The Macrotheme Review
A multidisciplinary journal of global macro trends

A Borrowing reasons and goals according to the opinion of Hungarian small and medium-sized enterpirses according to the size of the company [1]

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Abstract

There are many ways to fund a business by the enterprises. Money can be freed from the company for the operation and investment by replenishing the reserves, by reducing the surplus stock, or by holding back and reverting the result. However, if these resources are insufficient, only external funding can be taken into consideration either by involving new owners, or by raising money from the capital markets. Credit financing is the most relevant source of funding domestic small and medium-sized enterprises. In addition to borrowing, other external sources may also be involved, but their importance is low due to the lack of trust and financial knowledge and the underdevelopment of money and capital market relationships. In the post-crisis years, Hungary was one of the countries where lending started as slow as possible. Behind the slow recovery of borrowing was the low level of creditworthiness and the restraining of banks' lending activity. This situation was enhanced by the Hungarian National Bank's credit program, which enabled enterprises to make their investments that they needed years before. But with the end of the program, the future of the credit financing is questionable today. Debt financing is important for SMEs, but are the enterprises afraid of market-based borrowing, mainly because of the consequences of the crisis? If they would like to take credits, what would be the purpose of the lended money? The study tries to find answers to these questions in the light of the results of a questionnaire survey, pointing to the most important borrowing purposes and directions, which are important information for fundraisers and financiers as well.

Keywords: SME, internal financing, external financing, credit financing, primary research

1. Overview of literature

The financing of enterprises, especially small and medium-sized enterprises, is one of the most popular issues today. The crisis of 2008 drew the attention even more to the financing anomalies of the SMEs. The impacts of the credit crisis, initiated by defaulting mortgage bonds

[1] SUPPORTED THROUGH THE NEW NATIONAL EXCELLENCE PROGRAM OF THE MINISTRY OF HUMAN CAPACITIES

and savings invested into overpriced assets, passed incredibly slowly (Cowling et.al, 2012), it can even be felt today to some extent, although almost 10 years have already passed since the first shocking effects. Due to the excessive lending, irresponsible risk taking caused and still causes the demise of several banks, both before and after the crisis (Campbell, 2007). Measuring the lending activity and the lending risks has been an important question of the bank system ever since (Wang et.al., 2012), which is also highly dependent on the relationship between the banks and the enterprises. If there is a solid and strong relationship between the banks and the enterprises, then the banks are showing more willingness to lend money on the basis of senior lending, in fact, they are capable of taking higher risks too (Petersen – Rajan, 1994). The features of the enterprises (small or large, bank-dependent or not bank-dependent) have a huge influence on the available loans as well. The features of the enterprises also greatly affect both the difficulties deriving from information asymmetry and the transaction costs, through which they have an impact on the amount of available funds too (Leary, 2009).

The inadequate allocation and incorrect distribution of loans and the marginalization of the the small and medium-sized enterprises has a negative impact on the overall economic performance (Restuccia – Rogerson, 2008). The decline in the banks' desire for lending after the crisis set the national economies back by years worldwide, as they did not provide sufficient resources for the SME sector, which accounts for a significant part of the economy (Filippetti – Archibugi, 2011). Researches proved that subsequent to the crisis companies that had long-term credit resources were forced to hold back on their investments or even to stop them (Almeida et.al, 2011). Added to this is the enterprises' fear of credit resources, since a lot of enterprises had to overcome huge financial difficulties during the crisis and the subsequent years. In light of the above it can be stated that the external economic shocks and crises have a major influence on the supply of capital (and thus on the behaviour of the banks too), in addition to transforming the corporate behaviour in the field of funding and investment decisions (Lemmon – Roberts, 2010).

Loans play a key role in financing, especially with regard to boosting the economy and putting it back on its feet. Beck (2012) lists how lending can influence the economic growth: it is able to increase entrepreneurship and the size of the operating companies, it increases the export sales and therefore the export revenues too, and it improves the efficiency of economic policy instruments. Although trends had already appeared that emphasized the option of creditless recovery (Abiad et.al, 2011), this is unimaginable in the Eastern part of Europe under the current financing circumstances, hence the existence of this concept was denied by Biggs, Mayer and Pick in 2009. The special role of loans in corporate finance gained higher attention during the years after the end of communism, when from the nineties foreign-owned banks showed up not only in Hungary but in the region as well. Along with their liquidity the foreign subsidiaries also brought their practices and methods, which in the Eastern-European region unfortunately were not accompanied by such knowledge from the receiving parties that would have been able to treat the loans at the right place within the financing structure. In many cases the reason was the excessive indebtedness and the irresponsible borrowing, which was substantially overwritten by the bankruptcy of the Lehman Brothers in 2008 (Banai, 2016).

Coursebooks describe the financing of enterprises from two aspects. On one hand, we can define intrinsic sources, i.e. those that come from the operations, existence of the company, and external sources arriving from outside the company, from the money and capital markets. On the other hand, we can also speak about short-term, i.e. within a year and long-term (longer than a year) resources. Using these resources in the operations of the company and defining their proportions has long interested experts dealing with the topic. One thing can be stated, namely that no proportion of these pairs of resources can be applied to all enterprises operating in a given sector. Smaller enterprises which do not wish to grow due to anomalies in financing need different amounts and contents of resources than older enterprises which are able to get different resources because of their professional experience and and entrepreneurial network of contacts (Cabra-Mata, 2003).

Financial experts have been involved in developing the theory of optimal financing for a long time. The following names and theories can be mentioned in contemporary financial thinking:

1. The classical theory of capital markets by Modiglinai and Miller (Brealy – Meyers, 1999): which states that company financing has no considerable effect on company value, considering significant assumptions (no taxes, no transactional costs).
2. Willamson's principal-agent theory (Williamson, 1998): according to this theory the Principal (owner) delegates certain decisions to the Agent (manager), who has better information, insight in certain questions, which makes operative decision-making easier2, but might cause moral issues.
3. Meyers – Majluf hierarchy theory (Myers – Majluf, 1984): describes the background of company financing based on the previous theory, i.e. enterprises use reinvested earnings primarily, and if equity is not sufficient for financing they use external capital, and external equity ownership in the end.
4. Coase – Reis transactional costs theory (Coase, 1934): according to which financing with external capital (credit) means smaller transactional costs because of existing information than equity where potential investors have a significant need for information about the share or bond concerning their investment.
5. Brealy – Meyers' theory of choices (Brealy – Meyers, 1999): states that, based on the capital structure of companies the financing of a company is formed by the assets of the enterprise.
6. Grochla – Pfohl's classic description of financing theory (Pfohl, 1997): examines company financing according to four aspects (forms of financing, incidents, analysis and planning), and shows the benefits and drawbacks of each form according to these.

According to the banking practice, corporate lending is the segment that is able to react to the crisis-related economic circumstances the fastest. Crises are unavoidable corollaries of the modern economies, hence we are forced to adapt and prepare to them. Several articles and studies have already dealt with the causes of the crisis of 2008. Some are looking for those responsible on the demand side (households, companies, states), others blame the supply side (banks, financial institutions), and certain opinions accuse the regulators (supervisory authorities, central banks) with escalating the problems (Lentner et.al, 2011). The issues of the financial intermediary system first appear in the erosion of resources and in the declining willingness to take risks. Due to the decreasing corporate revenues and shrinking markets (caused by the crisis), the value of the available cash-flow is getting reduced as well, as a result of which the debt

[2] Financing decisions also belong here. The Agent is not always likely to choose the most optimal financing alternative for the enterprise because of his mid-term interests.

service causes difficulties, which will be an obstacle within a short period of time to borrowing more funds.

Given what has been described above, we tried to assess the beliefs about loans based on the opinions of the other side, highlighting the facts and thoughts that have a major impact to the borrowers' way of thinking.

2. Material and method

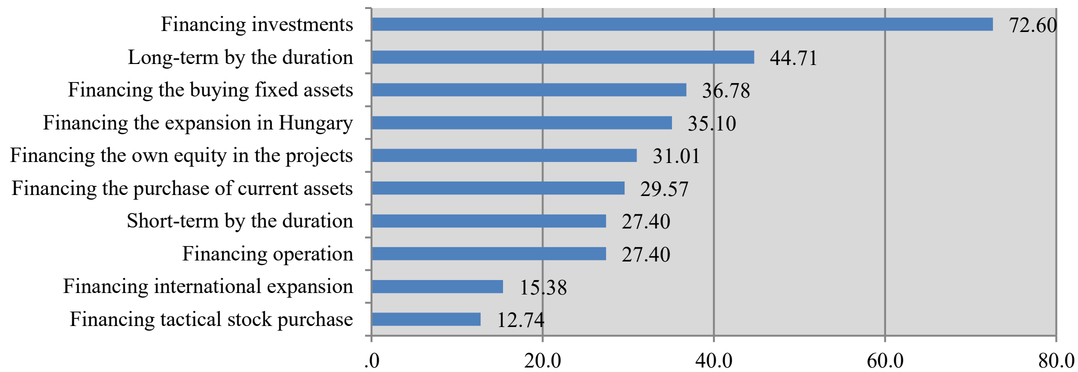
The research results introduced in this study are part of a primary questionnaire research conducted in 2017. The research was carried out in Hungary with the help of a pretested and standardized questionnaire form. The present research was preceded by a previous survey among enterprises, which had been preceded by an in-depth interview analysis. The present questionnaire form was created as a result of these two former rounds, and it was a complex questionnaire, covering the financing and investment activity of the enterprises. The survey paid special attention to the enterprises' project management and project financing practices as well.

During the research we received 521 questionnaires, but only 416 of them were assessable enough to be included in the sample. The results of the research are presented in this study based on the employment figures of the responding enterprises. The majority of the sample, 85%, comprised of smaller enterprises with less than 50 employees, which meant 355 enterprises. The proportion of the medium-sized enterprises was 9% (38 enterprises), while the larger companies had a percentage of 6% (23 enterprises), therefore it can be established that the results presented in this study introduce the reasons behind borrowing mainly from the aspects of the small and medium-sized enterprises.

3. Results

The study introduces the borrowing objectives and reasons from the perspective of the small and medium-sized enterprises. On the basis of the opinions of the enterprises participating in the sample, it became clear that if we took out a loan it would likely fund investments, which is confirmed by the highest percentage, 72.6%. Another important factor is that the loans should be long-term, followed by the fact that they would be used for purchasing fixed assets. The first three borrowing features shows a definite investment orientation. On top of these the enterprises also found it significant that the borrowed capital would finance their domestic expansion. What is peculiar is that the approached enterprises do not want to finance their international market entry or expansion and the tactical acquisition of stocks from loans at all. Another interesting result is that they wouldn't really like to take out current assets or short-term loans, neither now nor in the near future.

Figure 1.: Borrowing objectives and characteristics based on the opinion of the companies



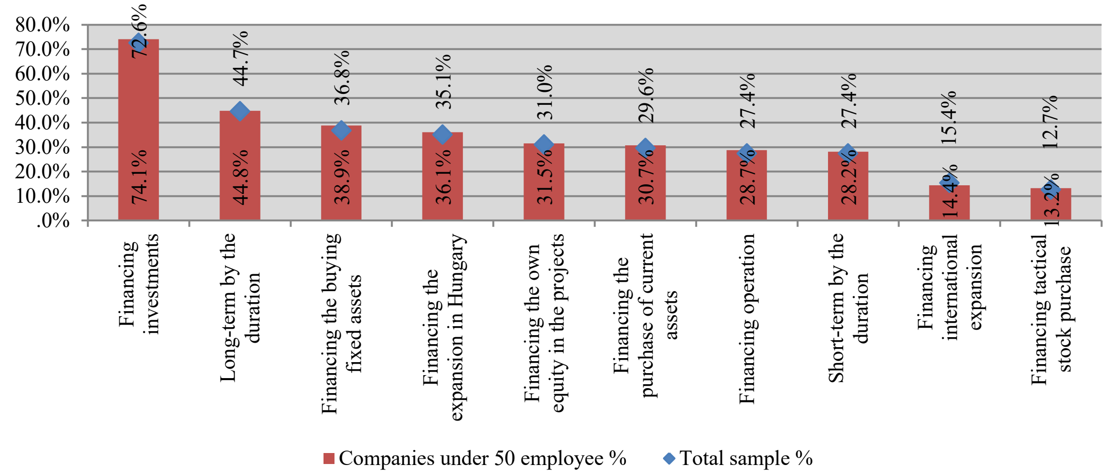
Source: own research, 2017, N = 416

The answers will now be evaluated by the size of the enterprises, grouping the responding enterprises on the basis of the number of employees.

First, let us take a look at the opinion of the enterprises with the smallest number of employees, namely with fewer than 50 people. These enterprises constitute the vast majority of the sample, hence their point of view will be close to the sample mean. It has become evident that the small enterprises would take out loans mostly for financing investments, and this goal received a higher rate by 1.5 percentage points than the sample mean, which indicates that the other two segments do not consider loans as clearly to be funds for investments, or at least they do not take that into consideration in the same rate. In the case of small enterprises we can undoubtedly see the dogma we learnt from our financial studies, which said that loans will not cause problems if they are spent on financing investments, because the investment will be able to cover the loan and produce the source of the reimbursement. With regard to long-term loans the result is roughly the same compared to the sample mean, and they would also finance fixed assets from loans in a higher proportion than the enterprises of the whole sample, which can be seen from the 2.1 percentage point higher rate. The small enterprises would finance their market entry by means of a loan in a smaller percentage than the sample mean, and in their case this is not a relevant appropriation, as the majority of the small enterprises are unable to be tested in the international competition due to the absence of resources and other factors.

It is an interesting fact that the long-term approach focusing on investments emerges in the small enterprises the most. In view of the above it can be noted that if the smallest enterprises took out loans, they would do it much more carefully than their larger counterparts, they would think in the long run and finance investments from it. They are modest in terms of other objectives and features too, which is best displayed by the rates around 30% or even under.

Figure 2.: Borrowing objectives and characteristics according to the opinion of the smallest companies

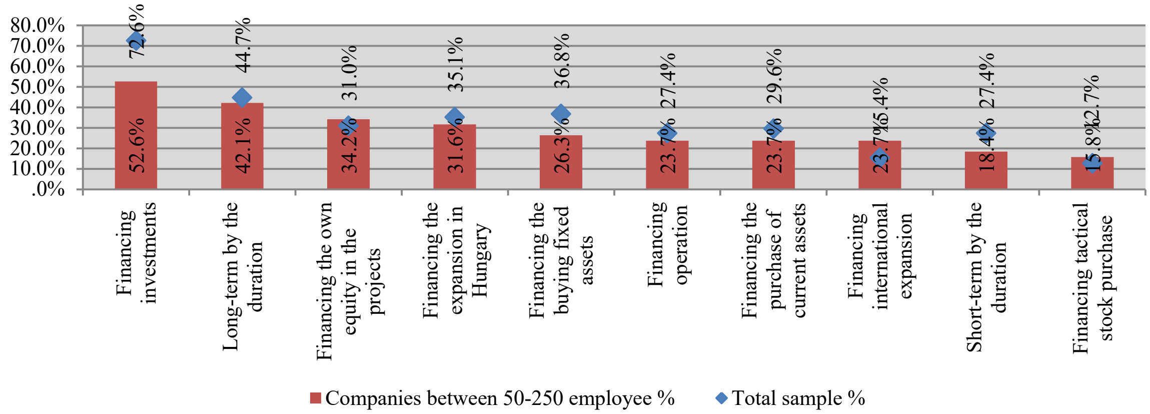


Source: own research, 2017, N = 416

In the case of the medium-sized enterprises with 50 to 250 employees the below graph clearly shows that they would also finance investments with the help of loans, and by all means they would only consider long-term loans. However, it is standing out that the enterprises willing to finance investments voted on this characteristic at a lesser rate than the sample mean by 20 percentage points. What is more, in respect of long-term loans the rate is lower again by 2.6 percentage points. In their opinion providing own funds for tenders is ranked third, beating the objective of purchasing fixed assets, and on its own this result was 3.2 percentage points higher than the sample mean. This implies that the medium-sized enterprises are braver, they have more courage for seeking to tender, with which they are capable of renewal, improvment and remaining in the competition. Accordingly, these enterprises see an opportunity in borrowing and they try to carry out further money-making activities through taking out loans. Unfortunately this also proves the capital shortages of the enterprises, and at the same time confirms their dependency on banks, but the situation can also be interpreted in a way that with financing own funds for tenders through borrowing the enterprises focus on reducing the risks of the owners.

In the case of domestic growth we can see a smaller rate that is lower than the sample mean by 3.5 percentage points, whereas financing fixed assets (that was ranked third based on the opinion of the entire sample), which was next in the line, is lower than the average of the sample by 10.5 percentage points. Tactical aquisition of stock occupies the last place, being preceded by short-term borrowing, which 9 percentage points lower than the opinion of the whole sample. The results explained above in relation to the medium-sized enterprises are illustrated in the below graph.

Figure 3.: Borrowing objectives and characteristics according to the opinion of the medium sized companies



Source: own research, 2017, N = 416

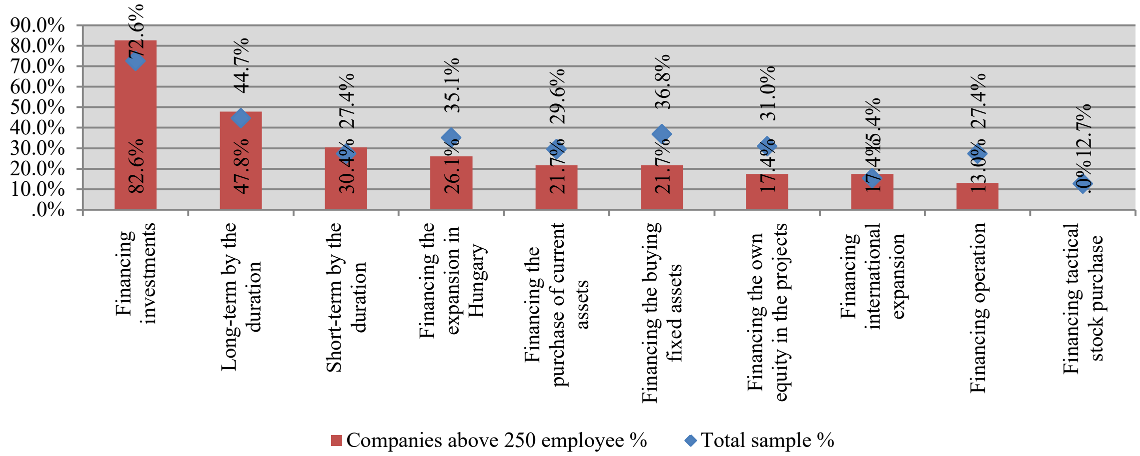
At the largest enterprises that have more than 250 employees the objective of financing investments has a strong (the strongest) presence again, which is certified by the 10 percentage points difference as well, compared to the sample mean. Long-term borrowing is more significant too (3.1 percentage points), and as a new feature, short-term borrowing also appears among the goals, which was diminished in the case of the other two segments.

Financing their domestic expansion from loans is more accentuated as well in larger companies than in smaller ones. The main borrowing objective being financing the domestic expansion was ranked fourth by the large enterprises, but it was still 9 percentage points lower than the sample mean. The reason for this is that the sample was mainly consisted of small enterprises, so the opinion of the large companies faded into the background. The same can be observed in connection with all the other borrowing objectives or characteristics, namely that the rates are lower than the figures of the whole sample.

Financing their expansion on the international market had the next lowest ranking on the list with 17.4%, which was higher than the sample mean, and it clearly shows too that the large enterprises are braver and more keen on entering the international market, because they have opportunities and resources to do so. In the second-to-last place was financing the operations themselves, which is very low compared to the sample mean (13%, compared to 27.4%). On this basis the large enterprises do not need loans for their day-to-day operations, since they can obtain the necessary resources from even commercial credits as well.

It can also be noticed that the large enterprises wouldn't like to finance their own funds for tenders via loans, which is demonstrated by the 13.6% rate of lagging behind the sample's average opinion (17,4% compared to 31%). In other words, the large enterprises that are well capitalized and are better able to connect to the capital markets are able to obtain resources from these markets, thus they are unwilling to provide their own funds for tenders through borrowing. All of this is also shown in the below graph.

Figure 4.: Borrowing objectives and characteristics according to the opinion of the biggest companies



Source: own research, 2017, N = 416

4. Summary

In view of the results presented in this study it can be established that the Hungarian enterprises do not dismiss debt financing, but consciousness and long-term thinking can undoutedly be discovered in their mindset. It is clear that the Hungarian enterprises – just like the foreign ones – have learnt from the crisis and they do not or would not take out loans just for any reason, as now they are much more conscious and prudent on this issue.

It is also obvious that the enterprises would like to finance investments and projects from loans, for which they need long-term loans, and after the borrowed resources are available at hand, they would spend that amount on fixed assets, i.e. the scope of the investments. They are reluctant to take out working capital loans for short term, because they learnt from the period subsequent to the crisis that it is risky and it could cause financial difficulties and even loan default.

In conclusion, for the future the enterprises intend to apply for debt-like financing more consciously, not driven by the credit supply of banks, but in a targeted way, for the purpose of the competitiveness and renewal of the company, which shows a higher level of financial consciousness from the perspective of the financial decision makers of the enterprises.

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