which should be mentioned is migration. Migration of high-skilled and better educated employees to other parts of the world, especially to the developed countries creates a problem of brain-drain problem. Sophisticated changes in labor codes, income tax deductions may be sufficient solution that can be taken by governments or employers themselves.

Salary expectation of skilled employees should be considered. This factor, along with migration is basically connected to the financial problems. Most of SMEs in the emerging markets, to pay ten or more times more than minimum wage is not affordable for only one employee. That is more problematic in terms of some jobs which require great deal of labor.

Importance of accessing finance for SME

Small and Medium-Sized Enterprises are considered one of the most important actors in today's economy. Without them, we can't describe modern businesses, or private sector of countries' economies. Their role on economic growth and job creation should be absolutely appreciated.

Since they are backbone of almost all economies, without their existence, economic growth of countries may fall under pressure of negative effects of current trends. These are the effective solution for economic diversification of countries and vital solution for unemployment problem which is one of the key issues of the world economy.

In the next paragraphs, statistical numbers are going to be employed in order to configurate better information about their importance in global economy, and economic conditions without SMEs' existence.

Formal Small and Medium-Sized Enterprises are contributed 50% of total employment in emerging markets. With the number of informal enterprises this number would be more important. This number is not just proof of their importance on unemployment, also for one more social problem in emerging markets: inequality.

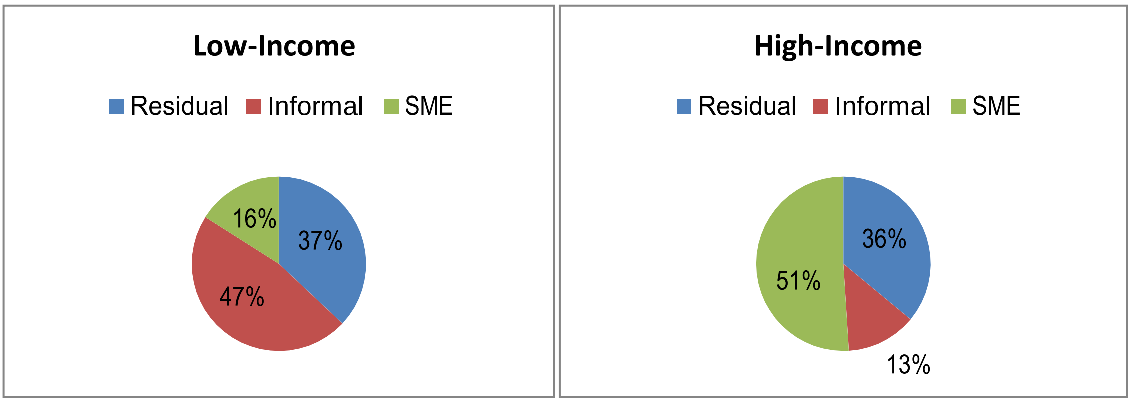


Figure: GDP contribution by sector

Their contribution to national income of emerging economies are estimated approximately 33%. Again note that this number is characteristic only for formal enterprises.

Importance of development of Small and Medium-Sized Enterprises could be understood in two different ways, according to Warner (Small and Medium Sized Enterprises and Economic Creativity, in Improving the Competitiveness of SMEs in Developing Countries: The Role Of Finance To Enhance Enterprise Development, UNCTAD, New-York & Geneva; (2001)):

- Their development is one of the building blocks of innovation and sustainable growth;
- Importance of their contribution to anti-poverty programmers in terms of job-creation and decreasing inequality;

In the previous paragraph, we mentioned some obstacles that SMEs face in emerging markets, which were non-financial issues. In this section, we'll discuss importance of accessing to finance for SMEs in emerging markets. Accessing to finance is crucial thing for every business, doesn't matter for its size. But if you compare this situation in developed and developing countries, you might face two different scenarios; in developing countries accessing to finance is more difficult and needs more effort. It is because of several reasons like, instability of economy and currency, lack of experience etc. Note that those reasons will be explained in the next chapters in more detailed. Facilitating of access to finance for SMEs could be resulted as developing of economic conditions by fostering innovation, macro-economic stability, and GDP growth in emerging markets.

Another fact in this regard to consider is, a need for money for product and operational diversification. In order to have highly-diversified portfolio, business need money to expand their business to expand their operations into new geographical areas and product markets.

Main importance of accessing to finance could be explained by their benefits offered to private businesses. Importance of SMEs can be explained in terms of their contribution to owners by the following ways:

- Starting new business, which itself could be translated direct positive effect on employment
- Making large amount of investment in capital and new technologies,
- Providing liquidity

Moreover, it will have indirect effect of creation new jobs in suppliers, distributors and some other related parties. For instance, increasing the number of suppliers, will have a direct positive effect on the cost of production in one company. As far as positive externality is regarded, innovation and development in R&D practices in one industry, may have a positive impact on the whole industry.

The World Bank and the International Finance Cooperation together establish ranking economies according to ease of doing business. On this rating, availability of getting credits for businesses is one the most important indicators. (See online: https://data.worldbank.org/indicator/IC.BUS.EASE.XQ?year_low_desc=false

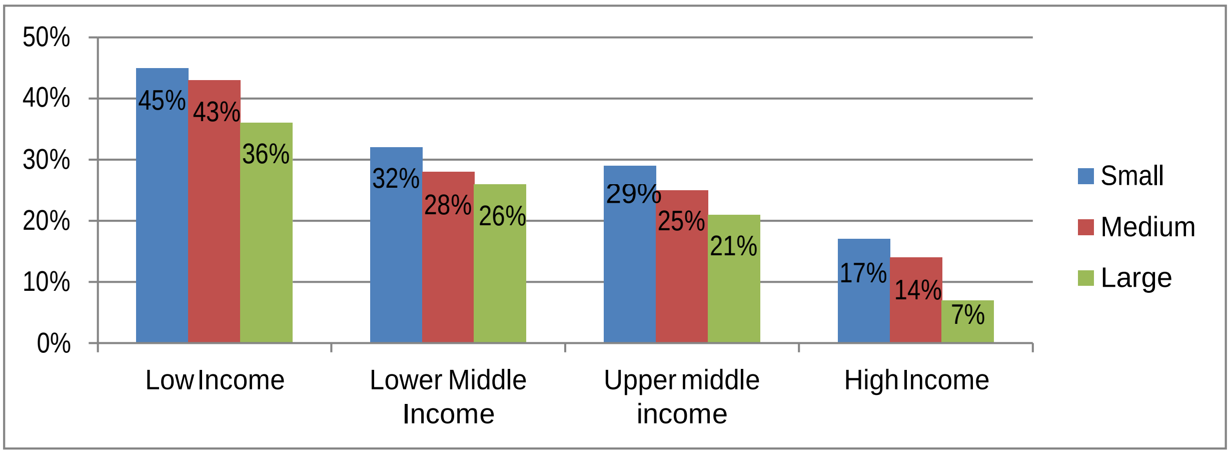
More detailed, with other indicators: http://www.doingbusiness.org/rankings)

The Global Entrepreneurship Monitor (GEM) Entrepreneurship Framework Condition, also determine possibility of getting of debt and equity financing, as one of important factors for stimulating and supporting entrepreneurial activity.

Financial Constraints of SMEs in emerging markets

In one of the previous chapters, we defined some challenges that Small and Medium-Sized Enterprises might face in emerging markets. In this section, we are going to discuss the most important problem; accessing to finance by SMEs in emerging markets. In the last paragraph we made introduction for this issue, especially importance of financing for the growth of private sector and economy. In this section, we are going to be focused more on reasons of this difficulty.

Before starting, we have to define term of “missing middle”. Missing middle is the term used to call lack of finance for Small and Medium-Sized Enterprises in emerging markets. Financing of “missing middle” is called “Mesofinance”. According to report of World Bank Group, (“What’s Happening in the Missing Middle” Salman Alibhai, Simon Bell, and Gillette Conner, Washington, 2017) in developing countries 70% of Micro, Small and Medium-Sized Enterprises (Out of 365 to 445 million, includes both formal and informal ones) can’t access external finances. Estimated amount of those unmet credits are US $2.5 trillion ($1 trillion only for formal enterprises), which mean 14% of GDP in the developing markets. In developing countries, finding sufficient financing source is problem for all businesses. But, SMEs are more suffering from this problem, according to researches. This is less noticeable for large enterprises and firms. As Beck, Demirgüç-Kunt, and Maksimovic (2005) mentioned, small and Medium Enterprises are suffering more financial, legal, and corruption difficulties than large firms, and these problems affects negatively the growth of SMEs to a greater degree. In the following table, you can find out percent of firms that accessing to finance is considered as their main constraint:



Source: World Bank Enterprise Surveys

As shown in this table, percent is more crucial in small ones, and decreasing numbers are observed when we are going from less-developed to advanced countries.

As business size grows, the more stable revenue stream allows companies to increase their creditworthiness and financial capital to grow.

Financing difficulties of Small and Medium-Sized Enterprises could be divided into two parts:

- Supply-Side Constraints
- Demand-Side Constraints

Supply-Side Constraints are those ones which are related to market imperfections. In developed countries, role of these constraints are less obvious, because market and regulations are more efficient to do business. Because of imperfect market and regulation systems, doing business is suffering from these problems more in developing markets.

These factors should be exactly analyzed and tackled by government, because imperfect systems should be first mitigated, then reasonable additional measures can be taken in order to create better business environment.

Supply-Side Factors:

- **Risk Profile:** Basically, every investment has some risks. It is important fact that investors have to consider when they invest their money on any business or project. Micro, Small and Medium- Sized Enterprises are considered riskier choice than large ones because of several reasons.
  Firstly, they are operating in more-competitive environment. Also, in their industry, they have a little share and those businesses are price-takers. They are competing for little margins than large companies, so it makes them less profitable, which put some questions about rate of return in the future and probability of failing. Second, SMEs don't have efficient human and capital resources as large businesses. Also, all the non-financial factors like, political environment, lack of infrastructure in emerging markets could be considered risk factors for outside investors.
- **Informational Asymmetries:** In most of the cases, important information about businesses is hidden by entrepreneurs. This hidden information can't be easily accessed; sometimes it is getting impossible at all to reach this information by external parties, in our case, outsider investors and lenders. Also, less-educated people in developing countries have difficulties on preparing accurate and reliable financial statements about company. So, it makes informational asymmetry problem more difficult to solve. This problem leads two main issues; "moral hazard" and "adverse selection". First, because of lack of crucial information, investors might have difficulty on differentiating of "high quality" and "low quality" businesses and projects. This is called "adverse selection". Secondly, if investor invests some amount of money on business, he might not be informed what is going on exactly to his money, how entrepreneur use his money. Second issue is called "moral hazard".

- **Transaction Costs:** Even without considering risk factor, financing to small and medium size enterprises is considered expensive business. Some costs are fixed and do not depend on amount of investment; administrative costs, legal fees and costs incurred to get accurate information about company like credit profile of company from specialized agency, evaluation of loan application, conduction due diligence about business or projects etc. In developing countries, these costs are higher, because of problems of getting information that we discussed in the previous paragraphs. So, it is not efficient to incur these costs on small amount of investments, note that small enterprises need small amounts than larger companies. Small amount of loans are less profitable, so incurring these costs might be resulted losses for lenders.
- **Collateral:** It is one of the most important problems in the relations between lenders and borrowers. In nearly all of the cases borrowers are asked to introduce collateral when they apply for loans. Lenders do it because of reducing loss, when their investment is lost. It could be considered reducing risk lenders connected with the problem of "moral hazard". But most of owners of SMEs are unable to give requested collateral, because they are new in the market and they don't have anything enough to introduce the banks as collateral. Also, in developing countries it is difficult to register of property titles and collaterals, because of needed insufficient public services.
- **Banking sectors:** In developing countries, insufficient government intervention is common. Because of these interventions, most of the banks adopt tough lending policies and set higher interest rate, which makes getting credit more difficult especially for small enterprises. Also, in these countries, banks are operating in less-competitive environment. This is the reason why banks don't want to take risks in order to be competitive. They have known clients, offering services for those clients and less-risky large businesses would be enough for banks.

Demand-Side Factors:

Besides supply factors, there are some other constraints for SMEs to access to finance. Those factors could be grouped under "Demand-Side Factors" which explains why some businesses put limits demand for getting finance voluntarily. It is worth noting that these issues are based on demanders, in our case, business entities which demand financial resources to run their businesses.

- **Negative Attitude towards Outside Investors:** This is basically related to equity financing. When businesses are issuing stocks, owners might feel that they are not only owner anymore. These feelings push owners to evaluate alternative options.

  Another point to consider is, obviously, shareholders of the company may require a number of reports for each period. This may embarrass management because they may not feel obliged to report everything about what they have done.
- **Information Requirements:** Because of mentioned reasons, some banks ask very hard information requirements. This policy could discourage businesses to apply for bank loans. Preparing more financial statements and related documents means more costs that increase cost of lending.
- **Collateral and other types of requirements:** Also cost of lending is higher because of some other reasons. For example, registration of collateral would be incurred extra costs for businesses. Also, high interest rate provided by banks could discourage businesses to get loans.
- **Poor Quality of Projects:** Sometimes general quality of projects that introduced for financing could be below minimal required standards. Also lack of knowledge of preparing effective business plan is potential problem for SMEs when they apply for loans.

Recommendation

In this chapter, practical solution ways will be discussed in detailed so as to clarify main practices and approaches to encourage capital and debt market solutions for SMEs financing problem. By this regard, banking sector and capital markets have been divided in order to see how mechanism works in reality and how measures may be effective in order to guarantee sustainable solution for SMEs' access to finance problem.

Banking Sector

In the previous paragraphs, importance of Small and Medium Sized Enterprises was discussed in more detailed, in terms of their role on GDP growth, employment, innovation on emerging markets. Also, it was proved that financing problem is not only one of the main problems, but the most important problem that these enterprises face in emerging markets. Some fundamental reasons were discussed, in the next section, solution ways will be discussed more detailed.

Finding stable and efficient funding source is very important issue for the future of SMEs. First important source is bank lending comes to our mind first. In fact, just 18.7% of total bank loans are those given to SMEs in Asia. It is not enough number for these enterprises, because they have great share on number of all enterprises. In other word, SMEs are largest for their number in emerging markets. This number of bank lending might be even lower during crisis. Also, focusing only on banking lending, would be insufficient for the long-term innovations. In emerging markets, banks are trying to provide only short-term credits, because of risk on long-term lending. Also, high interest rate and tough bank regulations make bank loans less interesting for business owners. In this section, we will discuss some solving ways for issues related to bank lending. But in fact, relying on only bank lending might not be enough, businesses have to find alternative ways like Non-bank financial institutions and Capital Markets, which this report will give some solutions about these alternative options.

In fact, in emerging markets role of non-bank financial institutions and capital markets is not as big as role of banks. Because owners don't rely on those two alternatives and banks could seem better and easier choice for them. But to overcome financing difficulties, options for financing sources should be diversified, because only banks don't have enough capacity to take full responsibility on this issue.

In their period of start-up, owners of SMEs generally don't need extra financing sources. Financial needs of SMEs could be met by owners' own money, or family members, friends, sometimes micro financial institutions. But during expansion, those sources could be not enough. In fact, external financing sources are needed by enterprises in these periods. In the later periods, it will get easier to get loan from banks, because enterprises have enough collateral, stronger relationships with banks in their maturity period. But in the period of first expansion, it is harder and needs more effort to enjoy external funding. Problems need to be solved during these periods, because SMEs now need more money and if they are successful, it will be much easier to get external funding in the future.

Three main policies need to be developed in order to solve financing problems of SMEs for banking sector:

1. Credit Guarantee Schemes
2. Credit bureaus or registries and financial statements
3. Collateral registries

Credit Guarantee Schemes: According to World Bank, these schemes is something that provides third-party credit risk mitigation to lenders through the absorption of a portion of the lender's losses on the loans made to SMEs in case of default, typically in return for a fee. It could be understood as insurance of loans provided by bank. This insurance is made by some organizations which are called Credit Guarantee Schemes. In most cases, these guarantees cover lenders or bond investors in case of default on payment by borrower. Importance of these guarantees could be emphasized by their role on three issues:

- Overcoming information asymmetries- in terms of higher lending administrative costs of smaller firms and problem of adverse selection
- Diversifying or transferring risk- by bringing third party into action
- Reducing collateral requirements- Remember it is big problem for new enterprises

There are many types of guarantee schemes. These are:

1. Public Guarantee Schemes: created and managed by governments. They involve state subsidies, especially initially. The most important advantage is that in case of default guaranteed amount is taken out from government budget;
2. Corporate Guarantee Schemes: are established by private sector like banks and chambers of commerce. Main advantage is that because of competitive environment, they offer less interest rates in most cases. Main disadvantage is when they are running for loss, they stop their operation or make their guarantee conditions harder to meet;
3. International Schemes: those are mainly multilateral government or Non-Governmental Organizations initiatives, e.g. the ILO, UNIDO or the European Investment Fund;
4. Mutual Guarantee Schemes- generally established by borrowers that don't have enough access to financing.

<u>Design of credit guarantee schemes:</u> Main importance of these schemes is helping small enterprises which have limited access to external financing. Especially those who don't have enough collateral, guarantees could be effective option to take. In the next section, we will analyze how these schemes work, and what they are doing for facilitating lending practices:

Risk sharing: This is a good question to ask: In case of failure, how much of amount will be paid by guarantor. Let’s call this percent as coverage ratio. If this percentage is higher, it will encourage banks to participate in the scheme. In practice, there are some schemes that offer 100% coverage ratio. This percent could be met in developed countries like Canada and Japan. In one hand, I will increase banks’ participating in schemes, but it has some side effects. If risks are not shared, now banks have less incentive to properly assess and monitor risk. Because now bank knows that in case of default, it will be fully repaid; there is no need to take extra actions. It is a fact that credit guarantee institutions are running for loss in Japan. Putting less than 50% coverage ratio will increase adequate assessment and monitoring of loans. But I will discourage banks on participating in these schemes.

According to Levitsky, this ratio could be between 60 and 80 percent. World Bank made research on 76 schemes, and determined equilibrium ratio on 80 percent. But these numbers don’t work in all cases. In Italy and Mexico, these numbers depend on the risk assessment and the type of loan. In Chile, there is a fund called FOGAPE which determine rates based on an auction.

Fees: Credit Guarantee Schemes issue guarantees with getting some fees. Amount of fee is important not only for relations between borrowers and lenders, also future financial sustainability of these organizations. Fees are main source of Schemes’ income. So, they have to be higher to cover administrative costs. It has to be in fair level that encourages lenders and borrowers to participate. Fees could be paid by borrower, lender or both. It is usually 1% of issued loans. Some schemes offer an annual or a per-loan fee that ranges from 1 to 2 percent.

Defaults: Default rate is crucial question in terms of sustainability of schemes. More defaults mean more pay-outs to lenders that reduce effectivity of schemes. For well-established and mature schemes this rate is not more than 2%. But in developing countries, It will be even higher because of market imperfections. Newly established schemes in developing countries might observe more than 5% default rate. At the beginning, it is not telling full story, but continuing such high rates will be dangerous for scheme's future.

Guarantee payouts have to be option as a last resort. Before payout, guarantors (or lenders) should negotiate rescheduled payments. It has to be done by experienced staff, so effective managerial skills play important role on this period.

Involving donors, the public sector and the private sector: Main role of government in facilitating credit guarantee schemes would be establishing the effective regulatory environment. In some countries, like Colombia or Chile, government subsidies are main resource of financing. But number of subsidies should be minimized, because of its bad effect on determining the supply and demand, and therefore the price and quantity of credit. According to Commission of the European Communities, because of maintaining liquidity, government subsidies might be given, but only for short-term. Donors also have important role on funding schemes, not in developing countries, it is not much common practice. Moreover, private sector's contribution is essential on funding guarantee schemes. As a private sector's representatives, banks and other private institutions play important role on capitalization of schemes. Equity financing is other option for funds' financing. Resources collected from its members, could decrease dependency of Corporate Guarantee Schemes on public financing.

Credit bureaus or registries and financial statements: In the developing countries, nearly all of the banks have strict regulation that requires many documents, financial statements. It discourages many enterprises from getting credits. As discussed, because especially small enterprises don't have enough capacity to prepare those financial documents. Sometimes it could be costly to be done it with outside experts which also could be resulted outsider parties have access to businesses' secret information.

Financial documents made by enterprises themselves could seem unreliable for lending institutions, because in that case businesses can introduce asymmetric information that exaggerate their appearance of creditworthiness.

Well-established credit bureaus play important role on decreasing information asymmetries between lenders and borrowers. They make lending-application process easier and give more chance to SMEs to access appropriate financing sources easily by collecting and analyzing reliable credit information.

Credit bureaus could be understood as one institution that gathers needed financial information about borrowers, and give this information to lenders for a fee. Information coming from credit bureaus is important for lenders in terms of deciding to accept loan application and determining interest rate based on risk.

Reports prepared by credit bureaus are included different information like credit history of businesses or individuals. Credit history is itself included information about one's credit experience like, its repayment maturity, total amount of credit it has been used and is using, outstanding debt collections, some information on public records like bankruptcy, tax liens, foreclosure, and repossession. They could include some other non-credit information like borrower's telephone number, address, payment history on cell phone bills, utility bills, businesses' employment, salaries etc. Based on this information, they determine credit scores on businesses based on defined standards. Note that non-credit information is not taken into account when determining credit scores. Credit score is crucial criteria on deciding approval of loan application.

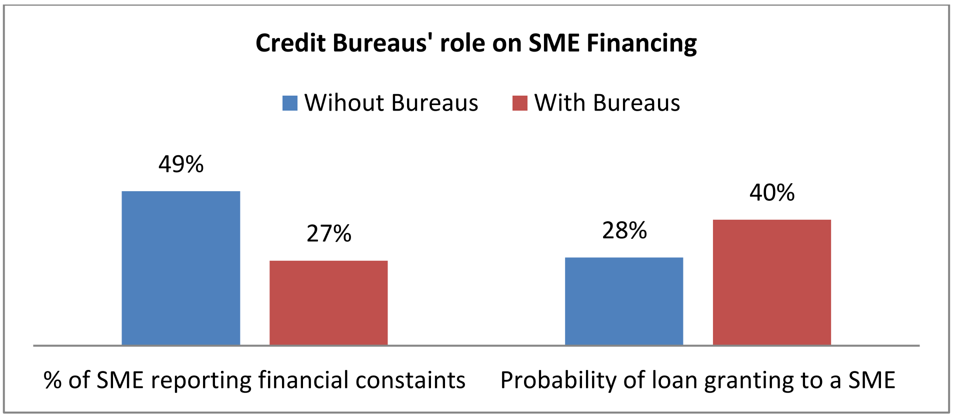
Credit bureaus play important role on countries' economy by their contribution on different aspects:

Reducing default ratio: They offer more precise information about borrower, so lenders can make decision more effectively. This factor reduces moral hazard issue. Also bureaus could act like enforcement tool. Borrowers have to repay their debts. If they don't do that, they could be listed as "bad debtor" by credit bureaus. It will also negatively affect their credit score, which could be resulted disadvantage in future borrowings.

At the end of 2002, in Shanghai, decrease was observed in non-performing loans ratio from 6.67 to 4.52. It happened at the end of first year of local credit Bureau. This rate was declined by 2% in the Guatemala 6 months after establishing first national credit bureau. (Luoto, McIntosh, Wydick; "Credit Information Systems in Less-Developed Countries" 2004)

In addition to this, information provided by bureaus could be helpful during recovery process. Thus, it makes easier recovery payments on defaulted loans.

Facilitating access to bank credits; As discussed, reducing risk of asymmetric information makes it easier to apply for bank loans for borrowers, and make it easier to make decision for lenders. Effects on credits bureaus are described on the following figure:



Source: Love, Mylenko, 2003. Based on data of 5000 firms in 51 countries.

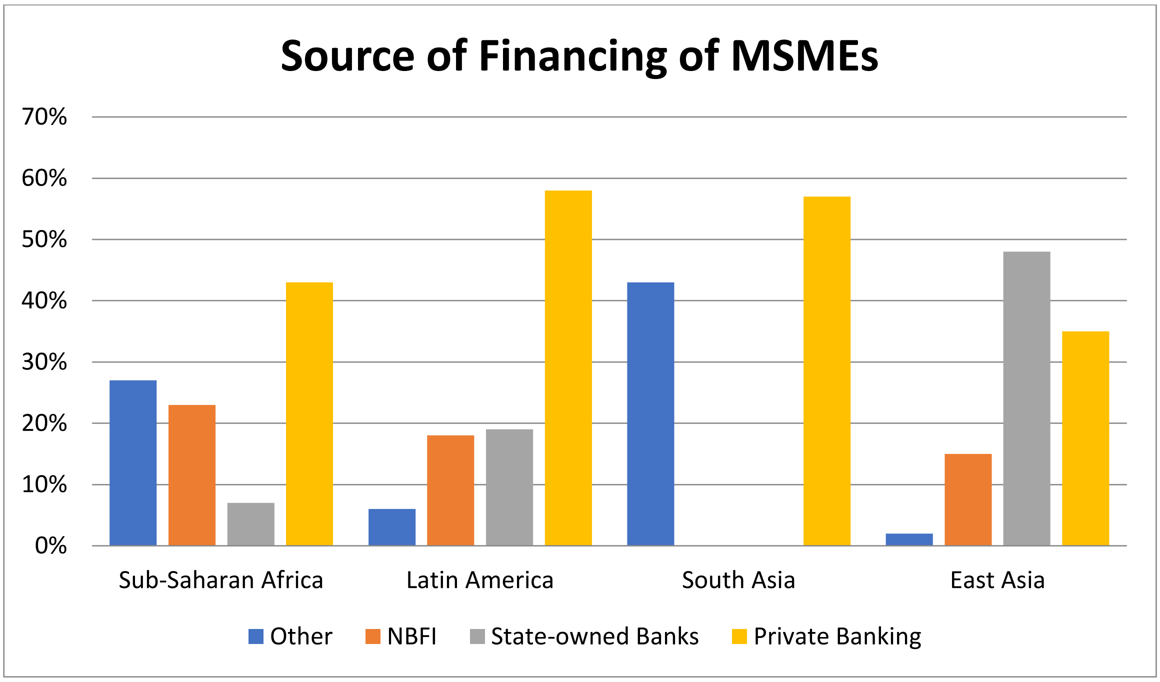
Collateral registries: Collateral is something offered by borrower to the banks, to secure loan. Every bank needs to see collateral on loan application, because in case of default on repayment, banks can own this collateral to cover its losses. Collateral would be any asset, movable or immovable assets. Most of countries don't have secured transaction laws and collateral registries; it makes problems for lending process. Because of this lack, banks only accept immovable fixed assets like buildings and land. It will cause problems, in case of default. Seizure is sometimes difficult and could take many years. Reforming the framework for movable collateral lending allows businesses—particularly SMEs—to leverage their assets into capital for investment and growth. Modern Secured Transactions Registries increase the availability of credit and reduce the cost of credit. (International Finance Corporation, World Bank group "Collateral Registries") Movable collateral would be inventory, accounts receivables, crops and equipment.

Nonbank financial institutions

The most important action should be done in order to facilitate accessing to finance for SMEs is diversifying of financing sources Banks themselves are sometimes not enough to cover credit gap of enterprises. Notwithstanding this, high loan application requirements, tough regulation, high cost of lending on banks make bank loans less interesting for borrower. In other point of view, it encourages borrowers to find alternative financing sources. At this point, alternative actors for banks like non-bank financial institutions and credit markets play an important role.

In the next section, role of non-bank financial institutions will be discussed more detailed in terms of their importance on financing Small and Medium-Sized Enterprises. Most of the banks are reluctant to serve credits to business in the period of start-up and expansions. Most of permanent enterprises clients of banks are those businesses are on their steadily growing period. These enterprises have better condition on their loan application in terms of credit history, collateral, relationships with banks.

Non-Bank financial institutions like venture capital firms and Micro Finance Institutions would be better options for business which are on their start-up and expansions periods. But in fact, they have little share on financing SMEs in developing markets, as shown in the following table:



Source:

http://financegap.smefinanceforum.org/?country1=South%20Asia&country2=Latin%20America&country3=Developing%20Countries

Note that other section stands for own funds, contribution family members, friends etc.

In addition to this, Non-Bank Financial Institutions are more sensitive for any changes in external environment. Changes in currency rates, financial crisis affect NBFI than banking sector, because they have less-diversified business. Since they have smaller capital requirements than banks and other financial institutions, they may have less capital base in order to maintain liquidity in the most sensitive cases.

One of the main reasons why NBFIs are not developed in developing countries is not having sufficient regulatory and policy frameworks of such countries. Well-established regulatory and policy systems can encourage NBFIs to get more important role on country economy, and to be able to compete with commercial banks. For example, credit bureaus are mostly serving to banking sectors, not non-bank Financial Institutions.

Micro Finance Institutions: These institutions would be better option for microenterprises. Like SMEs, they don't have enough capacity to meet commercial banks' tough loan requirements. In case of lack of collateral and ability to prepare enough reliable financial documents, microenterprises have to evaluate alternative options. MFIs also serve for small businesses, and a portion of medium ones.

Term of "Micro-Finance" could be understood as various financial services, like credit, deposits, insurance and others served for microenterprises. In some literatures, this term is defined in the same way with "Micro-Credits". In fact, micro-credit is one part of micro-finance which is used for broader purposes rather than focusing on only credits.

MFIs always charge more interest rate, but in fact returns on credits are higher. This is because of lending to microenterprises could contribute more growth and income on these businesses.

Main obstacles faced by Micro Finance Institutions in serving small business:

- Lack of serving products to businesses: Micro Finance Institutions are focused on short-term credits. But needs of small enterprises are changing over the time. Offering other products like long-term credits, Deposits, Insurance, Transfer and Payments, Guarantees, Leasing should be developed by those institutions in order to be more competitive.
- Unspecialized department and staff: Especially in terms of relations with customers and risk assessment, having well-educated and trained staff is crucial point.
- Evaluation of loan application: In fact, there are many missed facts and records on loan application forms of small enterprises. It pushes loan officers to take extra efforts and improvise on the evaluation modalities in order to evaluate loan applications effectively which could be costly in many cases.

Factoring: As we know, factoring is one type of operations which one business sells its invoices, or receivables, to a third-party. Third party is also called "Factor".

This third-party gets right to collect these receivable from customers. It is useful tool especially in case of quick cash-need of business.

It might be clearer through example: Company A is factoring company. Company B is any company that huge amount on their account receivable balance is observed. In order to maintain liquidity or meet quick need for cash-flow, Company B decides to sell its receivables to third party. Assume company B has receivable amount of $1 million and decides to sell it to Factoring Company. İt is decided Company A will pay initial payment of $700,000, after collecting all amount receivable, they will pay $250,000. Rest of money, $50,000 is revenue of factoring company. Benefit of Factoring Company is this 5%. Benefit of Company B is that, they "collect" their receivable in advance. In fact, they loss 5%, but getting cash earlier than expected would be considered benefit for companies. Getting less money now than expected in one year is better than having no money at the moment, especially when you need money. Risk of factoring not being able to collect receivables, sometimes collected amount would not be enough to cover initial payment.

Factoring might face some other problems in developing markets. In most of the cases, factoring is one part of bank operations, so there is less-competitive environment for them to innovate. Second and more important factor is considered the lack of legal framework in those markets. Effective legal framework could support factoring operation through allowing businesses to sell their receivables to third-party, and allow factors to require payments from borrower without consent and information of selling business.

"The Legislative Guide on Secured Transactions of the United Nations Commission on International Trade Law (UNCITRAL 2010)" would be efficient model for governments to set up such legal frameworks.

Venture Capital Firms: Venture capital is type of financing focused on mainly providing capital to start-up companies and small businesses that are supposed to have great profit potential for the future. This could also be sufficient option for newly-established businesses that don't have enough capacity to be financed bank loans and some other sources.

Venture Capital Firms' investments are characterized by their high-risk profile. Because, businesses financed by those firms don't have any reliable credit history, financial statements or collateral. Though they assume such risks, they believe that their investment will succeed, because of growth potential of businesses they invest in.

In return of investing money in business, ventures get some shares of the company. By this way, they become partly owner of business and have direct control over company on making important decision. At this point, they have similarity with other private equities. But in contrast to other private equity deals, venture capital firms are focused on financing startups and newly-established firms that have great growth potential, while other private equity financiers are financing larger and known businesses' shares.

Venture Capital Firms face some obstacles in developing countries. One of the main problems is lack of developed IPO. IPO plays important role especially by allowing venture investors to transfer control back to business owner. Besides IPO, some critical factors like legal framework, legal origin, having effective accounting standards are important factors for development of Venture Capital Firms in developing markets.

Capital Markets

As discussed in the previous paragraph, diversification is one of the most fundamental solutions for facilitating access to finance for Small and Medium-Sized Enterprises. Bank loans are considered main option for financing. In fact, as getting bank loans are not easy and efficient, alternative sources come to action. In the previous paragraph, one of the alternative ways: non-bank financial institutions were discussed. In this paragraph, next important option: behavior of Capital Markets will be discussed in more detailed in terms of Debt Markets and Equity Markets.

If even it is easier to access, bank lending and other types of financing are considered efficient for the short-run. Financing in such maturities would be enough for businesses which are on their start-up periods. But businesses seeking long-term growth need to access financing sources for the long-term maturity.

At this point Capital Markets come into action providing long-term financing for businesses. As it is not obligatory required principal and interest payment in equity financing, it is another advantage of Capital Market. That is the main difference between Equity Financing and Debt Financing that puts less pressure on the business cash flow. This is converted to advantage especially during financial crisis. In such markets, price of security can give some basic information about value and performance of enterprise (if we ignore informational asymmetries between businesses and investors). Also, easiness of exit makes this market attractive by investors (if we ignore liquidity of the market, because this advantage is realized when it is easy to sell securities)

Listing in exchanges has some positive indirect effects on listed enterprises. It increases effectiveness of the company, by putting more discipline on business management. If company is doing well, price of their securities will go up. Securities are only traded commodity that when price is increased, supply also will go up. Because rising price of stock is signal that company is doing well and it has future perspective.

In fact, in developing countries, capital markets are considered risky market, especially those markets for small and medium sized enterprises. Lack of available accounting information, some other risks related to political, economic and financial issues, lack of developed legal framework are considered crucial factors of risk in developing markets.

Secondly, issuing equity or debt securities is costly. In this perspective high transaction costs, huge listing requirements, difficult legal and regulatory frameworks are remained main issues in capital market. Those are the main reason why financing through debt and equity securities is mainly used by larger firms. Businesses are incurred various direct and indirect costs when they decide to go capital markets. Direct costs might be included following costs; costs incurred to get prepared for the listing – documentation, change in legal status etc. IPO is important point. Successful IPO could mean the most important part of the story; it creates self-image for listing companies. Establishing successful IPO requires spending some fees like; underwriting fees, accounting and audit fees, legal fees, listing fees, communication, marketing and investor relations fees etc.

Third issue is basically related to liquidity of the market. In order to make market more liquid, there must be many actors like demanders and suppliers in the market. In fact, Capital Markets seem new and not-clear market for businesses in emerging markets. Lack of knowledge about security-exchange markets is one of the main challenges that Capital Markets face in developing countries. For lack of experience and high-listing requirements are main issues for SMEs in going to Capital Markets. On other hand, interest of investors for SME Capital Markets is low. Investors are more interested in large businesses, due to fact of potential informational asymmetries and risk profile of small businesses. Liquidity of market itself is the reason why investors are less interested in small and medium enterprises capital market.

Fact of being more effective of capital markets for large firms has spill-over effects on accessing to finance for SMEs. As this fact increases interest of larger firms on capital markets, it reduces customer-base of commercial banks. It increases chance of SMEs to access to bank lending financing.

Based on models working on developed countries, following ways could be better solutions for development of SME Capital Market in developing countries:

SME Equity Platforms: In the national stock exchanges, higher transaction costs and listing requirements make these exchanged less interesting for SMEs, especially in developing markets. SME Equity platforms are alternative to these national stock exchanges, as their more affordable listing requirements and costs. In the world, there are many examples for those platforms which play important role on SMEs' accessing to equity financing: the Alternate Investment Market (London), TSX Venture (Canada), HK GEM (Hong Kong), Mothers (Japan), Alternext (Europe) and AltX (South Africa).

In fact, those platforms are best suited for bigger SMEs, especially for Medium ones. Their listing requirement still might be not efficient for Small businesses. Listing cost ($80-100 K) and remaining listed ($100-120 K per year) might not be affordable for small businesses.

On the other hand, existing of these platforms doesn't affect investors' activity and interest for SME capital market. Still informational asymmetries and complex regulatory system of SME Equity platforms make it not interesting for investors.

SME Debt Platforms: As their offering interest rate is low, bond securities are considered better option than stocks. There are not many such Debt Platforms in the world, but existing ones make huge contribution on financing SMEs in the World. MARF is Spain-based Alternative Fixed Income Market that is operating as SME

Debt Platform. In Germany, many regional stock exchanges have established those platforms where approximately 2.7 billion euros have been raised by 50 businesses. Alternext is also planning to lunch such platforms on its own.

Establishing information platforms: Security exchange market is only place where parties trade securities**.** Those markets can also make chance for SMEs to reach various kinds of investors like venture capitalists, angel investors etc., also different types of additional professional services like due diligence and prospectus writing, making successful IPO, financial PR and marketing services.

In those markets, companies also find some professionals like professional accountants, auditors and legal advisors. They are important actors especially in terms of preparing effective and reliable financial documents.

As discussed, one of the main issues in low interest on those markets is lack of information. Exchange could solve this problem by giving information about listed companies directly or through online platforms.

International SME Capital Market: Establishing pan-regional capital market could be resulted in mass number of participants in the market place. That would be best solution to increase liquidity of market, then, making easier exit prospects for SME. Businesses in less developed countries could get chance to be financed by oversea investors, which mean increasing of number of potential investors. Also as the market size is developed, investors now have more options to make decision where to invest, which makes it easier to make more rational decisions.

In fact, this type of markets could face difficulties, especially reasoned by differences between cultures and economies. Cultural and behavioral differences, differences in currencies, legislation regimes, listing and disclosure requirements, also restrictions on foreign ownership could be potential reasons for difficulties in these markets.

What Governments can do?

IPO Task Force: IPO Taskforce is established by governments in order to support SMEs on accessing capital. They are characterized by developing small enterprises listing, including making more information available and more transparency for fund suppliers, tax incentives for buying and holding securities by their number of recommendations. Such task forces were established in US, then in Europe by Europe led by the Federation of European Securities Exchanges (FESE), European Private Equity & Venture Capital Association (EVCA) and European Issuers (EI).

Financial Incentives: Establishing more effective financial structure for SMEs in securities markets by government would be resulted in increasing activity in capital markets. For achieving that, governments have to take some financial policies like tax relief for businesses' capital gains for selling securities in the market, tax deductions for SME equity, and stamp duty exemption for the shares of SMEs. Reducing of regulatory compliance costs would be effective policy on development of activity of security markets.

Centralized rating system: Government can collect different information about company, and based on risk analysis they can establish rating system. Establishing centralized rating system database would be helpful for investors in order to evaluate different companies and make rational decisions.

In case of rating system, some drawbacks may be arisen in terms of rationality. Developing countries, with a less democratic and stable governments may use this factor as a way to increase their monopoly power in selected industries. An effective solution would be establishing independent body under Government so as to collect and analyse this data.

Conclusion

This report was designed to explore what the main difficulties of Small and Medium-Sized Enterprises in developing market. The most important issue-accessing to finance was report's focus point. In fact, developing countries are not called "developed" because of lack of sufficient environment. There are many crucial issues in developing markets which also affect negatively businesses in these economies.

Small and Medium-Sized Enterprises are considered backbone of nearly all of economies in the world because of their huge contribution on economic growth, employment, job creation and innovation. Defining and solution of their problems would have direct positive effect on general economy. Societies are aware of this fact enough, policies regarding development of this sector are one of main priorities of governments.

In fact, it is not easy process, especially in developing market markets. Regulatory framework, current situation of existing businesses, behavior and educational level of population, economic condition, actors in nation business, all those have crucial problems that affect development of SME sector. Finding innovative ways to solve these problems and to establish more favorable environment is one of the central questions on societies.

This report was focused mainly on those problems and found some innovative ways to solve these problems, especially financial problems. First thing need to be developed is regulatory framework. Most of developing countries got their independence in near history. Governments don't have enough experience on solution crucial problem. Newly-established governments are suffering some important problems, like political turmoil. Also, most of developing countries have political problems with other countries, or between different ethnic groups within country. These are factors that make it difficult to establish stable economic environment. Economic factors, like low economic growth, unstable currencies, lack of financial infrastructure have direct negative effect on development of businesses.

Mentioned problems in this report, affect negatively SMEs to access financing sources. In terms of financing source, banks are considered first option come into mind. In fact, other discussed options like non-bank financial institutions and capital markets are not effective solutions in developing markets, at least for the moment. That is basically related to education level of population. People don’t have enough information about alternative sources, and people who have information don’t rely on those types of financing. Those are newly-established sectors, especially equity financing. People don’t want to trust them and “loss” their full ownership on the businesses.

On other hand, investors don’t have enough ability to evaluate riskiness of the businesses. At first sight, those might be accepted as risky assets, and they are avoiding invest in these risky assets.

At the moment, focusing more on banking sector will be more realistic way for societies. This report discussed issues in bank lending and defined important solutions for these problems. Government interventions are important at this point. Establishing more effective environment for relations between commercial banks and businesses would be important step for development of SME sector.

Development of equity financing and non-bank financial institutions is less important at least for now, development of these sectors need a bit time. Improving education level of people, investors’ ability would be initial steps for developing these sectors, and might have potential on future development and establishing more diversified financing source options.

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