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REGULATORY AND INSTITUTIONAL RESTRICTIONS ON SMALL BUSINESS LOANS IN SERBIA

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Abstract:
Lending to small and medium-sized enterprises is significantly more difficult compared to lending to large companies. In many studies, SMEs cite access to funding sources as one of the biggest barriers to business growth and development. In Serbia, bank lending is the main external source of financing for SMEs. However, in addition to the restrictions from the aspect of banks and the restrictions from the aspect of these enterprises, the restrictions on difficult lending to SMEs also come from the institutional and regulatory support of our country. EU regulations and strategic documents of our country are increasingly emphasizing the provision of adequate financing and lending conditions for SMEs, given that these companies are the backbone of each country's economy. It is especially important to preserve this sector in the period of the current crisis, by choosing adequate measures, subsidies and state guarantees. This paper aims to present the most significant limitations in giving loans to SMEs, from the regulatory-institutional aspect, i.e. limitations that can be removed or at least mitigated by adequate regulations.

Keywords:
lending restrictions, small business lending, regulatory lending factors.

1. INTRODUCTION

Financing is one of the most prominent obstacles in the development and survival of small businesses. The consequences of this situation are poor market and legal conditions regarding the financing of companies, a low level of entrepreneurial spirit and initiative, as well as an insufficient level of knowledge in the field of finance, especially for small companies in Serbia. All of these constraints pose serious challenges for all policy, market and lawmakers aiming their activities at sustainable recovery and long-term economic growth. It is necessary to invest the highest possible efforts on constituting regulatory and market conditions in order to create better conditions for financing small businesses (Đekić et al, 2019).

Financing for small companies is significantly more difficult than for large companies. However, the existence of a "financial gap" for small businesses, which means that a large percentage of them would use funds effectively and efficiently if available, imposes the need for a deeper study of the problem and finding solutions to facilitate the financing of small businesses.

Due to the underdevelopment of the domestic financial market, bank loans have been the dominant source of financing for small and medium enterprises for many years. Banks in Serbia account for over 90% of the total available sources of financing for small and medium enterprises, with a very small share of other financial institutions. Small businesses in particular face the problem of obtaining investment loans, most often as a consequence of the lack of adequate collateral, insufficient current financial capacity and the lack of credit history.

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Conditions for small business lending by banks have become significantly tighter during and immediately after the financial crisis, but have become less rigorous since 2010 (Board of Governors of the Federal Reserve System, 2012). Different economies have tried to solve this problem in different ways, and in developed countries, logically, small and medium enterprises have had greater support from institutions and the state than is the case in transition or underdeveloped economies.

However, regardless of the level of development of the country, certain sources of financing are less available to small and medium enterprises compared to large companies due to the fact that creditors and lenders perceive these enterprises as a risk group (Kokorović Jukan et al, 2019). Improving lending conditions for small businesses requires systematic efforts in several key areas of activity. For thirty years, governments of more developed countries and international organizations have been actively working to improve the conditions for financing small and medium enterprises.

This paper will, through an overview of the institutional framework in the EU, analyze the loan constraints that the SME sector in Serbia encounters and the regulatory barriers to lending.

2. THE ROLE AND IMPORTANCE OF THE INSTITUTIONAL AND REGULATORY FRAMEWORK FOR BUSINESS LOANS

Back in 2000, the Lisbon Strategy set the goal of strengthening competitiveness based on economic, social and environmental segments, with the creation of a favorable business environment for starting and developing innovative companies by simplifying the regulatory environment, especially in terms of SMEs and entrepreneurship, as one of the directions towards achieving this goal (European Council, 2000). Also, in the same year, the European Council in Feira (Portugal) adopted the European Charter for Small Enterprises. The Charter sets out the principles by which Member States commit themselves to: strengthening the innovative and entrepreneurial spirit in the EU; creating a regulatory, fiscal and administrative framework conducive to entrepreneurship and improving entrepreneurial status; ensuring market access with the least burdensome requirements; and, in line with the main goals of the public policy, facilitating access to the highest quality research and technology; improving access to sources of funding throughout the life cycle of enterprises; continually trying to improve the environment for small businesses, as well as providing superior support to small businesses (European Commission, 2002).

Serbia joined the European Charter for Small Enterprises in 2003. This charter provides basic guidelines and recommendations for the development of the SME sector. Recognizing the importance of the SME sector, in 2005 the European Union included the issue of improving this sector in the priorities of the Lisbon Strategy for Growth and Employment. The concretization of recommendations and activities from the European Charter, i.e. the directions of actions on specific targeted activities are presented in the document "Act on Small Enterprises for Europe", which was adopted in 2008. The Government of the Republic of Serbia has adopted several strategic documents related to the SME sector, and the Strategy for the Development of Competitive and Innovative Small and Medium-Sized Enterprises for the period from 2008 to 2013, through the annual action plan, for the first time binds budget targets. This Strategy is in line with the European Charter for Small Enterprises and the Small Business Act (Kostadinović et al, 2015). Also, the Government of Serbia adopted a new Strategy to support the development of small and medium enterprises, entrepreneurship and competitiveness for the period from 2015 to 2020, with an Action Plan, which follows the policy of the European Union. The goal of the Strategy is to improve the situation in key areas for entrepreneurship development, and the measures of the Strategy focus primarily on improving the business environment and access to finance, on continuous development of human resources and on strengthening the sustainability and competitiveness of SMEs.

The regulatory and institutional framework plays a major role in supporting or hindering individuals and businesses' access to finance. What the financial sector of each country will be depends greatly on the institutional and regulatory factors. Research has shown that a well-developed financial sector is positively correlated with economic growth (King & Levine, 1993; Roubini & Sala-i-Marin, 1995). An orderly and functioning financial system efficiently directs financial resources to economically justified projects and companies with promising and productive activities, stimulates savings and investments, and contributes to minimizing transaction costs. According to Hasan et al. (2017), the existence and strengthening of local banks in developing countries affects easier access to bank loans, reduction of financial costs, stimulation of investments and stimulation of SME growth. Regions in developing countries where local banks have a strong influence are characterized by faster development of newer firms. The opposite is the case in regions dominated by foreign-owned banks. Countries that pursue their policies in the direction of strengthening SMEs, should consider this issue and all other essential aspects for the functioning and development of these enterprises.

The overall performance of the Serbian economy in terms of regulatory and institutional policy can be seen through the assessment of the following five indicators (OECD, 2016a):

1. Movable property can also be an effective form of collateral. Therefore, a reliable registration system is necessary for this form of property as well. In order to reduce information asymmetry, it is necessary to strengthen the legislative framework regarding insolvency and collateral requirements, which would also help in the protection of financial intermediaries;
2. Insolvency proceedings shall be followed in situations when borrowers are not able to meet their monetary obligations. The absence or poor enforcement of laws governing this area restricts lenders from granting loans, because legally speaking, there is a higher risk that they will not be able to collect debts when borrowers fail to repay the loan;
3. Financial institutions often make collateral claims based on the borrower's assets and creditworthiness. So, this is an independent assessment by a financial institution. In order to facilitate borrowers' access to finance, it is necessary to define acceptable forms and amounts of collateral.

Lack of reliable information, i.e. the presence of information asymmetry, leads to comparatively high interest rates, even in the case of a long-term relationship between a bank and a company (Baas & Schrooten, 2006). Credit risk assessment information infrastructures, such as credit bureaus, registries or loan data warehouses, can reduce risk for the investor when deciding on small business financing and help identify investment opportunities. This could also reduce financing costs for small businesses, which are generally higher than the costs of large companies (OECD, 2015). Loan and collateral information systems would reduce the information asymmetry between borrowers and lenders. Registers in which data on assets and loans of potential borrowers would be stored would be of great use to banks in assessing client risk.

3. REGULATORY BARRIERS TO BANK LENDING IN SERBIA

A weak regulatory system cannot adequately protect creditors and investors, and may be ineffective, especially in the area of debt collection and bankruptcy, which further jeopardizes bank lending. In this sense, the tax and regulatory system can discourage the operation of SMEs in a formal framework, i.e. they can increase their activity in the informal economy, which reduces their contribution to economic growth, development and employment. This is all due to the impossibility or difficulty of accessing formal loans.

In countries facing weak legislation and higher levels of corruption, SMEs operating in the formal economy are often more likely to be loan constained, due to the high level of enterprise representation in the informal economy (Distinguin et al, 2016). Serbia has adopted several measures to reduce the informal economy, facilitate tax payments and register businesses. Tax collection is one of the most significant revenues for the state (Galečić & Barjaktaktarović, 2020). Also, a coordinating body for direct activities in the fight against the gray economy has been established.

Scores on various indicators of the regulatory and institutional framework regarding access to financial resources are shown in Table 10. The range of scores is from zero to five, and their explanation is as follows (OECD, 2018, p. 33):

- Level 0 – there is no framework;
- Level 1 – there is a draft framework and signs of government activity in this area;
- Level 2 – there is a framework related to a specific area that is firmly established. It has been adopted by the government or parliament;
- Level 3 – level 2 plus specific indications that the policy framework has been effectively implemented;
- Level 4 – level 3 plus proof that the framework has been controlled, and if necessary, adjusted;
- Level 5 – level 4 plus continuous corrective control of the framework and independent impact assessment, which is a part of a systematic policy adjustment practice to meet the best international practice standards. Level 5 is the closest to good practice defined by OECD standards.

Table 1. Regulatory and institutional framework – evaluation by indicators

Indicators	Serbia
Loan information services	4
Property registers	4,0
Collateral requirements	3,0
Personal and corporate bankruptcy proceedings	2,0

Source: Adapted according to (OECD, 2018, p. 164)

In terms of credit information services, Serbia improved its score, given that in 2016 it reached level 2.5. In previous reports, property registers were observed separately, so in terms of the movable property register system, Serbia was at level 3.0, while in terms of cadastre, Serbia reached level 2.0. In terms of collateral requirements, it had level 1, in terms of personal and corporate bankruptcy proceedings, Serbia remained at the same level.

Business reports provide an assessment of a large number of countries in terms of efficiency and transparency of enterprise operations. For this purpose, ten regulatory aspects that affect the ease of doing business in a certain economy and which, among other things, relate to business loans, are hereby analyzed. For comparison, in the 2016 report, Serbia was ranked 59th out of a total of 189 observed countries, 65th in terms of ease of starting a business, and 59th in terms of obtaining loans (World Bank, 2016). For 2018, these aspects of the economy and business are better rated, so, in terms of ease of starting a business, Serbia improved its rank to 32nd, and in terms of obtaining loans, it was ranked 55th (World Bank, 2018). Unfortunately, the data for 2020 are not encouraging, so Serbia is in the 73rd place in terms of ease of starting a business and on the 67th place in terms of obtaining a loan (World Bank, 2019).

Government regulation has a high impact on small businesses' access to bank loans. Very often, in order to protect themselves from excessive imports and macroeconomic instabilities that accompany low exports and high imports, countries support export-oriented companies and their industrialization, which leaves SMEs somewhat neglected or put in the background compared to large companies. However, small business is the backbone of most economies in the world, so many governments try to channel funds to these companies in various ways, such as: defining a minimum quota of loans that banks must direct to SMEs, subsidizing interest rates for these companies, establishing institutions for financial and non-financial support to these companies, providing loan guarantees and more. It is important to establish a system in which there is risk sharing during small business lending and the introduction of a best practice approach in lending. Improving access to loans for these companies should include more efficient loan bureaus, better regulation in the area of collateral and in the area of business insolvency. The Law on Capital Market, which was established in 2012 and 2013, improved the area of legislation in order to reduce market manipulation, protect investors and tighten reporting requirements (National Bank of Serbia, 2013).

However, SME lending is exempt from several regulations. Levels of euroisation remain high, which may adversely affect companies that do not have sufficient strength to continue their normal operations if affected by foreign exchange risk. In order to support the dinarization process, the National Bank of Serbia and the Government of the Republic of Serbia signed a Memorandum on the dinarization strategy of the financial system of Serbia almost ten years ago, in April 2012.

Adequate macroeconomic policies and an efficient regulatory and institutional environment can contribute to a sound basis for the growth and development of the entire private sector, not just SMEs. (Beck et al, 2006). A survey published in Oxford Economics conducted on a sample of 3,200 SME representatives in 15 countries and 16 industries found that as many as 37% of companies cite economic uncertainty as their biggest concern, while 15% cite political uncertainty (Oxford Economics, 2017).

Economic growth, stability and market competitiveness encourage banks to lend more to small and medium-sized enterprises, but high inflation and government borrowing limit them. High GDP growth rates and increased competition in the banking sector, especially in the fast-growing developing countries, have contributed to an increase in the volume of banking sector loans granted to small and medium-sized enterprises. World Bank studies and research have shown that in markets characterized by economic stability, high economic growth and a high level of competition in the field of business loans, banks have greater preferences and orientation towards lending to small and medium enterprises (Jenkins & Hossain, 2017). For these reasons, the role of the state in promoting small and medium-sized businesses is important, and in this context, the policy of public deficit control, sustainability and stability of the economy and promoting the competitiveness of business loans are important too.

The COVID-19 pandemic has had a significant impact on the Serbian economy. The crisis has hit the service and manufacturing sectors hardest. Retail and wholesale trade, transport, tourism and catering have been most affected (OECD, 2021).

Serbia has implemented the largest fiscal support package in the region to counter the impact of the crisis, and this has helped reduce the negative effects on many segments of the economy. The package included a wide range of measures to support businesses, including deferral of labor taxes and contributions, as well as corporate income taxes, wage subsidies and a moratorium on enforcement and interest on tax debt. Serbia has also introduced a state guarantee scheme for bank lending to small and medium-sized enterprises to support their liquidity. As in the rest of the region, the main instruments for providing additional business liquidity during the crisis have come from government support through subsidized lending or loan guarantees. Nevertheless, the financial sector, which can provide adequate lending and financing to SMEs, as well as adequate regulatory and institutional support, is a very important factor in crisis recovery for the economy as a whole, and for SMEs in particular.

4. CONCLUSION

Securing stable sources of business financing is one of the biggest challenges facing entrepreneurs and SMEs in Serbia. In developed market economies with developed financial markets, the range of financial instruments (sources of financing) available to enterprises is significantly higher compared to countries in transition and developing countries. In order to improve the relationship between the SME sector and the financial system, it is necessary to systematically approach the construction of a banking system that supports SMEs, which would create and highlight differences in banks' approach to SMEs in relation to other customer segments.

Adequate lending to SMEs requires a higher level of regulatory and institutional support that depends on the state and state institutions. Improvements need to be made in the area of credit information services, movable and immovable property registers, personal and corporate bankruptcy procedures, and more efforts are needed to reduce discrimination against SMEs in the context of lending, so that these companies are as attractive clients to banks as are big companies.

Holders and creators of the business environment and economic policy in our country should more efficiently direct efforts and funds to priority sectors, in order to provide investments that will increase the value in the private sector. Delaying the improvement of institutional and regulatory aspects in the area of the financial system and market increases the problems of business owners and prolongs the effects expected from a functioning economy. Legislation and the regulatory framework have somewhat improved. Sustainable economic development and financial stability must be based on a real economy and a strong private sector geared towards exports and innovation. A stable and strong economy rests on the representatives of small and medium businesses, as the main promoters of entrepreneurship, capable of surviving and developing in modern market conditions.

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