German Economic Team Belarus

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Improving Access to SME Finance in Belarus: Analysis and Recommendations

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Improving Access to SME Finance in Belarus: Analysis and Recommendations

Executive Summary

The development of small and medium-sized enterprises (SME) in Belarus is bounded by a number of factors, of which the limited access to financial sources is a key problem. Evidence for that assessment comes from SME surveys and from a quantitative and qualitative analysis of the Belarusian financial sector. The main sources of finance for Belarusian SME are internal equity and banking finance. Other sources of external finance play only marginal roles. This fact indicates that the SME finance market is underdeveloped. Furthermore, the volume of credits extended to the SME sector, which can only be estimated since reliable data are missing, is rather small compared to other European countries. To sum up: sources of finance are limited in terms of size and in terms of types.

International experience shows that policy can facilitate the access to finance for SME.

Firstly, a sufficient database on SME finance in general and SME lending in particular is a prerequisite for an effective policy design and impact analysis. A regular Belarusian SME banking credit monitor would be a good start. The set-up of such a credit monitor entails low costs and has an enormous information power for policy decision making.

Secondly, in order to improve the SME's endowment with equity finance, policy makers should facilitate the diversification of equity sources. Above all, an efficient regulatory framework for private equity markets is needed for Belarus. This includes a framework for Venture Capital funding, which is especially important for innovative SME.

Thirdly, in order to improve the access to external debt finance, a loan guarantee scheme (LGS) is international best practice. A good designed LGS that helps to overcome collateral constraints has a high impact on the targeted credit growth and entails only reasonable public outlays. Other credit market interventions such as interest subsidies are not recommendable, because they require high public expenditure and thus have low policy efficiency.

Furthermore, international best practice on SME innovation finance policy might be of interest for Belarus. Such a public support measure boosts innovation capacity of SME without drawbacks for the national research and development program. The equal access for both private and state enterprises to innovation programs and all kind of public support measures is the key prerequisite for SME finance policy effectiveness.

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1. Introduction

Access to finance is regarded as a major impediment for the development of small and medium-sized enterprises (SME) according to popular discussions all over the world. Regularly, opinion polls among SME owners report that access to finance is seen as a key problem by most SME owners. Although the explanatory power of such opinion polls is limited because of several biases and drawbacks on the methodologies used, the influence of such surveys on the public discussion cannot be denied. Therefore, it is worth analysing the situation thoroughly, comprehensively and balanced in order to determine whether or not a serious need for public policy intervention exists.

This policy papers aims at taking a step forward to a fact-based and balanced discussion on the topic of access to finance for Belarusian SME. In the next chapter, we present some stylized facts on the situation of SME finance and detect the areas for improvement. Chapter 3 highlights the most common policies towards SME finance and the international experience regarding the main policy instruments. Chapter 4 synthesizes the findings of the analysis with international experiences and derives recommendations for the Belarusian public policy with the goal of facilitating and enhancing the SME sector development.

2. Current situation of SME finance in Belarus

2.1. Overview

Access to finance is one of the main challenging factors that shape the business environment of Belarusian small and medium sized enterprises. Several surveys conducted either by international or by national organizations identify the access to finance as the first or the second most important obstacle to doing business. For example, the data from Business Environment and Enterprise Performance Survey (BEEPS) 2009 of the EBRD indicated that 60% of firms in Belarus considered access to finance as a strong impediment to firms' development in Belarus. A survey performed by IPM Research Center in 2012 revealed in turn that 46.5% of interviewed Belarus SME's cited access to financial resources as a biggest barrier to running business[1].

These surveys also indicate the excessive reliance of SME on internal funds. Table 1 presents the results of the IFC Enterprise Survey (2008) and shows that all SME's in Belarus, irrespective of their size, used internal finance as a main source for investment. According to this survey, only 20-23% of resources used by Belarusian SME in their operations came from bank financing. The share of trade credit financing was rather limited as well (5.3-9%), while an undeveloped domestic stock market was simply not able to provide any external support to firms.

[1] Business in Belarus 2012: Status, Trends, Perspectives. IPM Research Center. 2012. http://eng.research.by/webroot/delivery/files/english/sme/business2012e.pdf

Table 1: The Sources for Investment of Belarusian SME

	Belarus	**Small enterprises (1-19 employees)**	**Medium (20-99 employees)**	**Large (100+ employees)**	**Eastern Europe and Central Asia**
Internal Finance for Investment (%)	66.0	61.0	68.9	66.1	62.0
Bank Finance for Investment (%)	21.2	20.6	23.3	18.8	23.8
Trade Credit Financing for Investment (%)	7.7	5.3	8.9	9.7	5.0
Other Financing for Investment (%)	0.0	0.0	0.0	0.0	0.4
Working Capital External Financing (%)	N/A	N/A	N/A	N/A	30.5
Value of Collateral Needed for a Loan (% of the Loan Amount)	118.4	134.1	109.4	115.2	133.4
% of Firms With Bank Loans/Line of Credit	49.5	33.2	56.9	79.3	43.6

Source: Belarus Country Profile 2008. Enterprise Survey. IFC

The financial environment for SME's has not changed since last IFC Enterprise Survey conducted in 2008. In 2012 the National Bank of Belarus interviewed SMEs with the aim to identify the extent of their financial inclusion. It was revealed that financial inclusion of SME's for credit services is 38.1%, while 58.7% firms have not used external financing. However, surveyed SME's mostly utilize credits for working capital financing (23.2%), while fixed asset loans were used only by 9.5% of firms, leasing – by 6.6%, mortgage loan – by 4.1%[2]. According to the survey, the use of credit services varies from 4.3% among production cooperative societies to 37.8% among open joint stock companies. The highest rate of usage is reported among companies with 6 - 10 years on the market, and at medium enterprises with 51 - 100 employees. Furthermore, exporters were the most numerous among SME's that use credit services (53.2%), while among companies oriented towards the local market only 28.5% utilize bank financing[3]. However, the IFC findings show that the SME density is correlated not only with credit usage but also with extent of the use (amount of obtained loans). Furthermore, where SME lending (as a share of GDP) increases, SME density also increases[4]. The data on amount of funds provided for SME lending is not available in Belarus. Therefore, provision of crediting to the private sector can be used as a very rough approximate indicator that can shed some light on the size of banking finance of SME[5]. It

[2] Estimation and analysis of SME access to finance in the Republic of Belarus: National Survey Results. National Bank of the Republic of Belarus. 2012.

[3] Estimation and analysis of SME access to finance in the Republic of Belarus: National Survey Results. National Bank of the Republic of Belarus. 2012.

[4] Khrystyna Kushnir, Melina Laura Mirmulstein, and Rita Ramalho. Micro, Small, and Medium Enterprises Around the World: How Many Are There, and What Affects the Count? IFC. MSME Country Indicators. 2010.

[5] SME sector comprises not only private but also state-owned enterprises, which were not captured by this indicator, in addition, it includes loans provided to large private enterprises.

accounted for 20% of GDP as of 01.01.2013[6] and was very low compared to over 140% of GDP in the EU area[7].

Moreover, the extent of the use of credits by SME's in Belarus, which is not high in itself, was negatively affected by the global financial crisis 2008-2009 and the currency crisis 2011. Whereas finance in Belarus is mainly provided by commercial banks, which usually are more reluctant to credit small and medium sized firms than large (and often state-owned) enterprises, SME's appear to be especially vulnerable to macroeconomic conditions. In case of any sign of their worsening, banks reduce lending that is already relatively limited, or tighten credit conditions, as they consider the risk associated with provision of credits to this sector to be higher. Thus, the data of the "Monitoring of Banks' Lending Conditions" conducted by the National Bank of the Republic of Belarus in the fourth quarter 2012 show that banks expectations concerning a deterioration of terms of credits for SME's was justified. More than 30% of banks reported about a tightening of conditions for provision of loans in foreign currency for SME's due to reduction of the maximum loan term, and increase in interest rates. Banks also pointed at a contraction of credit availability in Belarusian rubles for SME's. In addition, in the fourth quarter 2012 banks enhanced requirements for business solvency and collateralization of credits for small and medium sized enterprises. Besides, up to 22.6% of banks indicated possible further worsening of SME's credit conditions in the first and second quarter 2013, while only 20% considered that it might improve[8].

2.2. Sources of SME Finance

Apart from bank lending, which is undoubtedly the main source of external finance for SME's in Belarus, there are some other financial products and channels that can impact the development of these enterprises, i.e. credit guarantee schemes, microfinance facilities (including credit unions), public start-up funds, business angel networks, leasing, access to the stock market and the availability of risk capital (*e.g.* venture capital, private equity). Table 2 presents the OECD quantitative indicators that assess the level[9] of SME's access to finance in Eastern Partnership countries, including Belarus.

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[6] Bulletin of Banking Stat, and istics. NBRB, January 2013. http://www.nbrb.by/statistics/bulletin/2013/bulletin2013_1.pdf

[7] OECD (2012) SME Policy Index: Eastern Partner Countries 2012. Progress in the Implementation

of the Small Business Act for Europe

[8] Monitoring of Banks' Lending Conditions. NBRB. October-December 2012. http://www.nbrb.by/publications/CreditsMonitoring/?f=6

[9] The score is based on the level of policy development in a certain area that transforms qualitative information into quantitative indicators. The methodology can be found in OECD (2012) SME Policy Index: Eastern Partner Countries 2012. Progress in the Implementation of the Small Business Act for Europe.

Table 2: Scores for Sources of External Finance for SMEs

	Armenia	Azerbaijan	Belarus	Georgia	Moldova	Ukraine
Credit guarantee schemes	3	2.5	2	2	3	3
Public start-up funding	2.5	2.5	2	2	3	1
Business angels network	1	1	2.5	2.5	1	1
Microfinance facilities including credit unions)	3	4	2.5	4	3	3
Leasing	2.5	3	3.5	3	3	3.5
Availability of risk capital (*e.g.* venture capital, private equity funds)	2	2.5	2	3	2	3
Access to stock market	2	2	2	2	2	3
Weighted average	**2.29**	**2.50**	**2.36**	**2.64**	**2.43**	**2.50**

Note: The score ranges from 1 to 5, with 5 representing the most developed value

Source: OECD (2012) SME Policy Index: Eastern Partner Countries 2012. Progress in the Implementation of the Small Business Act for Europe; see Scores and Methodology for further information.

As can be seen from the above table, Belarus has one of the lowest score among the analyzed countries. Especially underdeveloped are credit guarantee schemes, public start-up funding, risk capital and access to the stock market. These instruments of SME's access to finance policy receive a score of 2. Which is to say, that, for example, credit guarantee scheme facility in Belarus is just under consideration, public start-up funding exists only at the level of pilot projects with limited impact, and access to stock market is virtually non-existent due to different reasons. A score of 2.5 was provided to business angels' network development. It means that the level of SME's support provided through this channel is between policy awareness and pilot projects/schemes. Such financial instrument as microfinance (score 2.5) is at the level of pilot projects with limited impact on the amount of SME's access to finance. The funding mainly comes from state or international donors. And only leasing shows moderate activity and received the highest score of 3.5. The OECD assessments revealed that due to the low level of the development of external finance, SME's in Belarus are bound to rely mainly on internal funds, and on money from informal sources such as family and friends.

2.3. Current SME finance policy framework in Belarus

The policy framework for SME's finance is a complex interaction of financial institutions and infrastructure, as well as a regulatory and legal framework.

State financial support of SME's in Belarus is provided based on the provisions of the "Law on State Support of Small and Medium-sized entrepreneurship" of 1 July 2010 (N 148-3) and the Edict of the President "On Some Measures of State Support to Small Entrepreneurship" No 255 of May 21, 2009. According to the Edict, state financial support should be provided to small enterprises on a competitive basis when they implement investment or business projects in the following areas: creation, development and expansion of the production of goods (works, services); organization, development of the production, and realization of export-oriented, import-replacing products; production of products oriented at the efficient use of resources and energy; adoption of new technologies. The sources of financial support are the republican budget, including the "Belarusian Fund of Financial Support of Entrepreneurship", local budgets, including funds placed in deposits of banks and institutions of financial support to small entrepreneurs created in regions (the city of Minsk). Upon decisions of regional executive committees or the Minsk City Executive Committee state financial support may be granted by city, district executive committees and/or local administrations and also through institutions for financial support to entrepreneurs created in regions (city of Minsk). The "Belarusian Fund of Financial Support of Entrepreneurship" provides financial support on a repayable basis. The interest rate is set in the amount of the refinancing rate of the National Bank, however for the projects that have high the social and economic importance the amount of the interest rate can be set below the refinancing rate of the National Bank, but not less than half of that rate[10].

A regulatory framework of microfinance in Belarus is in the process of elaboration. The National Bank of the Republic of Belarus recently prepared a draft decree that would regulate microfinance institutions. According to this document, there will be two types of micro-financial institutions (MFIs) in Belarus: commercial microfinance organizations operating as a company with limited liability or a company with additional responsibility like non-profit microfinance institutions operating in the form of fund, the consumer cooperative of mutual financial assistance, association of the mutual financing (only for legal entities and entrepreneurs) and credit union of consumer cooperatives. It is planned to establish the National Bank requirements for the minimum capital for MFIs at USD 136,000 and the maximum size of microloans at USD 18,000, i.e. ten times less than the size of bank's microloan (USD 180, 000). According to the draft Decree the National Bank of the Republic of Belarus (NBRB) will maintain a register of legal microfinance lenders, which, in their turn, should submit to the National Bank the credit's info, which is necessary for creation of a credit history. The draft of the Decree also mandates that all MFIs should submit financial data to NBRB. In order to prevent the setting the unrealistically high interest rates the microfinance organization will have to disclose to the borrower the information on the annual interest rate on microloans in the contract. According to the draft of the Decree, a ban will be set for legal entities and individual entrepreneurs to attract micro-loans from individuals - residents except for micro-loans attracted from individuals who are founders and participants of these entities, members of the cooperative.

Currently, microfinance in Belarus is provided mainly by banks that are supported in this activity by such international organizations as EBRD and IFC[11]. In addition there are several credit unions (Consumers' cooperatives for Mutual Financial Assistance)[12]. However, they are small, have very limited resources, and therefore cannot meet the demand for micro-lending from **small business** startups.

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[10] http://law.by/main.aspx?guid=3871&p0=P30900255e

[11] In December 2007 IFC has signed an agreement, in partnership with EBRD and other European financial institutions (e.g. Commerzbank), to launch the Belarusian Bank for Small Business in order to increase SME's access to fiance. In July 2010, IFC bought 19.9 percent of equity and provided a $5 million loan to Belarusky Narodny Bank, which has a strong focus on small and medium enterprise finance. In 2102 the EBRD provided three of its partner banks with credit lines for on-lending to small and medium-sized businesses for an aggregate amount of €22 million.

[12] In February 2008 the Republican Association of Consumer Cooperatives for Mutual Financial Assistance was created with the aim to unite such organizations in Belarus.

The alternative instrument to bank loans is SME external finance in form of leasing that is attractive because it does not require any supporting collateral. It should be noted that the value of collateral needed for a banking loan accounted for 118.4 % of the loan amount in Belarus (Table 1). Therefore leasing is an attractive financing tool for SMEs, especially for those who want to expand production capacities. However, leasing activities, and in particular for equipment and machinery, remain very low and was estimated at around 3% of GDP[13]. Nevertheless, access of SME to finance through leasing has been growing in Belarus that was confirmed by OECD assessment, which gave the score of 3.5 for the level of the development of this financial instrument in the country. Leasing activities in Belarus are regulated by the Civil Code.

One of the sources of SME finance is risk capital that is especially important for setting up new innovative business. However, legislation related to risk capital is undeveloped in Belarus. The relevant legislation on venture capital financing was passed in January 2007 when the Edict of the President of the Republic of Belarus № 1 "On approval of the Regulation on the Creation of Innovative Infrastructure Entities" was adopted. This Edict opened the possibility of establishing venture capital organizations. However, the system of venture capital financing was not put into place. Therefore, in May 2010 the Presidential Edict № 252 authorized the Belarusian Innovation Fund (Belinfond), which funds innovative projects on a repayment basis, to assume the functions of a state venture capital fund. The specifics of the Belarusian model of venture capital financing through Belinfond is that it provides funds entirely for innovation and high-tech projects of state enterprises or organizations.

In addition, development of innovative SME's in Belarus can be supported through infrastructure of eight technology parks, four technology transfer centers with 28 regional representative offices, five innovation centers, and 46 scientific research centers. Belarusian Innovation Fund and some technology parks in Belarus also provide direct financing for scientific research and innovative projects. But, as in the case of venture capital financing funds are provided usually for state owned enterprises.

One of the tools that can be used by small businesses, which have been turned away by banks, is business angels that provide capital to start-ups and growing companies in return for a convertible debt or equity stake. Business angel network is in its earlier stage of development in Belarus. In November 2010 a Business Angels and Venture Investors Network (BAVIN) was registered in Belarus as a privately-funded organization with the aim to unite capital owners and owners of business ideas without intermediaries, to support angel and early stage investment, and to foster innovative startups with high growth potential. **BAVIN** does not provide funding directly to businesses. It acts as a Virtual business incubator that encourages interaction between small and medium sized enterprises and private investors with entrepreneurial experience[14]. BAVIN currently comprises 15 business angels.

2.4. Challenges, problems and chances for SME finance in Belarus

The previous sections of this chapter gave a comprehensive overview of the current state of SME finance in Belarus. While it became clear that an improved access to external finance is a key factor for sustainable SME development in the country, there are currently a number of respective challenges and problems for small and medium-sized enterprises. The following list focuses on the

[13] SME Indicators OECD.

[14] http://www.bavin.by/

major challenges, problems and chances that different kinds of SME's currently face in Belarus with respect to obtaining financial resources.

High and volatile interest rates

SME's are faced in general with very high and volatile lending rates by banks, which limit their external funding, especially with respect to long-term loans. As a driver for such negative conditions, the still shaky macroeconomic environment has to be mentioned as a prime reason, as inflation is still running above 20%, while inflation and depreciation expectations are still high.

However, these observations do not follow from a rigid analytical assessment of bank lending to different borrower segments, but are derived from selected empirical evidence and supported by survey results. In official statistical data on bank lending, there is no detailed information regarding credits provided to SME's and their conditions.

FX lending to SME's is curtailed by National Bank decisions, which prohibit such lending. While the possible negative balance sheet impact of such loans in times of financial distress should not be underestimated (creating problems in debt servicing for the borrower, but ultimately also for the lender/bank), certain SME's also export their products and services and thus are hedged to some degree against FX movements.

Collateral issues

In section 2.1 it was stated that collateral is indeed an issue, especially for small enterprises, where over-collateralization of loans is a standard business practice. Thus, lending is still mainly an asset- based process, and not directly related to the cash-flow of the company in question. This is of particular negative relevance for SME's, which often do not have access to sufficient collateral which is acceptable for banks.

General banking sector environment

Banks that work with SME's have made good progress in recent years, driven in part by the availability of funds supplied by international and bilateral financial institutions. These funds have been used to finance credit lines (MSME facilities) to local partner banks for on-lending to SME's. At the same time, technical assistance has focused on increasing the know-how and competencies of the banks' staff to originate such loans. Since a number of banks specialize in this particular area of private-sector-lending, competition is quite efficient and profitable projects have good chances for obtaining finance. This is particularly true for mature SME's that originate in Minsk and the Oblast centers, and which need working-capital finance. The situation is a bit different in rural areas, which are more difficult to service, and where the relevant know-how and expertise in working with SME's is still underdeveloped.

This know-how and expertise in loan evaluation is of critical importance for the long-term objective of a shift towards cash-flow based lending, especially as the financial reporting quality of most SME's is still far from perfect. The process of upgrading the books of SME's is another key long-term challenge in this respect.

The credit bureau run by the National Bank supplies according to a number of banks reliable information about potential borrowers, and is used by banks. Since banks get punished for not transmitting data, the quality of the data base is quite comprehensive and accurate.

Discrimination

State-owned enterprises (SOE's) have often access to lending under specific government programs at preferential conditions (e.g. subsidized interest rates). The same level of access is not available to private SME's, i.e. a certain degree of discrimination can be observed. A similar degree of implicit discrimination of private SME's exists with respect to access to the "Belarusian Innovation Fund", where the regulatory framework conditions of the fund exclude private SME's.

SME finance policy framework

The previous sections highlighted the limited funding possibilities available through state programs. However, apart from insufficient funds, the access conditions attached to such programs often do not meet the interest of the enterprises, which in turn limits their interest.

Gaps in the external finance mix

As was written before, the right mix of different external financial sources is a key success factor for SME development. In Belarus, SME finance is still very much dependent on banks and less so on other instruments. Specifically equity risk-capital is missing, which is of particular relevance to Start-ups. A viable Venture Capital market does not exist, which has also to do with a lack of relevant legislation. Private Equity is also underdeveloped, and so are Business Angel networks. Here lies a missed opportunity so far; as such instruments might also help to attract foreign funds (i.e. FDI), thereby closing the SME financing gap.

To sum up, there are general and specific reasons for a limited access of SME's to external finance in Belarus. While the high and volatile interest rate environment limits the long-term funding for all SME's, other factors impact particularly Start-ups and micro enterprises in rural areas and small towns. Furthermore, gaps in the available external finance mix negatively impact the financing of R&D and business development for all SME's across the country.

3. Policy towards access to finance for SME – Review of German and International Experiences

This chapter summarizes international experience regarding the most popular policy instruments aiming at improving the access to finance for SME. We focus on those policy tools that are applicable to both developed and transition countries. We do so because Belarus is quite developed with respect to the banking sector and with respect to SME productivity. Some finance instruments that proved to be successful in the poorest development countries like joint liability micro-finance schemes are not quite suitable for Belarus, because the Belarusian markets and institutions are already at a completely different stage of development. Furthermore, we take into account only those policy tools that are still in use in developed industrial countries; we do not consider outdated policies.

3.1. Loan Guarantee Schemes (LGS)

Table 3: International experience regarding: Loan Guarantee Schemes

Target Group	Start-ups, SME
Problems of Target Group	Unable to secure a loan, because of: - Lack of collateral, and/or - Unfavorable track record
Measure	LGS (typically government-backed) guarantees finance. A bank nominates the ventures for approval to the LGS. If the venture succeeds, then the bank takes the usual repayment. If the venture fails, the LGS is liable for 70-85% of loans; the bank is liable only for the rest.
Opportunities	Facilitates bank-borrower relationships In case of credit rationing or redlining ▪ More start-ups financing ▪ More ventures receive finance
Disadvantages and Risks	Low political efficiency = high net cost ▪ Administration costs ▪ Default loans Crowding out of private bank loans: ▪ No additionally: ventures use LGS that would have received loan anyway ▪ Banks use LGS to reduce their liability Adverse selection: ▪ Banks finance more risky ventures because of reduced liability (e.g. reduced screening effort) ▪ Higher failure rates on average than non-LGS-funded businesses In case of efficient credit markets with no rationing: ▪ Danger of supporting inefficient ventures ▪ Displacement effect: supported ventures displace viable incumbent ventures
Current policy trends	Reducing LGS volume: smaller loan sizes, smaller guarantee rates of government, stricter eligibility criteria

Conclusion 1: LGS schemes can be effective in case of credit rationing or redlining. They usually entail high costs and have many drawbacks, but they are superior to other types of credit market interventions.

3.2. Other Credit market interventions

Table 4: International experience regarding: Other credit market interventions

Target Group	Start-ups; small enterprises (esp. in rural sectors)
Problems of Target Group	Unable to receive loans from private banks, and/or Unable to effort high interest rates
Measures	Government issues direct loans Government provides interest subsidies
Opportunities	In case of credit rationing or redlining ▪ More ventures receive finance ▪ Positive (very small) long-term effects on job-creation
Disadvantages and Risks	Low political efficiency = high net cost ▪ Administration costs ▪ Default loans ▪ Interest subsidies Displacement effect: supported firms displace viable incumbent firms Crowding out of private bank loans: ▪ Direct competition between banks and state Adverse selection: ▪ Higher failure rates of supported ventures ▪ Negative long-term effect on productivity level of recipients
Current policy trends	Reducing those measures; if interventions are regarded as necessary, than LGS are preferred.

Conclusion 2: Direct government lending programs are even less efficient than LGS. The same is to say for interest subsidies in general, although the latter are still commonly used, e.g. in Germany.

3.3. Regulatory policies to promote equity finance

Table 5: International experience regarding: Regulatory policies to promote equity finance

Target Group	Innovative start-ups and SME in the technology sector
Problems of Target Group	Need equity to leverage debt finance High demand for finance High and unpredictable risks
Measures	Efficient regulation of private equity and venture capital markets Efficient regulation of stock markets Reducing legal restriction on the investors' side (e.g. pension funds) Effective legal investment protection (e.g. no expropriations) Efficient regulation for incoming foreign equity investments
Opportunities	Greater equity base of firms Greater debt finance through leveraging equity More innovative ventures High political efficiency ▪ No costs of implementation ▪ No effect on public budget ▪ No welfare-losses
Disadvantages and Risks	Regulations must take care of preventing destructive leveraged buy-outs by private equity companies, e.g. by means of high transparency requirements.
Current policy trends	It is of high priority in most developed countries and in fast developing transition countries.

Conclusion 3: Efficient regulation of private equity markets in general und venture capital markets in special are of high importance, as equity finance is an essential part of SME finance.

3.4. Other policies to promote equity finance

Table 6: International experience regarding: Other policies to promote equity finance

Target Group	Innovative start-ups and SME in the technology sector
Problems of Target Group	Need equity to leverage debt finance High demand for finance High and unpredictable risks
Measures	Tax incentives for private investors CIT reductions for corporate investments Subsidies for agencies that improve information flow and matching between investors and entrepreneurs Publicly sponsored Business Angel Networks Public sector venture capital funds Direct subsidies for private investors
Opportunities	Experience shows very low effects on equity finance
Disadvantages and Risks	Low political efficiency = high net cost ▪ Direct subsidies ▪ Tax revenue losses ▪ Administration costs Crowding out of private equity markets
Current policy trends	Decreasing importance in USA, UK, and Canada because of poor experience. Germany – to some extent against the international trend – uses quite a lot of such measures, but the impacts on the markets are rather marginal.

Conclusion 4: Subsidies and tax incentives should play no major role for modern policy aiming at improving SME's access to finance.

3.5. Innovation finance policy

Table 7: International experience regarding: Innovation finance policy

Target Group	Start-ups and SME in science and technology sectors
Problems of Target Group	Low budgets for research and development
Measures	State departments and state agencies with R&D budgets are required by law to give a fixed percentage of their budget for contracting out to private SME via a competitive bidding process. State departments and state agencies with R&D budgets are required by law to set aside a fixed percentage of their budget for cooperative research with private SME (and private non-profit organisations).
Opportunities	Increasing R&D activities in the SME sector Facilitating innovation in SME sector Very good experience, esp. from USA, Germany
Disadvantages and Risks	Efficiency: Good policy design is necessary in order to avoid high administration costs for the state. Take-up rates: good policy design is necessary in order to be attractive for SME (low administrative burden: efficient bidding process, efficient reporting/monitoring/evaluation etc.) A co-operative communication between administrations and companies is a prerequisite, because joint research requires mutual trust.
Current policy trends	High importance in industrial countries, esp. huge influence in USA Many programs in Germany as well.

The following Box 1 highlights the experience of Germany with this instrument in more detail:

Box 1:
Federal SME innovation finance policy program in Germany

The following German federal ministries

- Federal Ministry of Economy and Technology
- Federal Ministry of Education and Research
- Federal Ministry for the Environment, Nature Conservation and Nuclear Safety
- Federal Ministry of Transport, Building and Urban Development
- Federal Ministry of Food, Agriculture and Consumer Protection
- Federal Foreign Office

provide grants for SME for research & development projects. The project duration varies between 2 and 3 years. The typical project size varies between 0.45m and 3.5m Euro, of which 30%-50% are co-financed by the SME itself.

Grants are allocated by a competitive bidding process, tenders are published regularly (almost monthly). The grants are dedicated to certain fields of technology, with changing focuses.

Special feature No.1: The administrative processes such as tender, assessment of SME offer, approval, report and evaluation are improving continuously. Participation becomes easier and faster for SME. Costs of administering the program decrease continuously.

Special feature No.2: SME can fully exploit the intellectual property arising from the research financed by the program.

Conclusion 5: The international experience regarding innovation finance is of high relevance. Those programs require only little additional public expenditures and have promising long-term effects on SME sector development and competitiveness.

4. Recommendations for SME finance policy in Belarus

What lessons can be drawn from the analysis above regarding the improvement in access to finance for SME's in Belarus? In the following, we structure our recommendations into 3 key areas: analytical instruments, diversification of external funding and public support.

Analytical instruments:

Adequate access to finance is one of the most important problems for SME's operating in Belarus, and bank lending is the main source of this finance. However, little statistical work is done on this important financial channel. Banking sector statistics by the National Bank do not distinguish further among different classes of borrowers like SME's, etc. Thus, the relative stance of credit conditions (e.g. interest rates, lending volumes) and their development over time cannot be identified, as comparable, timely, and frequent data are missing. For policy makers, this implies that an important analytical instrument to monitor the situation and discuss possible policy interventions into the market is missing so far.

Recommendation 1: We propose to install a regular survey of bank lending conditions to SME's in Belarus, which could become an important analytical instrument for SME policy design with respect to financial issues.

Diversification of external funding:

In the medium to long term, the currently predominant role of bank lending should be complemented by other sources of external finance. This helps to offer a more complete funding mix for different kinds of SME's at different stages of their development.

While there are different instruments that should be developed in this context, policy makers should concentrate on developing equity finance. For this, an appropriate legal and regulatory framework is of paramount importance. Among the different types of equity finance, venture capital and private equity should be highlighted, as they play an important role as "risk" capital for innovative start-ups and SME's in the technology sector in more general.

The current plans to develop the legal foundations of a well-regulated and transparent microfinance sector are also important in the context of broadening external funding sources, and should be continued. Especially micro enterprises and self-employed businessmen would benefit from such developments, as the sector is currently underdeveloped.

Recommendation 2: External financing sources should be diversified by improving the respective legal and regulatory framework. Especially relevant is private equity and venture capital, as this would help especially innovative start-ups and SME's in the technology sector. However, also the microfinance sector should be developed in order to support micro enterprises and self-employed businessmen and thus facilitate a broader coverage.

Public support:

Apart from setting an appropriate legal and regulatory framework, the state could also intervene directly in the provision of funding in case private markets are not able to fulfill their functions efficiently. In Belarus, there is a limited amount of state support available, as has been elaborated in more detail in section 2.3. In order to maximize the impact of (limited) public funds on the development of a dynamic SME sector in Belarus, we recommend the following measures:

a) Loan Guarantee Schemes (LGS)

This instrument could help to overcome collateral problems, which are sometimes mentioned as a barrier to obtaining finance. The funds could be supplemented by international donors, which have vast experience in using this instrument due to its wide international application. While the details of such a scheme need further analysis in order to tailor-made it to the situation in Belarus, LGS might be an interesting instrument to improve access to finance in small towns and rural areas.

b) Innovation finance policy

An interesting approach to support innovative start-ups and SME's in technology sectors is through innovation finance policy. In such a scheme, the state (at different institutional levels) tenders a part of its own R&D budget to private SME's in a competitive bidding process (see section 3.5 for more details). The relevant stake to be tendered (say, 1-5% of the relevant budget) is set by law and helps to support SME activity particularly in the R&D sector. This internationally quite successful instrument might be of particular interest in Belarus with its vibrant high-tech sector and the promising development perspectives. Furthermore, no new budget spending is involved in this instrument, but rather a small but competitive re-allocation of funds from large enterprises (state and private) as well as other state institutions (e.g. state research centers) towards private SME's.

c) Equal access

A level playing field between private and state companies in terms of access to finance is of paramount importance in a competitive economy, as otherwise the allocation function of the system is not functioning properly. Regarding access to public funds, we favor a similar treatment of all companies that fulfill certain criteria (e.g. size), independently of their ownership. As of now, access to certain funds (e.g. Belarusian Innovation Fund) are in practice only for state enterprises, a fact that should be changed and access broadened to all types of SME's.

Recommendation 3: Public support can be a complement to other instruments, but should be limited to selected measures that do not require significant budget funds. Loan guarantee schemes and innovation finance policy are interesting approaches for Belarus in this regard, coupled with ensuring an equal access of all different kinds of SME borrowers to such public funds.

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