“INVESTMENT READINESS” - CORRELATION OF THE CAPITAL DEMAND AND SUPPLY FOR SMES

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ABSTRACT: In the context of the international financial crisis, the necessity to attract new financing sources and to ensure the correlation between the capital supply and demand became a new challenge for the firms, especially for the SMEs. The concept of “investment readiness” refers to the capacity of entrepreneurs to understand the specific needs of the investors and to be able to answer to them through relevant information, a high level of credibility and trust that can determine the investor to finance the project or the business. The SMEs should be prepared for investment if they want to satisfy the investors’ requirements and to attract the necessary funds. In fact, the central idea of the investment readiness is the necessity to take into consideration the both aspects of SMEs’ financing: the capital demand and the capital supply.

KEY WORDS: investment readiness, SMEs, financing, demand, supply, capital

1. INTRODUCTION

The European Union recognizes the importance and benefits of the entrepreneurship and innovations generated by the SMEs and have already taken numerous initiatives in order to support the financing of SMEs. But despite the efforts done at the EU level and the member states regarding the financing sources, the level of the funds invested in SMEs is still reduced, especially in the initial stages of firms’ development. But the stimulation of the offer should be correlated with the demand in order to ensure an efficient market. In these conditions, there are necessary supplementary efforts regarding the demand for funds. Besides, the international financial crisis generated many difficulties concerning the funds’ accessing by the SMEs and this led to the increase of the gap between the demand and supply of capital.

The SMEs have to be ready for investment if they intend to satisfy the investors’ requests and to attract the necessary funds. In fact, the concept of investment readiness is based on the necessity to take into consideration the both sides of SMEs’ financing: the capital demand and the capital supply. Thus, the “investment readiness”
refers to the capacity of entrepreneurs – looking for financial resources – to understand the specific needs of the investors and to be able to answer to them through relevant information, a high level of credibility and trust that can determine the investor to finance the project or the business. For short, “investment readiness” reflects the entrepreneurs’ ability to answer to the expectations of the investors when it is presented the business idea or the ensuring of the attractiveness of a business for investors.

2. ANALYSIS OF THE CORRELATION BETWEEN THE CAPITAL DEMAND AND SUPPLY

The investors are reticent when it is about financing the SMEs because the high risks and costs that can not be compensated by the incomes. In fact, between the investors and the entrepreneurs there is an asymmetry regarding their expectations: the investor look for minimizing the risks and maximizing the profit and the entrepreneur considers that its project is feasible and, in general, it is oriented towards a sustainable development of the firm, without looking for the immediate profit.

The disfunctionalities were manifested regarding both the funds supply and the funds' demand for SMEs. Regarding the funds supply for SMEs, the most affected are the firms at the first stage of development because the banks are not interested to invest in start-ups as long as they are considered risky and do not present sufficient guarantees. Besides, the payment of the principals and the interest rates represent an important financial effort for the firms that increase in the expansion stages of the business because the increase of the need for supplementary funds. On the other side, the number of business angels (private individual investors) is reduced and this type of investors search innovative firms in the expansion stage and which have a high potential for growth.

The venture capital funds interest to invest in seed and start-ups are also limited because they are looking for mature business and intend to beneficiate by a rapid development of the invested firms in order to get a higher increase of the firm’s value and its shares at the end of the investment period. Regarding the demand, many entrepreneurs do not have sufficient information regarding the financing opportunities and often perceive the loss of control of the firm as unacceptable.

There are three main causes to explain the lack of knowledge of the entrepreneurs regarding the financing: lack of knowledge about financing. Many entrepreneurs are unaware of the available and suitable options for financing which sources would be relevant to their adopted business strategy. For them, bank loans remain the preferred source of external finance and they often do not realize the benefits of a stronger capital structure for survival and expansion; fear of losing control. In Europe, some entrepreneurs do not seek for venture capital funding because they are afraid that it will mean giving up control of their business to the investors. However, investors do not only provide funding, but can provide knowledge and advice, becoming partners in the business. Equity investors also require greater disclosure of information about the firm than debt finance; Information asymmetry. Many SMEs with growth potential do not succeed in raising the finance they need
because of the low quality of their presentations. The entrepreneurs are not aware of the key factors that drive the investment decisions of equity investors and are not prepared to answer questions about these or lack some of the capabilities investors are looking for. Also, many business plans and management teams may have quality in them, but are insufficiently developed or are inappropriately structured and do not provide the assurances equity investors need.

3. MEASURES TO PROMOTE THE INVESTMENT READINESS PROGRAMS

Many entrepreneurs need counselling regarding the knowledge of the advantages and disadvantages of using alternative forms for financing as well the way to present the investment projects to the potential financing investors. This is why the investment readiness programs should be based on the best practice at the European level and to join any type of financing measures. In fact, few member state (Ireland, Spain, France, Austria, Great Britain) have already introduced measures to identify the financing gaps and developed investment readiness programs, helping the SMEs to understand what are the available options for financing, to establish a development strategy for their business, to elaborate business plans and to increase their equity. Thus, an investment readiness program can teach the entrepreneurs that the presentation of a business plan have to be adapted in order to answer to the investor’ expectations and also the way of preparing the financing proposal, of approaching a project in function of the financing source or the importance to know the exigencies of the financing investors.

The investment readiness programs aim to correct failures between the demand and supply capital market. They are designed to assist entrepreneur, especially innovative entrepreneurs that have firms with growth potential, raise external finance, in particular equity finance. These programs can include activities of training, guidance and advice, mentoring, technical support, networking and they usually contain tools for: assessing a business strategy, explaining the sources of financing and more specifically the advantages and disadvantages of raising equity finance; understanding investors’ requirements; structuring an attractive business plan; improving the quality of presentation and the negotiation with the investors; connecting the SMEs with investment plans with potential investors.

The investment readiness programs can be public (for instance, in Ireland and Spain) or private (France and Austria). In Great Britain are available also the public investment readiness programs and the private ones. But regardless the type, all programs have as final objective supporting the SMEs in attracting the financing sources. Reaching this objective suppose a process consisting of few stages. A first stage is the business evaluation and the elaboration of the business plan. Other aspects refer to the evaluation of the most appropriate financing form and its characteristics. As well, should be analyzed the potential barriers for attracting the investment (for instance the intellectual property assets).

Finally, should be ensures that the firm present properly the aspects regarding the investment. The quality of presentation and the convincing business plans are very
important for the success in attracting the funds and the investment readiness programs can help the firms in that sense. In all states there are numerous public and private organizations which offer support for the SMEs in doing their business. Some of these organizations are specialized in counselling the SMEs for financing problems. In general, the investment readiness programs are offered by: business angel and venture capital fund networks; incubators and sciences parks; national and regional business development agencies; accountants and consultancies; business schools and universities. Banks or other financial institutions are not necessarily direct providers of investment readiness programs but some of them offer financial management information to their SME customers and work with business angel or venture capital networks making referral of SMEs seeking risk capital.

The gap existing between the capital demand and supply is usually used to justify the intervention of the public authorities for correcting the market disequilibrium. Regarding the investment readiness programs, the possible contribution of the public sector is less obvious even there are some initiatives in that sense. That is why there are necessary measures to promote a simulative entrepreneurial environment and the public factors can play an important role in promoting the investment readiness programs, especially for attracting relevant partners, public and private as well.

4. CONCLUSION

There were done considerable efforts by the European Commission, the governments of the member states and diverse local and regional organizations in order to stimulate the funds’ supply for the SMEs. But the offer stimulation should be correlated with the demand for the funds. In this context, the investment readiness program intends to correct the disequilibrium between the supply and demand on the capital market. The investment readiness programs are designed to assist the entrepreneur, especially the entrepreneurs of the innovative firms with growth potential, to increase the external financing sources. At the European Union level should be taken measures for promotion the investment readiness programs, for identification and promoting the best practices and encouragement of creation the networks of stakeholders. On the other side, the SMEs should be aware of the potential benefits brought by the investment readiness programs and to participate actively to these programs that have as main purpose the stimulation of attracting investment funds, thus, being created the premises for a future development of the firms.

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