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**THE IMPORTANCE OF LOAN FUNDS SYSTEM  
FOR PROCESS OF FINANCING MICRO AND SMALL  
SIZED ENTERPRISES ACTIVITY**

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**Key words:** micro and small enterprises, sources of financing, loan funds.

**A b s t r a c t**

Limited access to external sources of financing is one of the basic barriers to development of micro and small enterprises. This is the cause why the majority of entities finance their activities using mainly their own funds. Development of the system of loan funds represents a form of supporting enterprises in access to capital.

The article aims at presenting the role and importance of loan funds as the institutions supporting development of small enterprises as well as defining the position of the loan system in the process of financing the operations of micro and small enterprises. The characteristics of funds operating in Poland and the analysis of their activities were presented. The statistical papers prepared by the Polish Association of Loan Funds provided the source of empirical data.

During the period covered by the study increasing activity of the funds was recorded. The observed trends found confirmation in the increase of capitalization of the entities studied as well as in the increase in the number and value of originated loans.

Currently just a few entrepreneurs use that form of financing and the reasons are the uneven geographic distribution of funds, low level of capitalization and ineffective information policies targeted at the community of entrepreneurs.

**ZNACZENIE FUNDUSZY POŻYCZKOWYCH W PROCESIE FINANSOWANIA  
DZIAŁALNOŚCI MAŁYCH ORAZ MIKROPRZEDSIĘBIORSTW**

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**Słowa kluczowe:** małe i mikroprzedsiębiorstwa, źródła finansowania, fundusze pożyczkowe.

### Abstrakt

Ograniczona dostępność zewnętrznych źródeł finansowania jest jedną z podstawowych barier rozwoju małych i mikroprzedsiębiorstw. Powoduje to, że większość podmiotów finansuje swoją działalność głównie z wykorzystaniem środków własnych. Formą wsparcia firm w dostępie do kapitału jest rozwój systemu funduszy pożyczkowych.

Celem artykułu było ukazanie roli i znaczenia funduszy pożyczkowych jako instytucji wspierających rozwój drobnej przedsiębiorczości oraz określenie miejsca systemu pożyczkowego w procesie finansowania działalności małych i mikroprzedsiębiorstw. Przedstawiono charakterystykę funduszy działających w Polsce oraz przeanalizowano ich działalność. Źródłem danych empirycznych były opracowania statystyczne Polskiego Stowarzyszenia Funduszy Pożyczkowych.

W badanym okresie odnotowano rosnącą aktywność funduszy. Obserwowane tendencje znalazły potwierdzenie we wzroście kapitalizacji badanych jednostek oraz wzroście liczby i wartości udzielonych pożyczek.

Obecnie niewielka liczba przedsiębiorców korzysta z tej formy finansowania, czego przyczyną jest nierównomierne rozmieszczenie geograficzne funduszy, niski poziom kapitalizacji oraz nieefektywna polityka informacyjna skierowana do środowiska przedsiębiorców.

## Introduction

Availability of financial capital sources and instruments is one of the basic factors determining efficient operation and development of the enterprise. Those issues concern both current (operational) field of business activity and implementation of investment projects. Dynamically developing financial market in Poland offers entrepreneurs increasingly wide possibilities of obtaining funds. There are instruments based on own capital (issuance of stocks, venture capital funds, business angels) and external capital such as bank loans, debt securities, leasing, factoring, loans from non-banking sources or aid funds flowing from international institutions and organizations.

The issue of financing the activities, and first of all of obtaining the necessary capital, is particularly problematic in the sector of micro and small enterprises. That group of businesses, as opposed to the large market entities, encounters numerous barriers limiting, and frequently even making impossible, conducting and developing the business. Limited access to external sources of financing is one of the major barriers. That unfavorable situation is caused, among others, by high requirements formulated by capital providers as concerns the credit history, level of own contribution, required securities or the scope of necessary credit documentation. Lack of experience of small entrepreneurs in contacts with financial institutions as well as low potential for internal accumulation of capital hindering the process of self financing of the enterprise and its profitability are issues that are also of importance. Those obstacles cause that the external capital is difficult to access and expensive for small businesses.

Considering the above barriers, supporting small businesses in access to the sources of external capital is highly important. Development of the system of loan funds the task for which is to provide capital support to small businesses represents one of the solutions.

The main goal of the paper was to define the role and importance of loan funds in the process of financing micro and small enterprises in Poland. The nature and specificity of operation of such institutions as well as the advantages of that source of capital were presented. Analysis and assessment of the lending activities of the funds was the subject of particular interest.

### **Methodology of studies**

The study encompassed loan funds operating in Poland during the years 2004-2008. The analysis covered such aspects of operations of the funds as the level of capitalization and sources of origin of lending funds. Additionally the study covered the number, value and structure of originated loans. The statistical papers prepared by the Polish Association of Loan Funds provided the source of numeric data.

### **Characteristic of the loan funds system in Poland**

Loan funds have operated in Poland for a relatively short time. The initial entities of that type emerged during the early 1990s. Programs of financial support to small and medium enterprises as well as the unemployed undertaking own business activities gave the impulse for establishing them. An example here could be the Government program "Project of Development of Small Business TOR#10", within the frameworks of which 34 Enterprise Development Funds were established (BARTKOWIAK, FLEJTERSKI, PLUSKOTA 2006, p. 58). The current system consists of 65 institutions operating 71 funds.

Loan funds are not banking sector institutions. Capital support of enterprises by providing loans to them is the main goal of their operations. The funds operate in different organizational-legal forms such as joint stock companies, limited liability companies, associations or foundations. They operate on the bases of the general law – the civil code and the code of commercial companies (*Kierunki rozwoju funduszy...* 2009, p. 6). The territorial scope of their lending activities is diversified. In this context the entities operating in national, regional and local scale are identified. This scope of operations is determined mainly by the amount of lending capital available to the individual funds.

The funds target their offer at the sector of micro and small enterprises mainly but also the individuals starting up their business activities (*Fundusze mają się dobrze...* 2006, p. 8). It is worth highlighting that the funds are entities grossly underappreciated by banks and other financial market institutions. Only a small percentage of funds focus their activities on funding medium and large enterprises.

The support from the funds is of short or medium term character. The period for which the funds are made available as a rule is not longer than 5 years (*Finanse małego przedsiębiorstwa...* 2009, p. 107). It is worth adding, however, that offering the entrepreneurs a grace period in paying off the loan installments is a commonly used practice. The amount of loan funds is also limited. In most cases it does not exceed several thousand zlotys. The loan funds obtained can be spent both on expenditures related to the operational activities of the enterprise and the investment projects funding.

The relatively low cost of capital is another characteristic of the funds. The interest rate depends on the level of the reference rate announced by the European Commission and the level of the margin, which usually does not exceed 3%. Its level is determined by the amount of funds applied for, loan maturity and the purpose of spending the funds and the risk related. The commission for originating the loan is also lower and the situation is frequent where there is no fee for acceptance and processing of the loan application and for the early payoff of the funds obtained. This results in a lower burden of debt servicing costs to the enterprise increasing at the same time its profitability and ability of self-financing.

Low requirements of funds concerning securities for funds lent also deserve attention. Obtaining a small amount of loan requires the enterprise to present the blank bill of exchange with the declaration only. Additionally, the funds offer the entrepreneurs a significant freedom of choice accepting both personal securities (e.g. civil guaranty or bill of exchange issued by individuals or legal entities) as well as collateral such as blocking the funds on banking account, mortgage, pledge or assignment (*Raport z ewaluacji...* 2008, p. 30). Mutual guaranties by entrepreneurs using services of a given fund are also commonly used. This causes that the loan is relatively easily available as an instrument for financing operations of the enterprises.

Higher accessibility of funds also results from absence of complicated and lengthy origination procedures. The scope of the required documentation is limited significantly which is exemplified by absence of the requirement of preparing the business plan, financial statements and other documents necessary for creditworthiness assessment. As a consequence the waiting time of the entrepreneur for access to the loan funds is shortened.

Development of the loan funds system, in addition to improving access to the external capital, also offers the entrepreneurs numerous other benefits. Among them the increased supply of capital sources and decreasing the financial costs should be mentioned. Using the services of the funds offers small entrepreneurs the ability of establishing the credit history necessary for cooperation with banks and other financial market entities. Also the experience gained in contacts with a financial institution is important. Additionally, funds make a number of services that are not of financial nature such as information, advisory and training services in conducting business activities, and in particular in financial management available. Support to development of small business manifests also through assistance in obtaining capital from other sources, e.g. banks (*Wspieranie rozwoju...* 2002).

### Activities of loan funds in Poland during the years 2004–2008

As already mentioned, 71 funds operate in Poland. Currently an organized system of collaboration encompassing all the units does not exist. A significant proportion of the funds (53%), however, is associated in the National System of Services the mission of which is to support development of enterprise in key areas requiring state support. The associations associating the majority of the discussed entities also play an important role. They fulfill numerous functions of information, advisory, promotional and lobbying character. They also prepare reports of operation of the funds and disseminate the results of their operations. The Polish Association of Loan Funds is the entity assembling the largest number of loan funds.

The lending capital amount is the basic factor determining the scope of operations of the funds. The results of studies presenting the funds capitalization levels are represented in Figure 1.

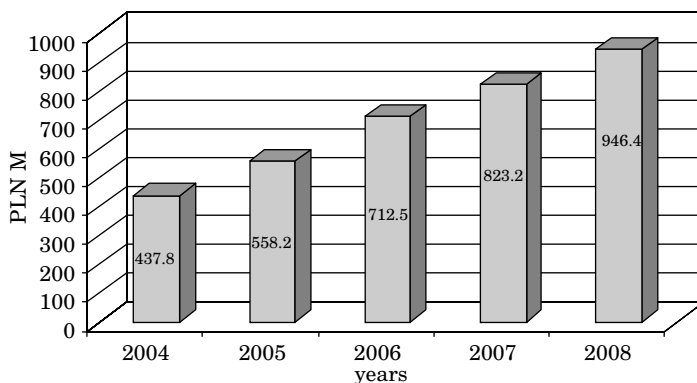


Fig. 1. Capitalization of loan funds in Poland during the years 2004–2008

Source: own work based on the data of the Polish Association of Loan Funds.

The data indicate dynamic development in funds capitalization. During the period covered it was 116.2% and the highest growth rates were recorded during the years 2005 and 2006 (27.5% and 27.6% respectively). The structure of loan capital sources was dominated by funds obtained within the frameworks of the Sectoral Operational Programme Increase of Competitiveness of Enterprises. As at the end of 2008, their share was as much as 36.1%. Own funds made available by the institution operating the fund represented another major source of capital (24.5%). On the other hand the scope of funding the operations of loan funds from local government subsidies (6.2%), debt securities (loans, credit – 8.3%) and other sources were minor.

The level of polarization of the funds as concerns the capital in their possession attracts attention. Among the entities surveyed, as many as 38 had the loan capital valued at no more than 3 million zlotys. Only in case of 14 funds the level of capitalization exceeded 20 million zlotys. At the same time it should be highlighted that 5 largest entities had the capital of 378.6 million zlotys representing as much as 40% of the total capitalization of all funds covered by the study.

The number and value of originated loans is the measurable effect of the operations of loan funds. The results of studies in that aspect are presented in Table 1.

Table 1  
Number and value of loans originated by loan funds during the years 2004–2008

Item	Year				
	2004	2005	2006	2007	2008
Number of originated loans	13 309	16 005	19 537	20 976	19 640
Value of originated loans (PLN M)	204.4	240.8	370.6	417.5	438.4
Value of loan assets (PLN M)	266.7	340.6	482.1	597.8	705.8

Source: own work based on the data of the Polish Association of Loan Funds.

The period covered was characterized by increasing activity of funds. During the years 2004–2008 they originated 89.500 loans representing the total value of 1.67 billion zlotys. The highest growth rate in the number of originated loans (47.6%) was recorded in 2005. That was the period during which the funds presented the highest activity in obtaining loan capital, which allowed them a significant increase in the scope of services provided. Similar trends were recorded as concerns the value of originated loans and the value of active loans.

The structure of originated loans considering the amounts of funds originated was another aspect of loan funds operation that was subject to analysis. The results are presented in Figure 2.

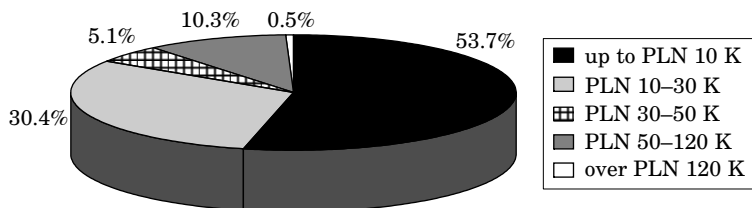


Fig. 2. Structure of originated loans according to the structure of originated funds (as at 31.12.2008)

Source: own work based on the data of the Polish Association of Loan Funds.

The results of that analysis indicate clearly that the loan from a fund was not an instrument for obtaining significant funds. Its average value as at the end of 2008 was PLN 16 500 only and the share of instruments not exceeding PLN 10 000 was dominating. The loans exceeding PLN 120 000 and more had the lowest share in the total number of the loans originated. They were originated mainly by the funds with the highest level of capitalization.

The structure of loans according to the purpose of funds use was another important issue subjected to the analysis. The results are presented in Figure 3.

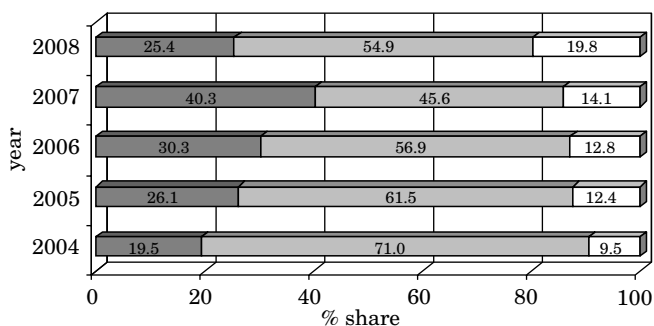


Fig. 3. Structure of originated loans according to the purpose of spending the loan funds during the years 2004-2008

Source: own work based on the data of the Polish Association of Loan Funds.

During the period covered, the dominating share of expenditures on implementation of the investment projects of the enterprises was recorded. To a lesser extent the entrepreneurs used the funds obtained for expenditures related to current activities such as purchase of materials and raw materials for production, payroll of employees or tax payments. The trends observed could indicate that services of loan funds were used mainly by enterprises at the initial stage of development that required significant capital outlays. Limited access to external sources of financing causes that the loan from

a fund is the only possibility of financing the necessary expenditures for the indicated group of businesses. During the period covered, an increase in the number of borrowers allocating the funds obtained to both investment and operational activities at the same time was also recorded.

The structure of loans considering the number of people employed by enterprises using that form of financing is the issue that requires special attention. This allows determining the direction of loan capital allocation considering the enterprise (borrower) size and the financial needs related to it. The results of that analysis are presented in Figure 4.

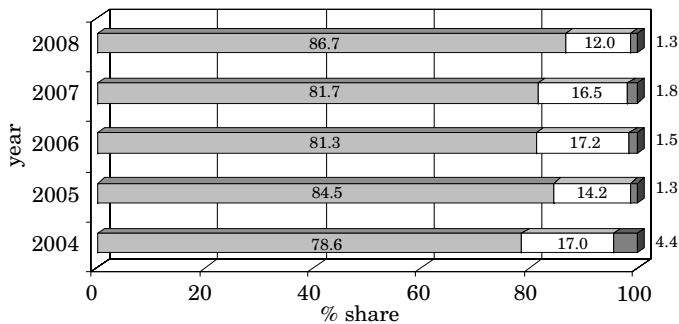


Fig. 4. Structure of originated loans according to the employment in the enterprise of the borrower during the years 2004–2008

Source: own work based on the data of the Polish Association of Loan Funds.

The results of studies indicated clearly that micro-enterprises were the main beneficiaries of loan funds. Small enterprises employing no more than 49 persons had a much lower share among the beneficiaries. The marginal share of entities classified as medium and large enterprises is also worth noticing. The limited capacity for satisfying relatively large financial needs of such entities through collaboration with a loan fund could be the reason for lack of interest in loans from such enterprises. The trends observed, however, confirm the appropriate direction of loan funds allocation.

The results of conducted studies indicate an increase in importance of funds in the process of financing micro and small enterprises. Since establishment of the first lending institution they have originated 171 300 loans with the total value of 2.8 billion zlotys. It should be highlighted that not only unemployed and small enterprises (the so-called direct beneficiaries) but also guaranty funds that develop their activities by offering guaranties to borrowers are beneficiaries of that lending activity. Also the banking sector obtains benefits from such activities by finding potential borrowers possessing



the credit history required by the banks among the clients of the funds. In this aspect the complementarity of loan in relation to bank credit manifests. The positive influence of lending activities on socio-economic development is also important. Supplying capital to the local economy supports the process of establishment and development of small businesses and limits the phenomenon of unemployment.

Loan funds, however, encounter many barriers limiting development of their activities. Low level of capitalization is the main issue. Only a small percentage of funds possess significant financial resources while capitalization of the majority of them does not exceed 10 million zlotys. This is not without influence on the scope of services provided and the capacity to satisfy the financial needs of enterprises. The uneven spatial distribution of funds also represents a significant barrier. The largest numbers of funds are available in Mazowieckie, Śląskie and Dolnośląskie voivodships. There are regions, however, (Lubelskie, Świętokrzyskie, Opolskie voivodships) in which the number of funds does not exceed 2 or 3. This is a significant barrier in access of entrepreneurs to loan funds. Among other obstacles, representatives of funds indicate lack of access to bank information on entrepreneurs, insufficient level of collaboration with guaranty funds and limited information and promotion of the offer of the funds in the community of entrepreneurs.

## Conclusion

Limited access to external sources of financing is currently one of the major barriers limiting development of micro and small enterprises. This is caused mainly by high requirements of financial market institutions concerning credit history, securities for payoff of funds originated and high capital costs. Loan funds offer entrepreneurs access to necessary capital supporting in that way the process of financing the business activities conducted.

During the period covered by the study, increasing activity of funds in both obtaining the loan capital and conducted lending activities was observed. The trends observed were reflected in the increase in the number and value of originated loans. It should be highlighted, nevertheless, that the scope of activities of loan funds continues to be too small for the demand reported by entrepreneurs. Results of studies indicate that Polish enterprises use loans only to a minor extent as the instrument for business activity funding. This results from numerous barriers limiting the development of lending system and in particular low level of funds capitalization, their uneven geographic distribution and low effectiveness of information policies targeted at the community of entrepreneurs.

The above barriers coupled with the increasing importance of funds in the process of micro and small enterprises financing create the necessity for undertaking actions supporting development of the lending system in Poland. The activity is expected from both the government authorities and territorial governments. Opportunities for development of that system are also seen in the effective use of aid funds from international institutions and organizations, in particular the European Union.

Defining the position of the lending system in the process of micro and small enterprises financing it should be highlighted that loan funds are not competitors to banks. The area of their interest encompasses entities underappreciated by those institutions, i.e. the unemployed and small businesses. As a consequence, the task of the funds is not only to provide capital support to the smallest businesses but also preparing them to the future collaboration with financial market institutions.

The dynamic development of funds and increasing interest in that capital source indicate the large development potential of the lending system in Poland. Numerous and strong as concerns capital funds should be an important source of financial support for micro and small enterprises. Development of that system will surely contribute to improved accessibility to loan funds, increased innovation and competitiveness of enterprises and as a consequence socio-economic development.

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