




## THE ROLE OF FINANCIAL SUPPORT FOR THE PERFORMANCE AND SURVIVAL OF MICRO-ENTERPRISES

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**Abstract.** *Purpose* – to examine the Latvian micro-enterprises having indicated the external financing as an important factor for their development.

*Research methodology* – the results of the ad hoc survey (WAPI) on companies registered in Latvia in nationally defined sectors are used. Valid responses were received from 2.511 companies, of which 1.879 were micro-enterprises, the results were processed by using the SPSS programme.

*Findings* – micro-enterprises that have not received the necessary external financing in previous years were less sustainable in the later period. Of the liquidated micro-enterprises examined, 16% were closed in 2020.

*Research limitations* – the study highlights the impact of the availability of finance factor on the survival of micro-enterprises.

*Practical implications* – the findings are useful for business support policy makers to identify preventative measures to ensure the resilience of micro-enterprises in times of economic turmoil when the spread of the Covid-19 has affected economy.

*Originality/Value* – although scientific research on the need for financial support for companies has already been conducted in recent years, our study emphasizes the importance of access to finance for micro-enterprises.

**Keywords:** banks, finance institutions, firm performance, micro-enterprises, micro-entrepreneur financing.

**JEL Classification:** G21, G23, G28, L25, L29.

**Conference topic:** Contemporary Financial Management.

### Introduction

Small and Medium Enterprises (SMEs) are recognized all over the world as backbone of modern economies because they make major contributions to global economic growth and sustainable development through employment generation, poverty alleviation, wealth creation and food security (Peter et al., 2018). According to the World Trade Report (World Trade Organization, 2016) in developed countries, SMEs account for more than 90% of enterprises, contributing 60–70% of employment and 55% of gross domestic product (GDP). In turn, the OECD report showed that SMEs could provide up to 45% of total employment and 33% of GDP in emerging countries (Organisation for Economic Co-operation and Development [OECD], 2017). According to the findings of the Small Business Administration 78.6% of newly established businesses between 2005 and 2017 survived one year (Small Business Administration [SBA], 2018). Unfortunately, only about half of these companies have a business life of five years. In turn, only one in three small businesses typically reaches ten years of operation. Although the data presented here refer to the United States, other studies show a similar trend worldwide (Erskine & Yong, 2020).

The aim of our study is to find out the importance of financial support for the development of micro-enterprises from the point of view of entrepreneurs themselves and the reaction of financial employers, promoting the availability of financial support for micro-enterprises, which is the largest share of SMEs in Latvia. The study focuses on the

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availability of financial support in Latvia for micro-enterprises in accordance with the European classification system (European Commission, 2003). Micro-enterprises make up 94% of all economically active enterprises in Latvia (Central Statistical Bureau of Latvia, 2020).

According to the OECD (2020), the SME lending sector in Latvia is dominated by banking sector lending, which accounted for 74% (at the end of 2018) of total lending to local non-financial corporations (NFCs). Although loans to the SME banking sector decreased by 8.3% in 2018, excluding one-off effects, the volume of loans to SMEs did not change significantly (-1.0% year-on-year). In 2018, new loans (flow) to SMEs were slightly higher than in 2017 (3.9%). In 2018, the new lending (flow) to SMEs was slightly higher than in 2017 (by 3.9%). Over the period covered by the OECD assessment, the overall economic environment remained favorable, supported by rising investment and domestic demand. Risk and growth capital in 2017 increased from 79.4 million euros to 120 million euros. In 2018, 3 new acceleration funds were introduced to the market in addition to several seed, start-up and growth capital funds to promote the development of venture capital investments. Currently, the distribution of state support programs continues through the JSC Development Financial Institution Altum (ALTUM), which offers assistance and financial instruments to various target groups, including micro enterprises. The government facilitates access to finance (through a microcredit, start-up and loan program) for companies that lack the financial credibility (collateral, net worth, cash flow and credit history) needed to access finance from commercial banks or private investors (ALTUM, n.d.). ALTUM's task is to implement state aid programs to compensate for market failures that cannot be remedied by private financial institutions.

The results of a business survey are used in this article. A computer-assisted web interview (CAWI) questionnaire was sent to Latvian companies with publicly available e-mail addresses in the period from January 10, 2018 to January 25, 2018. The request to complete the questionnaire was addressed to the person in charge of corporate finance. The target audience was all Latvian companies operating in sectors eligible for state aid. The entire studied segment included all active enterprises registered in the Latvian Register of Enterprises with 11 defined NACE codes, i.e. a total of 32 308 enterprises. To improve representativeness, data were evaluated by industry share. The ad hoc online business survey (WAPI) asked entrepreneurs to disclose their sources of funding for the three-year period 2015–2017. Valid responses were received from 2511 companies, of which 1879 were micro-enterprises. Respondents identified the diversity of financial sources and answered whether they needed additional funding for their performance in the near future. Previous study based on this survey had shown alarming results: according to the data processed by the SPSS, micro-enterprises most often chose bank financing (short-term and long-term – 11%) among many sources, while only 4% of respondents used loans from the financial institution ALTUM (which is the principal intermediary of state aid in Latvia). In addition, the study showed that although almost half of the micro-enterprises needed new or additional funding, a large part of them relied solely on internal finances (Beizitere et al., 2020b). This article provides an in-depth analysis of the reasons for refusals by financial institutions from the point of view of entrepreneurs. In order to find out the impact of the financial shortage in the previous years on the future operation of micro-enterprises, the sample of micro-enterprises from the survey was additionally analysed. This group ( $n = 667$ ) showed that access to finance has been an important factor for their growth. Among the liquidated companies, most relied on internal financing, but only a few had received a loan from a bank or finances with public support. Of the liquidated micro-enterprises examined, only 16% closed down in 2020 (which may have been affected by the business restrictions imposed by the coronavirus Covid-19).

## **1. Theoretical findings**

Academic research is devoting a lot of attention on microenterprise financing including important aspects of several stages of company development (Prijadi et al., 2020) and on financing of microenterprises (Hartungi, 2007). SMEs are a powerful economic engine in many European countries (Moya-Martinez & Pozo-Rubio, 2020), substantial contributors to employment and to the GDP growth in many countries (Martinez et al., 2020), SMEs and employment creation are very important for countries all over the world (Herr & Nettekoven, 2017). Political decisions are often important for business support (Daugėlienė, 2016). Small business is characterised by flexibility, agility, the ability to respond quickly to the slightest changes in economic environment and market requirements (Verovska & Zujeva, 2019). SMEs are not only an important source of employment; they can also become a source of innovation and increased productivity (Herr & Nettekoven, 2017). A very useful material for different stakeholders is publication by the Organisation for Economic Co-operation and Development, for example, “Financing SMEs and Entrepreneurs 2020: An OECD Scoreboard” which provides a comprehensive framework for policy makers and other stakeholders to monitor access to finance by SMEs and entrepreneurs (OECD, 2020).

Finance is the elixir that assists in the formation of new businesses, allows businesses to take advantage of opportunities to grow, employ local workers, and in turn support other businesses and local, state and federal government through the remittance of income taxes (Duff, 2019), the extent to which enterprises have access to finance is an important determinant (Doove et al., 2014). For their development, also the trade credit had a large positive impact

on firm survival, such that a one standard deviation increase in trade credit results in a 21% decrease in the likelihood of distress (McGuinnessa et al., 2018). The availability of funding is one of the key problems in the small and medium-sized business not only in Europe but also all over the world economic space (Rupeika-Apoga & Solovjova, 2016).

The importance of non-traditional, alternative/innovative financing is gaining recognition in both developed and emerging economies throughout the world. SMEs' financing in Europe remains primarily bank based, in spite of many policies proposed to develop alternative financing instruments (e.g., adopting directives on venture capital, improving the transparency and visibility of SMEs on capital markets, etc.) (Rupeika-Apoga & Saksonova, 2018), several specific aspects of micro-enterprise financing are also recognised as specific for green economics (Rouf, 2012). Access to finance has been identified as the most important problem that SMEs face. Lack of access to financing is consistently cited by SMEs as one of the main barriers to growth (Harelimana, 2017), however financial support is a determinant of the success of small, medium and micro enterprises (Rungani & Potgieter, 2018). Government support programmes creates important contextual conditions that facilitate the capacity of SMEs to contribute to development through the production of goods and services and the creation of employment (Peter et al., 2018), and are seen as important tools for enhancing the performance of SMEs.

SME financing in Europe is not homogeneous but that different financing patterns exist. The cluster analysis identifies six distinct SME financing types: mixed-financed SMEs, state-subsidised SMEs, debt-financed SMEs, flexible-debt-financed SMEs, trade-financed SMEs and internally financed SMEs. These SME financing types differ according to the number of financing instruments used and the combinations thereof. Furthermore, the types of financing available to SMEs can be profiled according to their firm-, product-, industry- and country-specific characteristics (Moritz et al., 2016). Despite enormous effort by government to foster growth and development in the SMEs sector through various support programmes, the rising failure and underperformance of the SMEs sector suggest a contrary effect (Peter et al., 2018). A crucial element in the development of the SME sector is access to finance for the creation, survival and growth of small businesses. Many governments in developed countries design programs to improve the competitiveness of the local firms.

The main goal of government financial support is to promote business in order to accelerate economic growth (Hartšenko & Sauga, 2013). Controlling for family funding, bank financing, equity of business angels and venture capitalists, industry, size, as well as entrepreneur's characteristics, the results reveal that government guarantees and government equity have a direct effect on new firms' competitive advantage and only an indirect impact on performance (Pergelova & Angulo-Ruiz, 2014). A study (Bertoni et al., 2019) concluded that loans guaranteed by the European Investment Fund had a positive effect on companies' assets, sales and employment. Businesses also had a better chance of survival and less chance of going bankrupt. In addition, the positive impact was stronger for new and smaller companies, which generally do not have a good credit history. There was a greater positive impact on those operating in the service sector than in manufacturing, but the impact did not seem to be higher in high-tech and knowledge-intensive sectors than in low-tech sectors.

In general, the strategic use of financial instruments, such as loans and investments, is key to the success of every business. Financial trends also define the state of the economy on a global level, so central banks can plan appropriate monetary policies (Duff, 2019). Main findings show that alternative financial service providers are competing and often outcompeting the traditional ones at high speed. Conducted empirical analysis shows the most available financing sources except banking products are Friends and Family and different state (including European Union grants) support programmes, Venture Capital and Business Angels (Rupeika-Apoga & Saksonova, 2018). More and more importance is paid to security aspects (Davidavičienė et al., 2019; Raudeliūnienė et al., 2014).

In 2014, institutions of public financial support, non-bank credit institutions and Venture Capital funds increased their share in the micro-enterprises financing (and in the financing of all enterprises). The greatest changes in the structure of the micro-enterprises financing occurred due to the aid granted to small businesses by institutions of public financial support (Prohorovs & Beizitere, 2015) and the trend is continuing now. Other research works emphasize that probability to innovate increases when firms use internal financing and grants. The same applies when funds come from family and friends, while not found conclusive evidence for bank loans (Aiello et al., 2020). Important aspects are also marketing aspects (Batraga et al., 2018) which also often influence decisions on the financing for company.

Several reasons have been identified for SMEs to fail ultimately. Among them, frequently mentioned explanations are financial management skills and performance (Erskine & Yong, 2020), also lack of financial literacy of micro, small and medium-sized enterprises owners/managers is often mentioned among the reasons of their financial exclusion (Beizitere, 2018; Saksonova & Papiashvili, 2021). Research from Korea proves that "financial resources from the Korean government indeed help Korean SMEs survive, but do not necessarily help them achieve higher annual assets and sales growth" (Park et al., 2020). However, when government-based diagnostic and support services are combined with public loan financing, they prove to be effective in enhancing the Korean SMEs' annual assets and sales growth (Park et al., 2020).

## 2. Empirical research results and discussion

A survey of the companies was conducted at the beginning of 2018 to find out the possibilities of micro-enterprises in Latvia to obtain financing and, among other things, to identify the most frequently used reasons for refusal. A study conducted so far, based on the above survey, has shown companies have indicated access to finance among the most important 13 factors limiting business activity (Beizitere et al., 2020a). At the same time, external financing was not widely used among micro-enterprises, as according to the survey data processed, micro-enterprises still prefer internal financing (64%) among many sources, whereas only 11% of the respondents used public funding (Beizitere et al., 2020b).

An in-depth study was carried out to find out the discrepancy between financing opportunities in Latvia, including the relatively large financial offer of European Union funds, and the reluctance of micro-enterprises to obtain it. The financing needs of entrepreneurs on the one hand, and the reasons for rejection of financing provided by financiers on the other hand are demonstrated below. The survey consisted of questions, many of which required them to be answered on a scale of 1 to 5 (where 1-restricted but 5-unrestricted).

The survey data processing, reliability tests have been done by the data analysis programme in the SPSS environment and report a high Cronbach's alpha coefficient (see Table 1).

The distribution of company's responses according to their needs for additional (external) financing to perform company's activities or to realize the idea is included in the Table 2.

Research results indicate that 43.4% of micro-enterprises in Latvia do not need additional (external) financing – they are ready to reach their company development by themselves, 38.1% of the micro-enterprises in Latvia need additional (external) financing.

There are several ways in possible getting of external financing including the state-owned financial institution ALTUM that offers public support financial instruments such as loans on terms that are easier to enforce than bank terms, various guarantees, including to guarantee the repayment of bank loans, and venture capital funding for fast-growing and innovative micro-enterprises (ALTUM, n.d.). Demand for financing differs by regions of Latvia.

Research results indicate that there are different needs for additional financing by company location. Distribution of company responses on needs for additional (external) financing to perform company activities by regions of Latvia is included in the Figure 1.

Research results indicate that in most of the cases micro-enterprises in Latvia do not need additional (external) financing in more developed regions – Riga, but smaller number of companies – in less developed region Latgale. Many of them are ready to reach their company development by themselves (see Figure 1).

Looking in more detail at the views of micro-enterprises, given the number of employees, additional external funding is needed more for those with 5–9 employees to achieve the company's development (see Table 3).

Many companies has applied to different institutions for external financing including to the state-owned development finance institution ALTUM but many of them were refused funding. The distribution of the refusal aspects of micro-enterprise financing is reflected in the Table 4.

Research data in Table 4 indicate that most of financing refuse reason was *insufficient cash flow*, followed *insufficient collateral* and *insufficient own capital*. Smaller numbers of refuse for financing were *related to problems in the company's industry* and *negative owner reputation or credit history*.

Table 1. Data reliability tests by SPSS (source: authors' constructions)

Case processing summary				Reliability statistics	
		N	%	Cronbach's Alpha	N of items
Cases	Valid	1879	100.0	0.823	13
	Excluded <sup>a</sup>	0	0		
	Total	1879	100.0		

Note: <sup>a</sup> – listwise deletion based on all variables in the procedure.

Table 2. Distribution of responses on the question “Does your company need additional (external) financing to perform company activities?” (source: survey of micro-enterprise entrepreneurs, n = 1879)

Answers of respondents	Frequency	Percent	Valid percent	Cumulative percent
Yes	716	38.1	38.1	38.1
No	816	43.4	43.4	81.5
Hard to say	347	18.5	18.5	100.0
Total	1879	100.0	100.0	

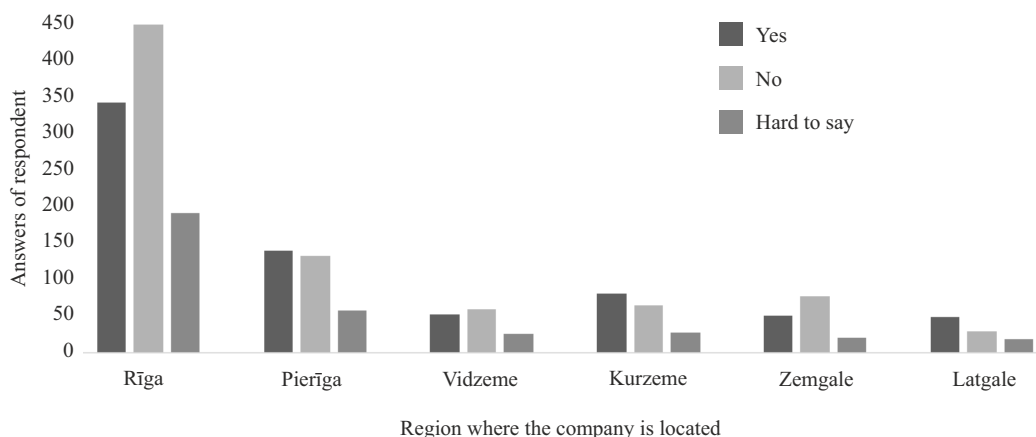


Figure 1. Distribution of responses on the question “Does your company need additional (external) financing to perform company activities?” by regions of Latvia (source: survey of micro-enterprise entrepreneurs,  $n = 1879$ )

Table 3. Distribution of responses on the question “Does your company need additional (external) financing to perform company activities?” by share of employees in percent (source: survey of micro-enterprise entrepreneurs,  $n = 1879$ )

Answers of respondents	Share (in %) of companies by responses by employees in the company		Total ( $n = 1879$ )
	1–4 employees ( $n_{ref} = 1413$ )	5–9 employees ( $n_{ref} = 466$ )	
Yes	36	46	38
No	45	38	43
Hard to say	19	17	18

Table 4. Reasons for refusal to finance micro-enterprises (source: survey of micro-enterprise entrepreneurs,  $n = 1879$ ;  $n_{ref} = 171$ )

Reason for refusal to finance	Number	Share from respondents (%)	Share from refuse (%)
Insufficient cash flow	57	3	33.3
Insufficient collateral	48	2.6	28.1
Insufficient own capital	45	2.4	26.3
Insufficient cost-benefit ratio	22	1.2	12.9
Lack of owner guarantee	18	1	10.5
Start-up company or till 5 years	16	0.9	9.4
Concerns about the viability of the project	13	0.7	7.6
Insufficient self-financing for the project	11	0.4	5.2
Negative owner reputation or credit history	9	0.5	5.3
Problems in the company’s industry	6	0.3	3.5
Other reason	22	1.2	12.9
Hard to say	28	1.5	16.4

Other reasons for a bank or leasing company to refuse to provide financing mentioned by number of entrepreneurs are given in the Table 5. Among the answers provided, there are those that describe the entrepreneur’s emotional attitude towards refusal, for example, those that characterize the behavior of an ALTUM employee. However, most of these answers could be reduced to some of the answers listed in Table 4. For example, answer *Previous year’s balance sheet with a “–” sign, Previous year’s deficit, The micro-enterprise declaration was not sufficient proof of income and The company has been operating at a loss for the past 2 years* correspond to the general respond *Insufficient cost-benefit ratio*. The attitude of banks or other financial institutions in refraining from lending to a micro-enterprise would probably be understandable here. In turn, answers *Lack of pledge and Inadequate loan percent rate offered* refer to respond *Insufficient collateral*. Obviously, the company had to turn to the financial institution ALTUM and not to the bank to deal with the problem of insufficient collateral.

In order to find out the impact of the financial shortage in the previous years on the future operation of micro-enterprises, the sample of micro-enterprises from the survey was additionally analysed.

Table 5. Other reasons for a bank or leasing company to refuse to provide financing mentioned by number of entrepreneurs (source: survey of micro-enterprise entrepreneurs,  $n = 1879$ ;  $n_{ref} = 22$ )

Responses	Number of employees in the company	
	1–4	5–9
The product (electronics) is in the idea stage	1	
The representative of the ALTUM replied: “You have enough money for yourself! Capitalia (a financial institution entrusted with granting loans from ALTUM resources) referred to the recommendation not to give money according to ALTUM data!”	1	
Previous year’s balance sheet with a “-” sign	1	
Previous year’s deficit	1	
The micro-enterprise declaration was not sufficient proof of income	1	
Insufficient number of customers	1	
I offered an application that performs lunar cycle calculations using astrological methods	1	
Inadequate loan percent rate offered	1	
Incorrect rejection, such as typos, dots, length marks, etc.	1	
The company has been operating at a loss for the past 2 years	1	
Negative attitude of ALTUM employees towards the owner	1	
The company’s field of activity is construction services	1	
The Latvian state is not interested in the development of small business	1	
Frequent reason for refusal that the company is older than 5 years	1	
Tax debt	3	1
Lack of pledge		1
Illiquid equipment		1
In the opinion of bank “financial analysts” will not be able to return, because the cash flow was not ideal in the last year		1
Does not support the tourism industry		1
Total number of responses from entrepreneurs of micro-enterprises	17	5

A small sample was selected, consisting of micro-enterprises, which answered the question: “What factors significantly limit the growth of your representative’s business?” The micro-enterprises that indicated that access to finance has the most significant impact on them were examined. Growth impediments were rated on a scale of 1 to 5. Micro-enterprises that responded to the question as “almost restrictive” (4) and “restrict” (5) are considered to be limited. The total number of micro-enterprises whose access to finance factor limits their growth was 667 or 35% of all surveyed micro-enterprises ( $n = 1879$ ).

This group ( $n = 667$ ) showed that access to finance had been an important factor for their growth. In examining the viability of post-business survey, it was found that according to the data of the Latvian Register of Enterprises, some companies (9% of the selection) had problems with continuing their business (see Table 6).

Among the liquidated companies, most relied on internal financing, but only four of micro-enterprises had received a short-term financing or a long-term loan from a bank and five of them had obtained finances with public support. Of the liquidated micro-enterprises examined, only 16% closed down in 2020 (which may have been affected by the business restrictions imposed by the coronavirus Covid-19). It should be emphasized that the majority (77%) of micro-enterprises that were forced to close down had 1–4 employees.

Table 6. Status of the company on 31.01.2021 (source: Latvian Register of Enterprises, survey of micro-enterprise entrepreneurs,  $n = 667$ )

Status of the company	Number of micro-enterprises
Active	607
Liquidated	49
Suspension of economic activity	6
Insolvency proceedings	4
Legal protection process	1

## Conclusions

Academic research has shown that there are several ways to get support for company financing, and they analyze widely the ways to overcome problems with company financing by finding various innovative solutions.

In previous years, less than half (38%) of Latvia's micro-enterprises needed additional external financing for development. Among them, there are fewer (36%) relatively small micro-enterprises with one to four employees that need additional funding.

Overall, a small proportion (9%) of micro-enterprises for which access to finance was essential for their operations had problems in continuing their business in the period following the survey of enterprises. However, among these companies, a large part of the smallest micro-enterprises (considering the number of employees 1–4) were forced to close down their business in 2018–2020.

Refusal of financing was mainly due to *insufficient cash flow*, *insufficient collateral* and *insufficient own capital*. The lower number of refusals was related to *problems in the company's industry* and *negative owner reputation or credit history*.

The results show that financial donors have been very cautious in financing micro-enterprises. It is possible that many micro-enterprises could avoid certain types of refusals by turning to the financial institution ALTUM. ALTUM offers programs with public financial support, for example, in cases with insufficient collateral, or in the start-up phase when financial indicators are not sufficiently stable.

Despite Latvia's policy to improve access to public finances, including support for micro-enterprises, there have been few targeted measures and their opportunities have not always met their intended targets. In the past, there has been no popular public supported financing instruments among micro-enterprises, although the terms of financing programs offered by the government have been less strict than those for bank lending.

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