

FINANCING THROUGH BANKING CREDITS FOR RURAL FIRMS. OPPORTUNITIES AND CONSTRAINTS

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The non-government credit, in general and the consumer credit, in particular, expanded rapidly during the last years, confirming the general development trend of the economy. Still, the money supply and non-government credit in Romania as percentage of the GDP are lower than in any other accession country and it is often argued that the supply of bank loans to SMEs is weaker than the potential demand for such services. In this study, the emphasis has been given to an assessment of the determinants of the demand for credit by firms in rural areas, as well as to the factors which constrain the supply of bank loans to these firms. Several reasons and conditions concur to give rise to the under-representation of rural credit in the overall loan portfolio of banks, such as: the banks' presence in rural communities is weak for profit considerations; the bankers continue to believe that rural clients in general, and farmers in particular, have little financial discipline and normally do not have the capacity to repay their loans; the limited banking culture in rural communities and the lack of trust in using bank services; the tough conditions in getting a loan (the high real interest rates, the short grace period, the collateral requirement). Besides, the elaboration of a business plan and submitting a loan application file according to the banks' demanding requirements are often beyond the possibilities of common rural entrepreneurs. All these constraints are valid for all rural businesses, but agriculture, with its assumed high risks, is by far the most disadvantaged.

Keywords: financing, banking credits, rural firms, constraint, opportunities.

The own capital is the main financing source for starting an enterprise in Romania. For the existing small and medium firms which need to invest in restructuring, expansion or diversification of their activities, the internal resources from retained profits will not be enough and they will need access to outside funds in order to pursue their development. External funds may come from various sources such as commercial suppliers, banks and leasing companies, equity investors and capital markets, and others like governments, international financial institutions and non-governmental organizations (NGOs). Bank loans, a potential important business financing source, still covers only a small percentage of the

financing needs of the small and medium firms from rural areas in Romania, while the situation is a better for larger enterprises and in bigger towns.

One of the reasons that financial resources allocated to rural areas remain under-utilized is the inadequacy of financial services to match the needs of local business, notwithstanding the number of specially designed financing programs in this respect.

MATHERIAL AND METHOD

This study was accomplished during 2001- 2006, and the data were gathered and adapted from different sources: the Annual Report of the National Bank of Romania, the Statistics Yearbook, the Annual Report of the MIMMCTPL (Ministry of SMEs, Trade, Tourism and Liberal Professions).

As statistic methods there were used investigation methods. Also in analysis was used the conclusions of the survey “Situation and needs – SMEs’ opinions”, organized by the National Agency for SMEs and Cooperatives, published in October 2004.

In order to underline the strong points, weak points, opportunities and threats regarding the demand of the credits for agriculture farms, we used the SWOT analysis.

RESULTS AND DISCUSSIONS

Accordingly with the economic positive growth, the number of Romanian SMEs registered an increase in all activity sectors, in the last years. The number of SMEs from agriculture is lower than in the others sectors (industry, constructions and services) and represented just 2.8% in the total SMEs in 2004 in comparison with 3.1% in 2000 (*figure 1*).

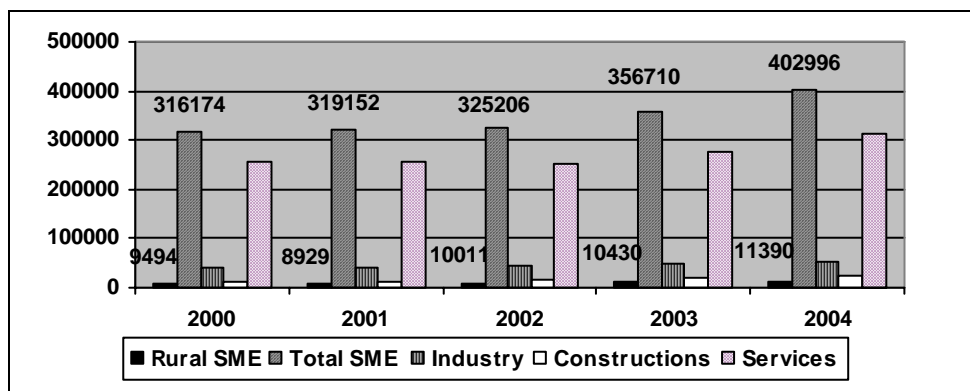


Figure 1. Evolution of number of SMEs by activity sectors

Source: Ministry of Public Finance and National Institute of Statistics

At national level there is a high asymmetrical distribution of the SMEs: a majority of micro-enterprises (94.5%) while the medium SMEs represent only 0.9% and the small firms represent 4.6% from the total SMEs.

The rural economic activities in Romania are: agricultural production, agro-processing and non-farm rural economic activities. Each of these rural activities present special features and accordingly with these should be analyzed the constraints and opportunities for financing.

The positive factors for financing the agricultural production are the followings: good potential (large agricultural land area, fertile soils, cheap labor force, long agricultural tradition) but currently under-utilized; importance of agriculture in the overall economy; physical yields of wheat per hectare are above the EU average level and have attracted foreign investors; pioneering the farming of biotech crops, in particular soybeans; an increase in livestock production; various ecotourism opportunities.

On the other hand, agriculture sector development is faced with negative factors and challenges:

- excessive fragmentation of farm plots and a polarized farm structure;
- agriculture production has a predominantly subsistence character;
- few modern agricultural inputs, equipment and services are used, mainly due to a lack of financial resources;
- agriculture exports are dominated by raw materials and products with a low added value: live animals, cereals, oil crops, wine, summer vegetables;
- low labor productivity.

Although estimations of the total agricultural financing demand are difficult to make, it is obvious that the potential demand exceeds the current financing supply. Potentially profitable crops and products for bank lending could be: export crops cultivated on irrigated land; production of high value with an international market niche demand; production of biotech crops that get international organic certification standards; limited land-based and labor and capital-intensive greenhouse production, utilization of thermal waters and sterile soils, production of potting soils, flower production, fish farming.

Regarding the agro-processing activities, the food beverage sector is a core industry in Romania. The demand for food increase each year and while the food processing industry is making impressive progresses, agricultural production is not keeping up and a large amount of food has to be imported in order to satisfy local demand. In order to comply with EU and international quality and packaging standards, the food industry urgently needs investment in the restructuring of facilities, in up-to-date technologies and in new equipment for sterilizing, control and packaging.

A strong integration process is taking place in the food industry, whereby large private farming business groups invest in food processing facilities, while food and beverage companies invest in agricultural production and develop linkages with farmers to increase the quantity and quality of the raw materials that they need. While contract farming financing arrangements and commercial supplier credit from input and equipment dealers are increasing, it is not expected that they can substitute for bank lending.

The main non-farm rural economic activities are the followings: textile and apparel (SMEs constitute approximately 70% of the total number of textile companies), wood and furniture, glass and ceramic; rural tourism.

The non-farm rural SMEs share has several positive features: potential for economic growth and further expansion of exports; sufficient supplies of required raw materials; relatively cheap labor supply; high quality products in some sectors; skilled labor and strong traditional skills; benefits brought by the EU accession (EU market, foreign investors, structural financial aid).

The main problems and weaknesses of the rural non-farm SMEs are: inadequate manufacturing facilities; limited marketing skills and low business management skills; transportation costs to overseas markets, expensive working capital loans from banks, limited services from business support organizations.

The SWOT analysis regarding the SME demand for bank loans reveals the major constraints and opportunities.

The strong points in the demand for credit by rural SMEs are the followings:

- a high investment demand by commercial farmers for inputs, equipment and irrigation facilities. In the agro-processing industry there is an urgent need for large-scale investments in plant restructuring and new equipment in order to be able to comply with the quality standards of the EU. Non-farm rural economic activities also need investment funds in order to maintain their competitiveness and to enter into new export markets;

- a good credit culture of loan repayments among Romanian entrepreneurs, in particular in the rural areas;

- new Government strategies towards the development of SMEs and the agricultural and rural sectors, including the food and agro-processing industry;

- the expanding operations of the Rural Credit Guarantee Fund which works in close collaboration with banks;

- increased interest and motivation of banks to diversify the bank products offered to rural SMEs;

- interest of micro finance institutions in developing collaboration agreements with banks for providing loans to SMEs in rural areas.

Major factors that constrain the rural SME demand for bank loans include:

- constraints identified by potential borrowers in their relationship with banks: applying for a loan takes too much time; too short loan maturity; high interest rate; lack of a grace period; banks are perceived as discriminating against small firms, conservative and not pro-active;

- cultural constraints on the part of potential borrowers: reluctance to incur debts;

- business constraints: insufficient profitability of the business to repay the loan principal plus interest; the collateral requirements of banks; the inability to receive more than one bank loan at the same time; the requirements for the SME applicant; lack of business management skills;

- other constrains: deficient marketing of bank products; lack of adequate business support services; lack of a rural bank branch network.

Opportunities for increased loan demand by rural SMEs include:

- increased demand for investment loans in view of the EU accession (compliance with product quality, sanitary and environmental standards).
- coordination between different financing programs for SMEs;
- extension of micro credit operations under the new Law on micro finance institutions;
- investment demand in order to face increasing competition;
- investment in agriculture production and the scheduled privatization of state-owned agriculture companies will stimulate the further development of private SMEs in rural areas;
- a more stable and favorable overall economic and business environment will encourage increased investments by SMEs.

The main threats are the followings:

- the EU accession is expected to trigger off a high death rate of SMEs, in the event that they do not succeed in complying with the EU norms;
- lack of bank procedures and bank products that are adapted to the specific features and financing needs of rural SMEs;
- extension of grant finance schemes may undermine the entrepreneurial culture and loan repayment discipline of rural SMEs;
- lack of own capital from retained business profits for needed investments.

Despite the measures taken by the Government and the Ministry of SMEs for creating a favorable framework for development the SMEs and for improving their access to the financing sources, there are still many deficiencies regarding their financing (*figure nr. 2*).

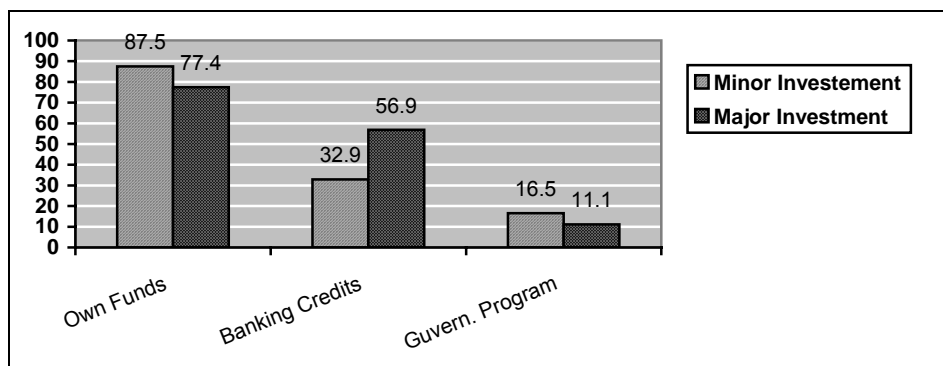


Figure 2. Financing sources for the Romanian SMEs

Thus, the main financing sources for the SMEs are the own funds (87% in the case of the minor investment and 77,4% for the major investment). The banking credits are financing sources for 32.9% minor investment and for 56.9% major investment. The governmental resources represent just a supplementary financing source.

CONCLUSIONS

There is good and consistent evidence that economic growth in Romania has gathered pace and rural areas are not excluded from this general tendency. However, resources allocated to rural areas remain under-utilized. In order to support SMEs in their financing and development it is important to solve both external problems (related to the overall business environment) and internal problems (which depend on the way in which SMEs are organized and perform their activities).

A non-exhaustive list of external problems of SMEs financing includes:

- high interest rates and commission charged on bank loans;
- discriminatory treatment of SMEs, micro-enterprises and individual entrepreneurs by banks as compared to large companies;
- narrow range of bank products that are offered as compared with the specific features and needs of rural SMEs;
- high level of taxes and social contributions paid by SMEs;
- discontinuity in the fiscal regime and regulations, affecting the capacity of SMEs to adopt long-term business and financial plans;
- scarce access to appropriate, up-to-date technologies, as most of the SMEs have inherited old, technologically poor equipment.

The internal problems of SMEs financing include:

- poor internal organization and operational performance of the enterprise due to initial low managerial skills and a lack of knowledge of modern business management, marketing, finance and accounting principles;
- reliance on limited own financial resources and lack of access to external funds have condemned many SMEs to low operational efficiency and a limited scale of operations, thus affecting their further development;
- poor access to useful information regarding alternative potential markets, partners, clients and the overall business environment.

The rural SMEs can hardly compete with other market participants. Therefore, both lenders and potential borrowers need to adjust their current practices to become more flexible to the rural firms needs for financing.

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