VOLUME 10 NUMBER 3 Aug 2018

ISSN 2076-9202 (Print)
ISSN 2218-046X (Online)

International Journal of Information, Business and Management

ELITE HALL PUBLISHING HOUSE

International Journal of Information, Business and Management

ABOUT JOURNAL

The International Journal of Information, Business and Management (IJIBM) was first published in 2009, and is published 4 issues per year. IJIBM is indexed and abstracted in **EBSCO, ROAD, OALib, Ulrich's Periodicals Directory, ProQuest (ABI/INFORM Global) , ZORA (Zurich Open Repository and Archive), IndexCopernicus, JournalSeek, New Jour, getCITED, Directory of Research Journals Indexing, Open J-Gate, Universal Impact Factor, CiteFactor, ResearchBib, EBSCO Open Access Journals, Scientific Indexing Service, InnoSpace - SJIF Scientific Journal Impact Factor, The Index of Information Systems Journals, National Central Library Taiwan, National Library of Australia , National Science Library (Chinese Academy of Sciences), German National Library of Economics, Eurasian Scientific Journal Index, INTERNATIONAL INSTITUTE OF ORGANIZED RESEARCH (I2OR), Stanford University (USA), The University of New South Wales (Australia)**. Since 2013, the IJIBM has been included into the EBSCO (Business Source Corporate Plus database), one of the largest full-text databases around the world. Since 2013, the IJIBM has been included into the ProQuest (ABI/INFORM Global) list. Since 2014, the IJIBM has been included into the National Science Library (Chinese Academy of Sciences) one of the top databases in China.

IJIBM is an international journal that brings together research papers on all aspects of Information, Business and Management in all areas. The journal focuses on research that stems from academic and industrial need and can guide the activities of managers, consultants, software developers and researchers. It publishes accessible articles on research and industrial applications, new techniques and development trends.

IJIBM serves the academic and professional purposes for those such as scientists, professionals, educators, social workers and managers. It provides new methodology, techniques, models and practical applications in various areas.

ISSN 2076-9202

International Journal of Information, Business and Management

CONTENTS

ISSN 2076-9202

ISSN 2076-9202

THE NEED FOR FINTECH COMPANIES AS NON-BANK FINANCING ALTERNATIVES FOR SME IN DEVELOPING ECONOMIES

[1]Zoran Temelkov
[2]Marija Gogova Samonikov

Abstract

Stricter banking regulation implemented in the post crisis period limited the access to finance for SMEs even further. Limited access of funds combined with the riskiness of SMEs influenced banks' readiness to lend funds to this sector. Thus, the development of small and medium enterprises is significantly hindered. Considering the importance of SMEs for economic development, limited access to finance consequently results in impeded economic growth.

Aside of obstructing the traditional financing channels, the post crisis period is characterized with development of new financing alternatives. These non-bank financing alternatives enabled the expansion of SMEs by providing new financing channels.

While in the developed countries fintech companies are going through a boom period, developing countries still lag behind. Even though the fintech financing is offering numerous benefits for SMEs, some countries are neglecting them and postpone their implementation.

Keywords: SME, fintech, financing, bank, developing countries

1. INTRODUCTION

Small and medium enterprises are crucial part of every economy. Their importance is consisted in the fact that they have significant contribution toward the job creation and social development. This in turns leads toward economic growth, which is the primary goal of every economy. Irrespective of the importance of SMEs sector for the economy and economic growth, this sector faces major obstacles, especially in developing countries.

These obstacles are hindering the possibility for creation and growth of small and medium enterprises. Maybe one of the most important obstacle is the limited access to finance. SMEs are faced with tight lending environment from the traditional banking channels. Due to changes in banking regulation, the banking sector is opting for limited exposure to SME sector. This unwillingness of the banking sector to provide funds to SME segment, has created the potential for development of alternative

[1] Prof. Zoran Temelkov, PhD, Faculty of Tourism and Business Logistics, University "Goce Delcev" - Stip, Macedonia, e-mail: zoran.temelkov@ugd.edu.mk (corresponding author).
[2] Prof. Marija Gogova Samonikov, PhD, Faculty of Economics, University "Goce Delcev" - Stip, Macedonia, e-mail: marija.gogova@ugd.edu.mk.

ISSN 2076-9202

financing sources. The alternative financing models are utilizing technological innovations and are evolving as new financing channel for entities with limited access to funds, and financial products.

These alternative financing models (fintech platforms) are increasing the financing possibilities for SME sector. Specifically, SMEs can decide whether they want to finance their activities through debt financing, equity finance or crowdfunding.

One limitation when it comes to fintech platforms is that alternative financing sources may not be available in some developing countries. Even though they offer numerous benefits, these economies are lagging behind the creation and implementation of fintech sources. Thus, SMEs in the developing economies are highly dependent on the banking sector for securing the needed funds.

2. IMPORTANCE OF SME'S FOR DEVELOPING COUNTRIES

Small and medium enterprises are particularly important for the economy i.e. the economic growth because of the numerous benefits they provide. First and foremost, SMEs are creating new jobs within the economy, and second, they have significant contribution toward social development (Angela, R., 2011). Namely, Nelson Duarte (2004) is stating that the economy benefits from SMEs not only from job creation and social development point of view, but also, there are benefits in terms of taxes, innovation, and most importantly, economic growth.

The importance of SMEs for the economy can be depicted from the fact that SMEs portion in the business worldwide is up to 90 percent, where SMEs are also creating from 50 to 60 percent of the jobs. Nicoleta Raluca Robu and Ludovica Ioana Savlovschi (2011) are supporting the aforementioned by stating that from statistical point of view, SMEs constitute around 99 percent of all companies. Moreover, more than 60% of the newly created jobs are created by the SMEs (Nicoleta Raluca Robu and Ludovica Ioana Savlovschi, 2011). The participation of SMEs in the economy also contributes toward the GDP growth. According to Dalberg Global Development Advisors (2011) SMEs growth is positively related with the GDP growth because SME increase the level of output produced in the economy. In addition, SMEs can provide support when it comes to income equality and more importantly they provide support for poverty alleviation. Taken into consideration the number of job positions created by SMEs, any policy aimed and augmentation of the SMEs sector can be directly related to the goal of reducing poverty. The creation of new jobs and improvements in the living standard means that the SMEs development and growth can contribute toward improvements in income distribution as well (Peter Raynard and Maya Forstater, 2002; Al Berry, 2001).

Regardless of the importance of SMEs for the economy, the potential for creation of new SMEs as well as growth potential of existing SMEs is impeded by plentiful obstacles, especially in the developing economies (Thorsten et al. 2008). Because of the vast social and economic benefits arising from the creation and development of SMEs, policy makers are making efforts to remove the obstacles responsible for hindered SMEs creation and growth. Whereas one of the biggest obstacle for SMEs creation and expansion is the limited access to finance.

3. PRESENT SME FINANCING ENVIRONMENT

ISSN 2076-9202

As it has been noted by (Yao Wang, 2016; Parmendra Sharma and Neelesh Gounder, 2012) one of the major obstruction for SME development and growth is the limited access to finance. With insufficient level of funds SME can perform only limited number of activities, thus growth potential of these enterprises is also restricted (Angela, R., 2011).

The traditional funding sources for small businesses have long been consisted of funds from friends and families, as well as personal funds (personal savings). But although these funds might be sufficient for the initial phase of starting the SME, in most cases they can only finance operating activities for a short period of time. These funds are not enough to cover any growth related activities. Thus, limiting the growth potential for SMEs. Aside of this category of funds, SMEs traditionally have used another channel through which they could obtain financing. Stated differently, SMEs have traditionally borrowed money from the banking sector to finance their operating as well as investment activities. The problem nowadays, the post-crisis period, arises in terms of bank willingness to finance certain sectors and groups of clients, more precisely the SME sector. Namely, the last financial crisis had widespread negative effects regarding the financing activities of higher risk sectors.

One such adverse effect arising from the 2007-2008 crisis, is the implication for SMEs financing. Specifically, SMEs are now operating in an environment in which they have difficulties to obtain financing through the traditional lending channels. This difficulty is direct result from the increased regulation and higher capital cost imposed on the banking sector for certain types of loans, and lending to certain categories of borrowers (World Economic Forum, 2005). Bank are generally trying to avoid customers who are characterized with increased riskiness. In case they provide financing to these risky customers, then banks will charge higher fees and interest rates.

3.1 CHARACTERISTICS OF SME SECTOR FOR POTENTIAL FINANCING

Although banks are providing financing to the private sector, they do prefer the larger companies over the SME especially start-up firms. This preference by banks to finance large companies is mainly because of the characteristics of small and medium enterprises. According to Laura Vasilescu (2014), the characteristics of SME because of which banks avoid to provide finance are:

- Weaker financial structure or lower capitalization
- Low level of diversification
- Low or non-existing credit ratings
- Mainly depend on credit to finance activities
- Limited financing options, limited access to financial markets
- Inadequate level of collateral or no collateral
- Higher transaction costs

These characteristics of small and medium enterprises are the reason why banks are disinclined to provide funding for this sector. First and foremost, the cost for banks to finance this sector are high especially taking into account the fact that SMEs usually require smaller loans. Thus, high costs for banks to service small businesses segment are not justified by the loan amount demanded by SMEs. Moreover, the riskiness of this sector is perceived to be high because of lack of collateral and lack of financing

ISSN 2076-9202

options. Because of the way assessment is performed by banks, lack of credit history is hindering the ability of potential borrowers, this is also the case with small and medium enterprises.

Aside of the aforementioned characteristics, there are also some other aspects of the SME responsible for their limited access to banks' funds. One such aspect is the asymmetric information that exists when it comes to borrowing funds to SMEs. The existence of informational asymmetries between SMEs and banks means that small business owner might withhold relevant information.

Moreover, Thorsten et al. (2008) are stating that banks have lower exposure to SME because they have higher level of non-performing loans coming from this sector, which is one indicator about the riskiness of this sector. In addition, they are also pointing out that banks charge higher interest rate and fees for loans provided to SME.

The above mentioned characteristics of SME are pushing banks to limit the funding provided to this sector. But on the other hand, SMEs have certain characteristic which makes them attractive for funding. Namely, small and medium businesses are operating in highly profitable environment. Because of the growth potential of SMEs, they have the potential to be highly profitable enterprises and/or investment.

Some of the characteristics of small and medium enterprises are major reasons why banks avoid to finance their activities. Banks are becoming additionally discouraged to lend to the SMEs sector after the 2007/08 financial crisis. This crisis resulted in numerous changes in regulations. The new environment has witnessed increased capital requirements for riskier loans because of augmented regulation (namely, Basel III). These new requirements are increasing the cost of capital for banks when providing riskier financing.

Considering the importance of SMEs for the economy and the fact that banking sector avoids to provide financing to this sector, the access to finance is impeded even more. Hence, the possibility for development of alternative financing sources has been created. This opportunity has been grasped by numerous non-bank financing firms willing to provide funding for the SMEs sector.

4. FINTECH FINANCING OPPORTUNITIES FOR SME'S

It was noted that the crisis had negative impact on the SME financing opportunities. But, it should be mentioned that the crisis had two sided effects. On one side there has been the increase in regulation and financing costs for the banking sector. On the other side it created an environment for development of new and innovative financing models. Thus, although the financial crisis had negative impact on traditional SME financing channels, it did provide ground for development of innovative funding channels. Namely, the obstacles faced by SME in terms of financing have created the opportunity for development of new business models regarding the offer of financial products (World Economic Forum, 2005, pp3.). These new and innovative financing alternatives have been explored in the FinTech area. FinTech companies are increasing the availability of SME financing alternatives, because of changes in the risk assessment techniques and funding sources.

ISSN 2076-9202

According to the World Economic Forum (2015) the potential of new FinTech financing alternatives is vast for SMEs. This in a way that their business models are efficient for a low scale financing, something SMEs need, and banks usually avoid.

These new financing models are fulfilling the financing gap for SMEs. The alternative financing models are utilizing the technological innovations through the employment of different types of financing platforms. The basic forms of alternative financing platforms are crowdfunding model or peer-to-peer lending (P2P) model. Worth mentioning is that there are also other types of financing platforms depending on the characteristics of specific financing and funding model (Robert Wardrop et. al., 2016).

Some of the most common alternative financing models as defined by Robert Wardrop et. al. (2016) are presented in table 1. These alternative financing models differ in terms of the financing sources and/or the funds disbursement model, as well as the market they serve.

Table 1: Overview of online alternative financing models

Alternative financing models	Definition
Marketplace/P2P consumer lending	Individuals or institutional funders provide a loan to a consumer borrower
Balance sheet consumer lending	The platform entity provides a loan directly to a consumer borrower
Marketplace/P2P business lending	Individuals or institutional funders provide a loan to a business borrower
Balance sheet business lending	The platform entity provides a loan directly to a business borrower
Marketplace/P2P real estate lending	Individuals or institutional funders provide a loan secured against property to a consumer or business borrower
Real estate crowdfunding	Individuals or institutional funders provide equity or subordinated-debt financing for real estate
Invoice trading	Individuals or institutional funders purchase invoices or receivable notes from a business (at a discount)
Equity-based Crowdfunding	Individuals or institutional funders purchase equity issued by a company.
Reward-based Crowdfunding	Backers provide finance to individuals, projects or companies in exchange for non-monetary rewards or products.
Donation-based Crowdfunding	Donors provide funding to individuals, projects or companies based on philanthropic or civic motivations with

ISSN 2076-9202

	no expectation of monetary or material return.

Source: Robert Wardrop et. al. (2016) "Breaking New Grounds – The Americas alternative finance benchmark report", Cambridge Centre for Alternative Financing, pp.30.

Going through the different alternative models, it can be noted that SMEs can finance their activities in a most preferred manner. Namely, the fintech platforms offer the possibility for debt financing or equity financing, even crowd funding. Furthermore, SMEs have access to funds from individual funders or institutional funders.

Noteworthy mentioning is that the aforementioned alternative financing models are some of the basic non-banking financing models utilizing the technology innovations, there are some other models as well. For instance, Peter Baeck, et. al. (2014) are stating the community shares and pension-led funding as additional financing alternatives. Fintech industry is highly innovative, and new alternative sources are created regularly.

5. BENEFITS ARISING FROM FINTECH FINANCING ALTERNATIVES FOR EMERGING ECONOMIES

Although initially online financing alternatives have been neglected by the banks, nowadays they are perceived as the major disruptor for the financial sector, especially banking sector. Thus, they are attracting attention and gaining on popularity among the customers as well as the potential investors. For instance, according to Robert Wardrop et. al. (2016) the peer-to-peer consumer lending model has accrued more than $25 billion in 2015 in the Americas, while balance sheet consumer lending segment has accrued a little more than $3 billion.

It is more that obvious that new financing alternatives should be developed and implemented, especially in the emerging countries where access to finance for SME is highly limited. Positive aspect from creating non-bank financing alternatives creation in developing markets are the new opportunities not only for borrowers, but also for investors (depositors). When talking about the benefits of alternative sources for financing, both sides should be taken into consideration i.e. borrowers (SMEs) and investors (entities willing to save or invest their funds).

Major benefit for SMEs coming from the fintech sector is access to finance, through which major obstacle impeding SMEs growth is eliminated. Another benefit would be consisted in the fact that fintech platforms are decreasing the transaction costs as well as the service cost for smaller loans. Meaning that there is justification to lend funds to small and medium enterprises, which is not the case with the banks service costs. Moreover, these platforms are reducing the search costs for borrowers, because platforms are bringing all investors at one place. Thus, it is much easier for the SME to find investors willing to lend (or invest) money in their start-up or growth plans.

One reason why banks avoid to lend funds to SMEs is the lack of adequate information. This

ISSN 2076-9202

means that the assessment process can have high costs not justified by the smaller loans demanded by SMEs. This problem is overcomed with the fintech financing alternatives. Because of the way credit scoring is performed by the lending platforms, lenders have lower assessment costs, consequently they are able to provide smaller loans to SMEs (Miriam Segal, 2010). According to Miriam Segal (2010) the benefits are also felt by the SME sector as well in terms of simplified and less costly application process (through online application).

On the other hand, investors also enjoy benefits from these alternative lending sources. Namely, with the trend of decreasing interest rates, certain instruments offer very low return. Consequently, investors are on a constant search for profitable investments. This search is eased with the creation and development of fintech platforms. Because platforms have lower operating costs and borrowers have higher level of riskiness, investors are able to earn higher returns. At the same time, these returns demanded by investors, are not hindering the growth potential of SMEs. Also, the fintech platforms offer the possibility for risk dispersion for investor, through diversification of their portfolio. Namely, investors (lenders) are financing the activities of different SMEs by providing fraction of their funds to different borrowers. In case of a borrowers default, different investors stand to lose small fraction of their funds, instead of one investor losing all of the funds.

Even though there are many benefits arising from the FinTech financing sources, there are also some risks involve. Risks that should be mentioned according to World Economic Forum (2005) are:

- Limited protection of investors
- Providing funding for unreliable borrowers
- The possibility for systematic risk as a result of insufficient regulation of this sector.

In addition, fintech platforms also come with certain risks for the SMEs. Namely, because of lower regulation, it is easy for a product or service idea to be stolen. Moreover, depending on the type of financing sources of fintech platforms, the SMEs might end up with non-professional investors. This is especially important drawback for equity financing platforms.

One of the primary benefit for developing countries arising from the availability of alternative financing sources for SME is the increased access to finance. Namely, Ross P. Buckley and Sarah Webster (2016) are pointing out that these new financing sources offer the possibility for the unbanked sector to be able to gain access to much needed funds (working capital, investment capital, etc.)

It should be noted that regardless of the benefits arising from non-bank alternative for financing SMEs activities, some developing economies still lag behind in the adoption of new technological trends. There are economies where the benefits of fintech platforms have not been considered or even identified yet.

CONCLUSION

The data shows that SMEs are particularly important for economic growth. They contribute toward job creation, social development, income distribution, higher taxes, and innovation. All these benefits coming from the SMEs sector are imposing the need for removal of possible obstacles which are hindering the

ISSN 2076-9202

creation and growth of small and medium enterprises.

One such obstacle is the limited access to finance. This obstacle is augment even further after the last financial crisis. Because of changes in regulation, banks have limited their exposure to the small and medium enterprises sector. In turn, this created the possibility for new financing channel to enter the financing market. These new entrants have different business models, in which the latest technology is incorporated. Fintech firms are providing alternative financing sources for SMEs (debt financing, equity financing, etc.). Fintech business models could additionally differ in terms of the type of investors (individual or institutional investor).

Considering the importance of SMEs for economic development, developing economies should pay special attention to these fintech platforms. Enabling SMEs to have alternative financing channel will eliminate their dependence on the banking sector, sector which is becoming conservative in their lending policy. Unfortunately, numerous developing countries are not implementing policy and procedures aimed at the creation and promotion of fintech platforms.

REFERENCES

Al Berry (2001). *The Role of the Small and Medium Enterprise Sector in Latin America: Implications for South Africa.* Trade and Industry policy Secretariat (TIPS), Working paper No. 5.

Angela, R. (2011). *SMEs' sector access to finance: an overview*. Annals of the University of Oradea, Economic Science Series, 20(1), 431-437.

Dalberg Global Development Advisors (2011). *Report on Support to SMEs in Developing Countries Through Financial Intermediaries.* Dalberg Global Development Advisors.

Laura Vasilescu (2014). *Accessing finance for innovative EU SMEs – key drivers and challenges.*Economic review – journal of economics and business, vol. xii, issue 2, November.

Miriam Segal (2010). *Peer-to-Peer Lending: A Financing Alternative for Small Businesses.* Office of Advocacy Issue Brief Number 10

Nelson Duarte (2004). *The role of SMEs for development: a literature review*. 44th Congress of the European Regional Science Association: "Regions and Fiscal Federalism", 25th - 29th August 2004, Porto, Portugal

Nicoleta Raluca Robu and Ludovica Ioana Savlovschi (2011). *The Role of SMEs in Modern Economy*. Economia. Seria Management Volume 14, Issue 1.

Parmendra Sharma and Neelesh Gounder (2012). *Obstacles to bank financing of micro and small Enterprises: empirical evidence from the pacific with some policy implications.* Asia-Pacific Development Journal Vol. 19, No. 2,

Peter Baeck, et. al. (2014). *Understanding alternative finance – The UK alternative finance report 2014.* NESTA.

Peter Raynard and Maya Forstater (2002). *Corporate social responsibility: Implications for Small and Medium Enterprises in Developing Countries*. United Nations Industrial Development Organization.

ISSN 2076-9202

Robert Wardrop et. al. (2016). *Breaking New Grounds – The Americas alternative finance benchmark report*. Cambridge Centre for Alternative Financing,

Ross P. Buckley and Sarah Webster (2016). *FinTech in Developing Countries: Charting New Customer Journeys*. The Capco Institute Journal of Financial Transformation

Thorsten Beck, et. al. (2008). *Bank Financing for SMEs around the World - Drivers, Obstacles, Business Models, and Lending Practices*. Policy Research Working Paper 4785, pp.

World Economic Forum (2015). *The Future of FinTech - A Paradigm Shift in Small Business Finance*. Global Agenda Council on the Future of Financing & Capital, October, REF 131015.

Yao Wang (2016). *What are the biggest obstacles to growth of SMEs in developing countries? An empirical evidence from an enterprise survey*. Borsa Istanbul Review 16-3 (2016) 167-176.

ISSN 2076-9202