

Sources of Financing and Innovative and Investment Activity of Small Enterprises

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Abstract: The necessity of using of innovative sources for investment supply by small enterprises in the course of their business activities is substantiated, classic and innovative sources of financing of innovation and investment activity of small entrepreneurship are differentiated. Directions of overcoming the limitation of investment financing are described; these are – use of venture assets in different forms and organization of their support by the government and the interested non- governmental bodies. The possibility of venture sources of investment financing use is shown- these are mezzanine financing, crowd funding and syndicate financing. It is substantiated that financing of project investment at small entrepreneurship has cross- point and complex characteristics that enables to overcome restrictions of small entrepreneurship on assets which it can always have.

Key words: Small entrepreneurship • Investment of capital • Innovations • Classic sources of assets financing • Restrictions on assets • Mezzanine financing • Crowd funding • Syndicate financing

INTRODUCTION

Formation of positive trends of sustained growth of the domestic economy is now bounded with strengthening of entrepreneurship. In this case, the most important form of business is a small entrepreneurship that performs not only the economic but also the social function. A distinctive feature of small enterprises is their mobility, portability, quick adaptability to changing economic conditions, which has a positive effect on functioning of the national economy as a whole. In recent years, small entrepreneurship have provided significant growth of major economic indicators of its activity, such as increase in revenue from sales of goods and services, improvement of financial results, increase of investment, demonstrating the growth of rate that exceeds indices of large and medium-sized enterprises. Simultaneously, due to their activities, small enterprises initially carry restrictions on the number of workers, in terms of assets, the marginal revenue from the sale of products and other,

which reduces their possibilities in the implementation of innovative and investment processes. At the same time, the need to create a high-tech innovation requires all entities to ensure high rates of growth in investments in innovation to establish a solid foundation for sustainable economic development. This largely relates to subjects of small entrepreneurship as the world practice has convincingly shown that entrepreneurship and innovations are interrelated and interdependent.

It should be noted that the investment aspects of enterprises' activities, including small enterprises, are covered in the works of well known foreign researchers J. Dean, H. Markowitz, M. Miller, F. Modigliani, S. Ross, B. Terborgh, J. Tobin [1-7]. They formulated the main principles of investment in science which are repeatedly confirmed by theory and practice. With the development of economic reforms, Russian scientists developed and clarified these provisions, including V.V. Bocharov, S.M. Bukhonova, N Guskova, Y.A. Doroshenko, D.A. Endovitsky, V.E. Esipov, A.G. Ivasenko,

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N.V. Kiselev, E.G. Makarkin, G.P. Podshivalenko, A.A. Rudychev, P.P. Taburchak, V.A. Chernov and others. Despite the large number of researches on actual problems of innovative and investment activity of small enterprises not all aspects are covered in whole. First of all it concerns management of innovation and investment processes in the subjects of small entrepreneurship, the content of which is still not fully disclosed in the economic literature, resulting in small enterprises which do not accept optimal solutions for the sound management of objects of their innovations and sources of investment activity financing. This happens to some extent and because of the infancy at the appropriate scientific-methodical level issues of management of innovation and investment processes. These circumstances determine the relevance and importance of the topic of this research.

The Main Part

Review of Sources Innovative and Investment Activity Financing of Small Enterprises: One of the most important aspects of the organization of investment processes in small enterprises is their financing. Understanding the financial support of investment activity of subjects of small entrepreneurship consider the general principles of creation of the source of investment processes' financing.

In the economic literature quite common is the understanding of the source of financing of the investments to be cash funds that can be used as investment resources. In this regard, we note that from the position of finance of an enterprise, cash is not the sources of financing and assets, so it would be better to talk about the kinds of liabilities directed to the financial provision of the acquired assets of investment character.

From the point of view of property relations, there are own financial resources of business entities (profit, depreciation deduction, cash accumulation and savings of citizens and legal entities, reinvested part of non-current assets, funds paid by the insurance authorities) and borrowed financial means of investors (Bank loans, bonds and so on). Indeed, the retained profit of the enterprise can be named as its full investment of financial resource; however, primary resources are authorized assets, reserve assets and additional assets, because during a certain period of time an enterprise may not make a profit. At the same time, the depreciation charge now cannot be regarded as a financial resource, as they are not recognized on the balance sheet, cash accumulation and savings of citizens and legal entities, as a rule, they are in deposits of credit institutions and can

be obtained only by an enterprise in the form of Bank credits, reinvested part of non-current assets is not regarded as a financial resource because it applies to assets. If to concern Bank loans and bond issues, it is, indeed real borrowed investment financial resources, provided their long-term nature. Speaking about the types of borrowed sources of financing of investments, there are often articles about lending, investment tax credit, leasing, forfeiting, securities and etc. In this case we are talking about the detail of borrowed sources of financing of the mentioned forms of investment financing. These are the inherently different forms of credit granted to the company, directly or indirectly, to the various participants in the investment process, specifically to the Bank financial institutions and tax authorities. A relatively new form of debt investment financing is the project financing, this type of financing includes investment projects that after their implementation provide a constant flow of financial resources and appropriate repayment of debt obligations. In this case the income received from the investment project implementation is the sole source of repayment of debt [8, p. 76-77]. Project financing has well recommended itself in recent years, giving a new impetus to investment activities of many enterprises. The advantage of project financing to other forms of financial support to the investment activity of enterprises is that the source of repayment are not just financial flows from the project and that the lender does not take into account the presence or absence of any assets of the borrower at the initial stage of implementation of the investment process. In addition, under the project financing we can use financial engineering and for implementation of the project, a special project company attracts resources accompanying the project and producing a final settlement with all categories of investors. In this case different types of financial instruments are applied [9, p. 26]. Thus, project financing is the most promising approach to mobilizing financial resources for the implementation of investment processes at the enterprise, allowing to escape from the balance sheet constraints and to invest in innovation.

In the structure of sources of financing of investment processes there are often state investment resources (budgets, off-budget funds, state borrowing, shares, property, the state property) and investment resources of economic entities [8, p. 189]. In modern economic conditions the state investment resources are actually not available to the enterprise of any size and they are given selectively to single economic entities, so these resources can be excluded from analysis of the sources of investment financing.

Summing up this brief review of sources of financing of the investment activity of enterprises and summarizing the existing views on the matter, we note that the classical sources of investment financing in the enterprise of any size and rank are the own financial resources (share assets, reserve assets, additional paid-in assets, retained earnings) and long-term borrowed financial resources (investment credits and project financing, bonds and promissory notes). Short-term borrowed financial resources in the form of bank loans, borrowings and payables of all kinds cannot be used to finance investment activities of economic entities, because the latter is the so-called «gap funds» when they fail to fulfill their obligations on short-term borrowings, since acquired by these borrowings investment assets are long term in their nature. Naturally, creditors, first of all, financial-credit organizations, while providing investment financing study in detail the financial and economic activity of enterprises, evaluate it according to the system of financial ratios (liquidity, business activity, profitability, capital structure and so on), calculate the indicators of efficiency of investment projects on the basis of the known criteria (NPV, IRR, payback period and so on). Thus, the possibility of borrowing for investment purposes in any business are always limited by the size of its own financial resources. To an even greater extent the problem of limits of financing of investment processes is relevant for small enterprises.

As it has been already noted, the character assets of small enterprises, initially limited, if adopted at financial lever is the basis of attraction of borrowed resources, which can be used for financing of investment processes. Further formed assets generate some revenue, which generates a corresponding profit. As a result the own capital of a small company can make all sides of its financial and economic activities and it can also exert a decisive influence on investment processes. The presence of small business investment projects aimed at innovations of all kinds, does not mean the beginning of the investment process until an adequate source of funding will not be picked up. The solution to this problem is a key prerequisite for the organization of investment activity of small enterprises.

Venture Assets as an Opportunity to Overcome the Limitations of Small Business: In our opinion, overcoming to the limitations of small entrepreneurship of the assets can be performed in two directions. The first direction is the use of venture assets in various forms. The first direction is the use of venture assets in various forms. According to the international standards, the term

" venture assets is understood as equity provided by professional firms investing and jointly managing the starting, developing or transforming private companies, which demonstrate the potential for significant growth. The owner of the venture assets divides the risk with the entrepreneur, long investment period is assumed; in addition to investment there are relationships with the management of the investing company, the payment refund is realized in the form of the increased price of the investor's share at the end of the investment period. As it can be seen, the use of venture assets, firstly, allows small companies to overcome the limitation on the assets; secondly, it is fully consistent with the nature of entrepreneurial activity, because venture assets is a risk source of investment financing, thirdly, it initiates changes in the organization of investment processes management of the subject of small business, having in view the creation of new organizational structures and formations for a joint venture with the investor for investment management processes.

The analysis shows that in the world practice, a round of venture investment financing acts mainly in forms of mezzanine financing, crowd funding and syndicated financing. So, in the case of mezzanine financing of the specialized investment funds and implements investment projects in the form of partial (tranche) stock loans [10]. The latter are a special form of the so-called mezzanine capital, at which the risk to the lender is covered by liquidity process equipment and machinery, as well as real estate project or its securities.

At this form of lending, the interest does not accrue on the loan and does not return the credit itself, but instead this the lender draws its «quiet participation» in the form of 49 percent (after all deductions and tax) of profit of the realized and put into operation project for the period of 20 years. The participation is conformed in the loan agreement between the parties.

Advantage of partial loans is that the lender accompanies an effective organization without debt obligations, which is due to such scheme of the investment and development has a liquid balance and high corporate rating. In addition, a small enterprise does not pay interest on the loan and does not return the credit itself, but instead, the lender participates in the net profit from the project. The «quiet part» of the lender in the profit means the absence of the creditor on the governing bodies of small enterprises without any right to vote in the adoption of the organizational solutions. Also, in this scheme, funding is not required bank guarantees from the borrower under the given creditor financing, which is reflected in the balance of invested a small business not

as a loan and as its own funds. Small business entity participates in organization of financing of the investment process of the minimum possible amount of its own assets.

Crowdfunding as a form of venture financing is associated with the spread of the Internet and its development in the framework of its social communities. Unlike traditional and non-traditional models of investment financing, implying obtaining relatively large investments on a limited number of institutional investors, crowd funding involves mass funding by receiving small amounts of money from a large number of participants in the investment process, linked by common interests, professional associations, social networks [10-12]. It is supposed that, having arisen in the music and film industry in the process of the development of media and online communications, crowd funding began to spread in the business environment and is very useful in the creation and development of new enterprises. Disadvantages of crowd funding include absence of a legal framework and imperfection of the mechanism of investments' return. In General the concept of the forms of venture financing of small business is quite productive, although it is quite a risky form, but financial resources are not from one to two investors and the large number of participants that provides borrowings portfolio for investment and minimizes portfolio risk in terms of financing of investment processes.

The second direction of overcoming the limitations of small entrepreneurship lies in the plane of its support by the government and the concerned authorities. Some Russian authors, speaking on financial support of investment processes in small enterprises belong to the methods of support of leasing, factoring, franchising, etc. In our opinion, it is not justified, as leasing, factoring and other operations with small businesses make credit organizations and other financial companies, which are not so much to contribute, how much exercise its own financial and economic activities. In our opinion, it is not justified, as leasing, factoring and other operations with small businesses make credit organizations and other financial companies, which don't only contribute but also exercise its own financial and economic activities. On the contrary, methods and mechanisms of support should include state support programs. So, in Russia since 1995 four Federal program of state support of small entrepreneurship have been developed, including the periods of 1996-1997, 1998-1999, 2000-2001, etc. These are real programs, which contained, including measures for financial support of investment processes in small enterprises. Another thing is that the state support

programs are not yet sufficient, but that is another question. For its positive decision we should study and analyze the world experience of support of small entrepreneurship business with the purpose of its adaptation and implementation in domestic practice.

As it has already been noted, the U.S. has the Administration for small businesses (Small Business Administration (SBA), organized in 1995, which solves the following tasks: assistance in obtaining credits for small enterprises, technical and informational support of small entrepreneurship, provision of loan guarantees for small businesses, direct subsidies and loans to small business from its own budget, with the addition of the SBA an Advocate's Department was specially created and it defends interests of entrepreneurs in the court and Congress of the United States [13, C. 28-29]. Therefore, public authorities in this case not only contribute to the organization of the investment financing of small enterprises, but they themselves act as a lender, at the expense of own financial resources.

Currently in American practice with the participation of the SBA there are numerous programs to support small businesses, in terms of influence on investment processes the following programs are the basic ones. On the basis of the law on investment of small businesses there is the development of state and local companies, which are established on the basis of laws of the States; the SBA provides them with long-term loans, which, in turn, are directed to replenishment of equity and long-term loans to small enterprises. Simultaneously private investment company of small business are created, the assets of which is formed from private sources and loans of SBA, the tasks of these companies provide capital and long term loans, small companies, projects with a risk of high degree. It is important that in addition to running on the Federal level, the SBA has a wide network of special institutions of the local government; in particular, in all States there are 100 regional centers of SBA employing up to 40 people in each, the SBA has 5 thousand people [14, p. 42]. As it can be seen, the American model of support of small business, first of all enables to overcome the mentioned limitations on capital; secondly, it is based on the interaction of state and private companies; thirdly, they fully comply with the principles of entrepreneurship, as it involves investment activities with a high degree of risk. This model is distinguished by the diversity in the forms of loans; some are fully presented by SBA, others are presented partly and partly by a bank, the third ones are presented completely by the bank at SBA guarantees at the level of 90 percent.

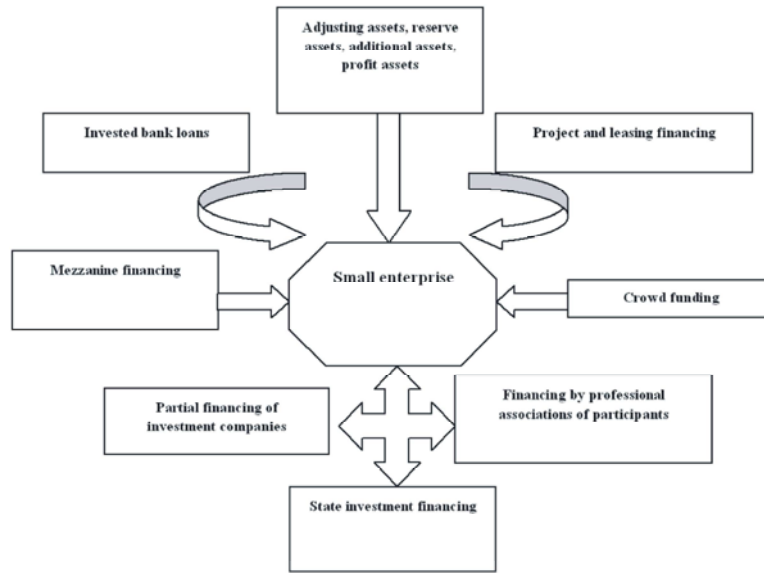


Fig. 1: Possible directions of investment financing of small business

Support of small entrepreneurship in Germany despite the American model has its own peculiarities, it involves public funding of private financial institutions, which are in their turn engaged in crediting small enterprises. The financing and crediting has both national level and the level of Federal lands, urban and land districts and communities. Participants in the programmes of support are the two main specialized Banks KfW Bank and the Dta Bank, the first one is the most significant one. The General principles of the mechanism of financial support is the provision of investment financing to small businesses through the so-called business banks, which take up 50% of credit risks, the remaining 50% take the KfW Bank. Support to small enterprises by the Bank of Dta is lending to start-up enterprises and the enterprises, developing their business. For financing small business entity applies to any local Bank and prepares a credit application, within the Bank Dta low-interest loans (interest rate of 6-8%) on the program of ERP can be provided in Eigenkapitalhilfr for investment in the first two years after the registration of a small enterprise. In addition to the concessional lending as an instrument of state support of small enterprises, in Germany they use loan guarantees and equity participation in investment companies in the assets of small enterprises. In the framework of Federal programs and guarantees specialized guarantee banks have to assume the risk of non-repayment up to 80% loan amounts. However, both loans and guarantees are provided only to creditworthy small businesses taking into account the accepted standards of an estimation of their financial position, which returns the principles of financial support to balance-sheet constraints.

Analysis of traditional and non-traditional sources of financing of investment processes in small enterprises can conclude that the capital of the subject of small business, as its main feature, can provide only a small fraction of the financing of investment processes, including creating the conditions for obtaining the «classic» investment loans. The other part of the funding should be organized on the basis of interaction of state bodies and support funds, on the one hand and financial and credit organizations and large enterprises, on the other hand. The role of financial and credit institutions if this is significant, because in both traditional and non-traditional schemes of financing of investment processes of these organizations are located in the centre of investment cash flows. The various schemes of interaction of all participants of investment processes, the development of these schemes is a methodical provision of the justification and implementation of the sources of financing of investment processes in small enterprises.

It seems that, despite the still not fully developed legal base of functioning and development of small business in our country, we can propose concrete forms of the organization of the investment financing of small enterprises taking into account the accumulated domestic and foreign experience based on current legislation of the Russian Federation. Having in mind the fact that our own financial resources of a small business is the value of the solution of the financing problem its investment lies in the direction of raising debt of financing in both traditional and non-traditional forms. Fig. 1 shows the possible directions of investment financing of small enterprises.

As it was noted before, the organization of financing of investment subject of small business forms authorized assets, reserve capital, additional paid-in capital and retained earnings. In fact, it is this value, which is determined after payment of the Charter assets.

Further there are «normal», classic long-term borrowings in the form of investment banking loans, credit organization, under the provision of this type of funding is guided by the normative framework and Bank lending standards, which limit the size of possible investment resources, the value of own financial resources, thus, there are balance limitations of small business, inherent in it by its definition. The first level of overcoming these limitations is the design and lease financing. In the first case, as it was noted before, the lender does not take into account the value of the assets the subject of small business, focusing on its financial flows from the project, in the second case there is a similar situation, because in accordance with the legislation of the object of leasing financing, for example, innovative non-current assets can generally remain with the lessor.

The Use of High-risk Sources of Investment Funding:

The second level of overcoming the limitations of investment activity of small enterprises is the use of high-risk sources of investment financing in the form of venture assets on a purely commercial basis. By obtaining mezzanine financing from specialized investment funds investment projects are provided to small businesses in

the form of partial (tranche) stock of loans, the lender has the «quiet participation» in the form of 49 percent of net income realized and put into operation project for a period of 20 years, assets' requirements of small business are minimal. Crowdfunding is simultaneously implemented through the establishment of contacts with potential investors via the Internet that will give massive funding from a large number of participants, first of all, members of professional communities. Even in the absence of normative-legal base of crowdfunding, investor's relations can be issued on the basis of existing legislation, for example, contracts of investment loans.

The Third Level of Overcoming the Limitations of Investment Provision of Small Entrepreneurship:

The third level of overcoming the limitations of investment provision of small enterprises is the realization of all possible directions of its public and private support. A small enterprise gets guarantees on loans and interest rates from existing government official bodies subsidies on loans, investment companies, intermediaries of public support - direct funding under the state guarantees and warranties other commercial banks, professional market participants, such as small business associations - some share of the funding, subject to its standards worked out by the associations. Thus, financing of investment processes in small businesses adopts a comprehensive, cross-cutting nature that helps to overcome the constraints of small enterprises.

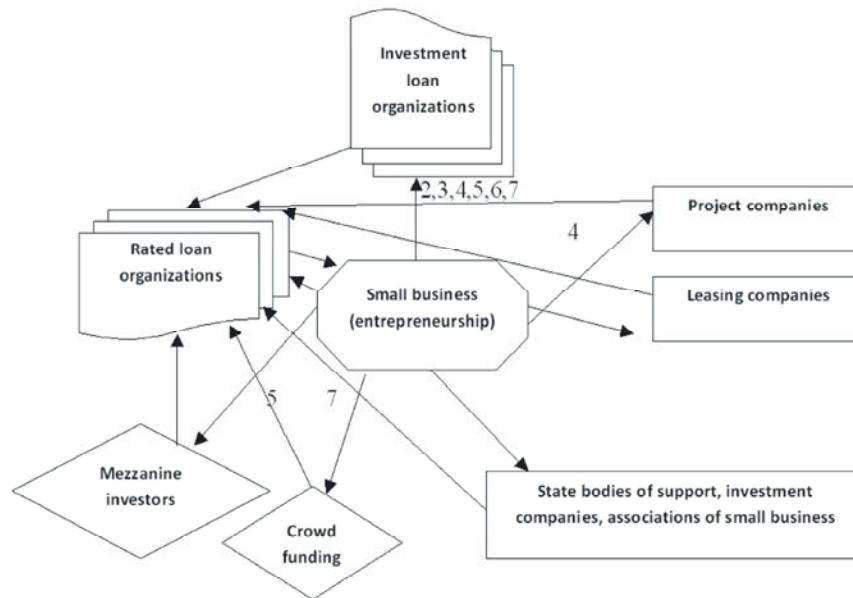


Fig. 2: Algorithm of interaction of subjects of small business with the participants of the investment process for complex financing

As it can be seen, initially, small enterprise opens an account in the calculation and loans organization, through which later there will be all payments, including its investment activity (1). Next, a credit application is given for investment loan in the investment bank, which can be realized (2) when the company accepts the standards of investment lending. The next stage is the attraction of project and lease financing from project and leasing companies (3, 4), it allows to bypass limitations of balance nature. Development of the investment activity of subjects of small business involves the interaction with venture investors in the face of mezzanine companies (5) and the investors of crowdfunding (6). Simultaneously a small business relies on financial support for their investments in the person of government bodies support, investment companies and associations of small enterprises (7).

An important moment in the formation of the sources of financing of investments of small enterprises is the structure of attracted investment of financial resources. The matter is that, being under the legislation of small enterprises, business entities have different amounts of their own funds. For a given volume of investments into innovative floating assets before the beginning of the investment process there can be proportions between classical, on the one hand and venture assets and innovation, on the other hand, the sources of financing investment activity. In our opinion, in real investment practice, a small business entity should strive to build a diversified portfolio of borrowed sources of financing of investments, which, *ceteris paribus* will contribute to reduce portfolio risk as it provides for the attracted investment resources.

CONCLUSION

In our opinion, one of the most important aspects of the organization of investment processes in small enterprises is their financing. Classical sources of investment financing in the enterprise of any size are own financial resources (share assets, reserve assets, additional paid-in assets, retained earnings) and long-term borrowed financial resources (investment credits and project financing, bonds and promissory notes). Own capital of the subject of small business which was initially limited, if financial lever is adopted, is the basis for borrowing resources, it creates all sides of its financial and economic activities, it also exerts a decisive influence on investment processes. The presence of small

enterprises of innovation and investment projects does not mean the beginning of the investment until there won't be an adequate source of funding. In our opinion, the overcoming of limitations of small business on assets can be performed in two directions. The first direction is the use of venture assets in various forms, which, firstly, allows small companies to overcome the limitation on assets and secondly it is fully consistent with the nature of entrepreneurial activity, because venture assets are a risk source of investment financing, thirdly, it initiates changes in the organization of investment processes management. We propose to use such sources of venture investment financing, as mezzanine financing, crowd funding and syndicated financing. The second direction of overcoming the limitations of small entrepreneurship lies in the plane of its support by the government and the concerned authorities. Taking into account world experience on the organization of investment financing on the basis of interaction of state bodies and support funds, on the one hand and financial and credit organizations and large enterprises, on the other hand, there are various schemes of interaction of all participants of investment process; these schemes are presented in the dissertation, their development represents a methodological support of the justification and implementation of the sources of financing of investment processes in small enterprises. Thus, financing of investment processes in small entrepreneurship adopts a comprehensive, cross-cutting nature.

Conclusions: The study of entrepreneurial activity in the framework of a market economy has led to the following conclusions:

- The modern Russian economy is currently being developed on the basis of activation of different forms of business activities, the most important of them is the small business, in this opinion the most important characteristic is commercial activity, small enterprises are characterized by their innovative projects and at the same time by their venture character;
- The subject of small business invests in innovation without the participation of the stock exchanges, as it usually does not operate on the organized securities' market, at the same time there is an active interaction with the banking and insurance organizations regarding the provision of debt financing and insurance of entrepreneurial risks;

- Characteristics of the innovation and investment processes in small enterprises did not differ significantly from the corresponding characteristics in large and medium-sized enterprises, the level of novelty and innovation is mainly new, improved, partial and innovation potential is moderate and limited;
- Classical sources of investment financing in the subjects of small entrepreneurship are their own financial resources and long-term borrowed financial resources; the basis of financing organization of investment in innovation forms authorized assets, reserve capital, additional paid-in capital and retained earnings; then there «normal», classic long-term borrowings appear in the form of investment banking loans of project financing, bonds and promissory notes; the financing of investment processes in small enterprises has a comprehensive, cross character that helps to overcome the limitations of their investment activity.

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