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## **SMALL AND MEDIUM SIZED ENTERPRISES IN BULGARIA: ALTERNATIVES FOR FINANCING**

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### **INTRODUCTION**

The paper studies the current situation in Bulgaria in regards to small and medium size enterprises and the main obstacles to their development. The analysis is based on results and information provided by different researches conducted in Bulgaria in 1998. The main objective of this paper is to outline different alternatives for financing of the investment activities of the small and medium size enterprises (SME). Sources like bank credits, financing with risk capital and other alternative resources coming from different international funds, programmes and bank institutions are subject to detailed presentation. The paper is a continuation of the previous two works of the author dedicated to the problems and perspectives of the SME development in Bulgaria in the transition period. The commitments implied in the Agreement for association of Bulgaria to the European Union set out new requirements for fast development of the sector of small and medium size business.

### **1. CURRENT STATE OF SMALL AND MEDIUM SIZED ENTERPRISES IN BULGARIA**

The prevailing part of the registered firms in Bulgaria is small in size – with a number of employees up to 50 persons. If we use different types of informational sources\*, we could come to the conclusion, that their part in the totality of all active firms in the economy is about 98%. Nevertheless the significance of the large firms is still fundamental for the magnitude and dynamics of the macro-economical indexes, particularly for the magnitude of the Gross Domestic Product (GDP). From that point

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\* The data is provided by the National Statistical Institute and Foundation for Entrepreneurship development in Bulgaria, 1998

of view the main force for economy growth are the big firms, while the small and medium size enterprises mostly create favorable conditions for its acceleration, but they still cannot be a main factor for its inducing.

The development of the sector of small and medium size enterprises has a particular significance for the dynamics of the employment and unemployment in our country. This type of firms reacted first to the changes in the macro-economical situation, as they considerably reduced their employment in the period of aggravation of the economic crisis, while during the second half of 1997 and during 1998 they started to create new working places again and became the main factor for the decrease of the unemployment. The perspectives for next one, even two years show that the large public firms and the already privatized ones will continue to reduce their employment with the aim to increase the production efficiency and productivity. It is expected that only the sector of the newly established private firms, which in most cases are small in size, could create new working places and take care of the employees, who will loose their work as a result of the restructuring of the real sector.

The most common legal form of the registered firms in Bulgaria is a one-person enterprise. About 75% of the Bulgarian firms and 78% of the private firms in the country are of this type. During the last years tendencies of increasing the part of the legal entities in the total number of the firms in our country are observed, these being mostly the companies with limited responsibilities and joint-stock companies (the last ones because of the running privatization process).

The branch allocation of the registered firms is influenced to a great extent by the allocation of the small and medium size enterprises of the private sector, because of their prevailing part. The largest is the share of the firms from the commercial sector, which represent 48% of all registered firms in 1997. First of all, these are small firms, in many cases without hired persons on a contractual base. Next in position, according to their relative share in the total number of registered firms, are the industrial firms, which are 10,7% of the country's firms. The importance of the big and medium size firms in that sector of the economy is relatively high. The next branches, where the number of registered firms is relatively high, are transport and tourism (hotels, restaurants, and tourist agencies). The other sectors, in which it could be considered that there is a relatively large number of established small and medium size firms are business services, construction and agriculture. In the last years there is a tendency for increasing the number of newly registered firms in industry, transport and restaurant business and decreasing the number of the retail business firms.

The main conclusion, which could be drawn on a comparative basis between the results of EUROSTAT survey of the firms, registered in 1996 and of the previous two surveys is, that the private sector begins expand beyond the frames of the family firm. The main arguments for that conclusion are the changes in the firm's structure, according to their size, number of local units and the place of activity execution. While before 1996 more than 80% of the registered firms were of a "family" type i.e. assuring employment for the entrepreneur and the members of his or her family, the

share of these firms decreased to 14,6% of all the firms, registered in 1996\*. In most cases these were firms with employees between 1 and 49. It is also observed a variation in distribution of the employment, according to the size of the firm. Until 1996 the prevailing number of the employees had been working in relatively big firms, with more than 150 personnel. As to the firms, registered in 1996, most of the employees have been working in firms with personnel ranging between 1 and 50 people. If the newly registered firms keep the same employment structure in the next years, that could be seen as an indication, that a development of a relatively strong sector of medium size firms, which could generate economic growth in the future, has began.

An indication that the small enterprises have began to expand beyond the frames of the "family" firm, is the entrepreneur ambition to create a network of enterprises, situated not only in the area of firm registration. Until 1996 more than 98% of the enterprises (in fact all of them) were operating only in the area, where the central office of the firm was located. In 1996 more than 15% of the newly registered firms had more than one operating local unit or every sixth firm from EUROSTAT's extract had tried to export its activity out of its area of establishment. That is an indication, that the newly established private business would not only put the basis of its activity (as during the period 1990-1995), but also will strive to develop further, to expand the dimensions of its activities.

The comparison between the dynamics of the development of the private sector in Bulgaria and in the rest of the Central and East European countries shows that similar tendencies as these in Bulgaria are observed in most of the above countries, but in our country they are running more intensively. In the Balkan region as a whole the number of the firms with personnel between 1 and 50 people is increasing. There are also changes in the employment structure, as a decrease of the number of the employees in the group of the biggest firms and an increase of their number in the smaller firms. These changes are most significant in Bulgaria in comparison to all the rest of the Balkan countries. The situation is similar if we compare the dynamics of the other indexes of the development of small and medium business in the other countries in the region and in Bulgaria.

The most important problems the small and medium size enterprises are facing derive from the shortage of financial support for launching of their activities, and also later for financing their main activity or financing the necessary investments for improving the firm competitiveness. To a great extent the shortage of funds is determined by the type of the sources of financing for establishing a new business, as well as for running its main activity. The chief financial source are the personal savings of the entrepreneur or of his or her family and on a second place - loans from his or her friends and relatives. Hardly 8-10% of the firms have had access to bank credits. That could be explained with the traditional caution of the commercial banks towards the

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\* See Mateev, M. *Small and Medium-Sized Enterprises Development in the Period of Transition to Market-Oriented Economy. The Case of Bulgaria, Volume I*, NOVA Science Publishers, 1998, pp.129 - 155

small enterprises, as well as with their limited credit activities to the real sector during the last two or three years because of the crisis in the bank system in 1996. Despite the acute shortage of financial resources, quite a little part of the firms has applied for bank credit.

The survey shows that, the banks have granted credits to about 40% of the firms-candidates (as the guarantee is 1,5 times bigger than the required credit). The distribution of the required bank credits in percentages, according to the amount of the loan is showed in **Table 1**.

Table 1.

Distribution of the requested bank credits in percentages of their total number	
to 1 000 USD	14.3%
1 001 USD to 5 000 USD	29.4%
5 001 USD to 10 000 USD	28.3%
10 001 USD to 100 000 USD	26.2%
Over 100 000 USD	1.8%

The conclusion is, that the credit granting depends not as much on the financial statement of the firms, as on the amount of its guarantee. Therefore a conclusion could be drawn that applying for credit resource has been decreased to some extent, due to the conditions of the credit granting. It is common view that the requirements of the commercial banks for serving the extended credits (collateral, terms and etc.) are too hard for the firms, and also the price of the credits defined with the real rate of interest, is also too high because of the high credit risk in the country.

The other two problems, related to the starting a business activity, are nearly equal in importance with the financial ones – the unstable and unreliable legal frame for the development of the small and medium size enterprises, as well the heavy bureaucracy. The bureaucracy problem includes not only obstacles such as issuing of licenses, most of which are unnecessary and are just a clerk's caprice, but also the proclivity of the governmental and municipal officials to take bribes. The bureaucracy issue has a main significance not only to the development of the small and medium size enterprises, but also to the business as a whole. Decreasing of the bureaucracy will improve the conditions for entrepreneurship in the country, as well as it will reduce the firm's transaction costs and in that way may contribute for increasing the inflow of investment in the country. Another problem, which is crucial for the business development in the country and is mentioned by the entrepreneurs, is the high taxation level in the country and the lack of credit demand by solvent firms. After attaining the macro-economical stabilization in the country the importance of this problem as well as the instability of the price dynamics has really decreased as an obstacle before business development in the country.

Due to the economic crisis in the country from the second half of 1996 to the beginning of 1998 a relatively big part of the firms included in the survey\* of the small and medium size enterprises in Bulgaria, executed in 1998, has decreased the amount of their sales in 1997 and during the first half of 1998. Nevertheless the part of the profitable enterprises included in the survey is prevailing. Only 8,4% of the firms from the extract have negative financial result (loss) in 1997, and another 11,9% are reported to have a financial result for the same year close to zero (minimal profit or loss). The rest of the firms have reported a positive financial result in 1997, as most of them are firms with small profit – about a half of the extract. Although a relatively big part of the firms have problems with keeping their market share, most of the small and medium size enterprises are striving to remain profitable. The shrinking of the incomes as a result of lower economic activity was accompanied with a respective shrinking of the expenditures. This behavior model strongly differs from the behavior of a great part of the public firms, which have increased their loss, because the reduction of their expenditures is less than the reduction of their incomes. The main reason for such behavior of the small and medium size enterprises is that they are functioning in the conditions of strict budget restrictions, posed by almost all economic agencies – commercial banks, suppliers, government budget. About 65% of the firms, which have significantly reduced their sales in 1997 and in the first half of 1998 have been profitable in 1997. The sale's dynamics is contributed to the reduction of the profit amount, although they were striving not to fall in the group of the losing firms. At the same time about 43,1% of the firms covered by the survey have reported facing serious problems in finding well-motivated and qualified employees (despite the high unemployment in Bulgaria), but only 16,1% - have not come across such difficulties.

The rise of the export level is another main factor for achievement of a stable economic growth. The abilities of the firms to respond to the changing export environment is crucial in that regard. The Foundation for Entrepreneurship Development ran a survey in May-June of 1998 among 650 firms from various sectors, with the aim to estimate the share of the small and medium size enterprises in the export, their stimulus and barriers. According to the data delivered by the survey carried out by Sova-5, 7% of the Bulgarian small and medium size enterprises, presented in the extract, are exporters. The prevailing part of them (69%) are going for trade and other services (financial, business, transport etc). One third of all exporters, included in the extract, are manufacturers. Among them the strongest export-oriented are the producers of chemical products, textiles and leather goods.

The high qualification of the managers certainly influences the internationalization of the firm activities. That is proved by the higher level of education of the managers and the owners of export firms in Bulgaria, as two thirds of them had graduated a high school (77%). The export-oriented firms, have higher requirements for the educational level of their managers. The previous experience of the firms in this sector is one more prerequisite for success in the export. Although the equipment and the technologies are of great importance for achieving high productivity and quality, meeting the

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\* A research of 650 SMEs in Bulgaria, conducted by Sova-5 and published by the Foundation for Entrepreneurship Development, 1998

requirements of international standards, less than a quarter of the Bulgarian exporters consider their equipment a modern one.

Bulgarian export firms registered a higher profit (38% of the firms from the extract estimate their profit for 1997 as a normal one) and a higher volume of sales compared to the non-export ones, but during 1998 the amount of their sales marked a slump, in parallel with the amount of their profit. Main commercial partners of the Bulgarian private exporters are countries from EU (44%), followed by Russia (18%), countries from Central and Eastern Europe (6%), CEFTA (3%), Arabic countries (3%) and others (15%). The best perspectives for Bulgarian firms are offered by Germany, Russia, Italy and Greece. The high risk in the contacts with Russia (a traditional partner in the past), is estimated as an obstacle for making a best use of the capacity of Russian market. A high percentage of the firms are not optimistic about their opportunities for export.

Bulgarian exporters prefer to sell their products directly to their client abroad, because in this way they limit the risk and increase their profit. However it has a negative aspects, as it limits the variety of channels for distribution, which the small and medium size enterprises are using. Working with materials supplied by foreign clients is a common practice among Bulgarian small and medium size enterprises (40% of the exporters) as one of the ways to achieve an easier access to the international markets, transfer of know-how and experiences. This practice is widespread among the medium size firms, producing textile, leather and shoes. However positive effects, this form of organization of the production brings risks, in term of limited contacts with the client and working on a short-term basis.

Contrary to the abstract conceptions empirically proved in the countries of Western Europe for the existence of a directly proportional dependence between a firm's maturity and its inclination for export, among Bulgarian small and medium size enterprises such dependence is not observed. A high percentage of the firms established in 1997 are already occupied with international activities. More than two thirds of the surveyed exporters, independently of the sector, in which they work, have oriented towards export in a less than a year after their establishment. Reasons for that are the running process of privatization, the opening of international markets for Bulgarian firms etc.

The strongest stimulating factors for starting an export are the shrunk domestic market, followed by the opportunity for market extension and hardly on a third place – the opportunity for increasing the profit. There is a tendency for establishing of firms with clearly defined export strategy. Unlike the entrepreneurs in Western Europe, Bulgarian exporters are more active in their efforts to go out on the foreign markets. The shrinking of the domestic market and the lack of optimistic perspectives for its growing in the near future, compelled the firms to rely for their surviving mainly on the export for the international markets. The most common obstacles, which the exporters meet, are the lack of working capital, the high taxes and the shortage of

investment capital. The particular barriers before the export are bureaucracy (54%), not enough assurance against the risk (47%) and high customs rates (43%).

**Table 2** presents an evaluation of the competitive advantages of the export firms in Bulgaria, according to the opinion of the surveyed firms (a research conducted by Sova-5).

Table 2.

Competitive advantages of the export firms in Bulgaria	
	High :
<b>Quality</b>	66 %
<b>Price</b>	43 %

The access to external financing and the amount of the credit are determinant for the competitiveness and percentage of the firms' export. The shortage of working capital occasionally prevents the firms from diversifying their clients and limits their chances to receive a better price and realize a higher profit. The shortage of credit frequently binds the Bulgarian firms with foreign clients, offering them advanced payment or a working capital and it is one of the reasons for widespread practice to work with materials supplied by foreign clients.

Providing information, sources for which are mainly the business partners (84%), clients (68%) and suppliers (44%), is another field in which small and medium size enterprises could be assisted. There is a need for centralized intervention, because the information about the target markets is proved to be insufficient and the absence of specialized center for export information is strongly sensible. The benefits of such an arrangement is evident by the fact that Bulgarian exporters demonstrate their interest in receiving information about tendencies, markets, clients, sources for financing etc., which could facilitate decision-making process.

The suggestion that the firms are familiar with the advantages and disadvantages, resulting from the Agreement for association with EU, was not confirmed by the survey. Only 28% of the firms are familiar with the agreement and they perceive it rather as an admittance of the country in EU, than as a direct effect on the foreign trade. The percentage of the firms, which intend to enter the market of EU, is also too low (less than a quarter) and only about 15% of the surveyed firms have undertaken special activities with a purpose of preparation for entering that market.

## 2. ALTERNATIVES FOR FINANCING SMALL AND MEDIUM SIZE ENTERPRISES

For entrepreneurs any place is good for business. The economic conditions in the countries of Central and Eastern Europe are completely different from the ones in USA and Western Europe, but that does not mean that they are worse. There is nothing bad in a higher risk, because it is rewarded with a higher than a normal profit. The higher business risk in the Eastern European countries especially in Bulgaria requires more entrepreneurs, that can come over the obstacles on their way from the initial idea to the fulfillment of the business project. There are plenty obstacles before the business in Bulgaria, but with persistence and flexibility almost every problem could be solved. Bulgarians are not suffering from the lack of entrepreneur spirit, or a lack of the rational and winning ideas. The shortage of private capital and the difficulties in finding a credit is the worst thing that could happened a person, who has business ideas and willingness to work, but is compelled to remain idle. Financial support of the business project appears as the biggest challenge for the Bulgarian entrepreneur. There are a lot of reasons for this to be a major problem, but the biggest “credit” goes to the bank crisis of 1996, which totally ruined the financial – credit system in the country. But as far as the problem exists, it is mostly certain that there is a decision for it. We shall try briefly to go through different alternatives for finding of credit capital.

### **1.1 Bank credit as a source of financing for SMEs**

The main problem for Bulgarian companies from the real sector of economy is unwillingness of the commercial banks to grant credits for their projects. The reasons for that unnatural behavior are the following\* :

- Ineffective legislation in the field of credit guarantees and collecting debts;
- Low interest rate;
- Strict norm requirements in the Bank Law and mostly the fortunate experiences in the past and the memory of the bank crisis in 1996.

The interest rate, which banks require for realization of business projects, range from 5 to 15 points over the basic rate of interest. Short-term ( 3 months ) credits, which are well collateral, are granted with the lowest possible interest, because of the minimal risk for discharge of the debt. Penalty interest for credit overdue is frequently equal to the agreed rate of interest plus 5 to 10 points. The granting and the amount of the credit depends on the quality of the project, financial potential of the firm, the amount and the type of collateral, and also the bank risk and the marketing positions of the firm. There are not any restrictions for the amount of the granted funds besides these provided in the Bank law (art. 29 - restrictions of the large credits).

One of the most important conditions for granting credits is the guarantee requirement (collateral). The most fundamental feature of the guarantee is its liquidity - the easier it could be sold, the easier banks could accept it. An expert team defines the marketable value of each guarantee. The value should cover about 125 –200 % of the credit amount. For a guarantee are accepted: monetary reserves (cash balances), deposit of securities and currency, mortgage of a real estate, deposit of machines, equipment and goods or inventory, which are not loaded with any other obligations. Under securities

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\* See also Mateev, M. *Small and Medium Sized Enterprises Development in Bulgaria: Problems and Perspectives, Volume I*, NOVA Science Publishers, Inc., USA, 1998, pp.157 - 174



should be understood government bonds, because it is more difficult for the banks to accept corporation securities, as a guarantee. In some cases, the value of the mortgaged property covers twice the amount of the corresponding credit. The mortgage should cover usually the credit and the three-month interest on it. It is required that the mortgaged fixed assets should cover the credit plus its one-month interest. To set up a deposit all requirements of Law for feature pledges should be observed. Extremely rare case is a Bulgarian financial-credit institution to accept as a deposit bank or firm guarantee. In the bank practice it is acceptable only in case the bank or the firm, which guarantees the credit, have irreproachable reputation and proven solvency. To receive the approval of the bank, the entrepreneur should present a well-drafted business plan, having in mind that for the banks the most important part is the financial one, in fact the forecasts for financial flows (incomes and loses), which are the main index of the project profitability.

Receiving financial support from credit institution looks like a commercial deal. Both sides should have good prospects and reasonable expectations that they will reach their objectives. In order for this to happen, the entrepreneur should present proofs that the need of funds is eligible and the terms of payment will be observed. The bankers should have the confidence in the capability of the entrepreneur to keep his or her promise. Both sides need facts, calculations and a perfect future plan to take the right decisions for the realization of the deal.

Managers of the small firms are usually making a mistake, when they are waiting for an urgent need for credit to appear and then they start looking for a bank. The chances of the entrepreneur to receive a financial aid when the business is in crisis are minimal. That is the most inappropriate time for starting such contacts. Relations with the banker should be initiated earlier, in order to be developed and confirmed, before the entrepreneur would need them. The firm's deposits are the best way to start the relations with the bank. Deposits are the basic commodities for the bank activity and the amount and/or stability of firm's payoff account could play an important role for receiving a bank credit.

The next step for the entrepreneur is to convince the bank that he is capable of managing his business and getting it out from the hardships and that he will conscientiously continue to meet the loan requirements. The credit inspector will collect information for the firm and will evaluate it – so the entrepreneur should regularly and voluntary provide him with the necessary information. Basically banks are the most conservative credit institutes. This fact is of great importance for Bulgaria, because of the conditions of the currency board and the result of the bank crisis in 1996. Bank credit is available only for big and stable private firms and public firms with proved solvency. For small and medium size enterprises receiving a bank credit (especially a long-term one) is almost impossible.

*European Commission in cooperation with the Ministry of Industry of Bulgaria extend long-term credits for development of financially stable and profitable small and medium size enterprises, which will increase the employment, economical*

development and export. Bulgarian Post Bank, Central Cooperative Bank and Express Bank take part in the credit line for small and medium size enterprises. The control over the spending of funds is conducted by Bulgarian National Bank (BNB). According to the conditions of this program only investment projects could be object of financing and the amount could be within 100 000 ECU (125 000 USD). The entrepreneur is obliged to ensure his own financing at least with 25% of the project value, and the credit's term is 5 years maximum with a gratis period up to 2 years. Greater advantage is given to export oriented firms. In fact the funds of that credit line are enough to satisfy only a small part of all credit claims. The credit line of the European Commission for small and medium size enterprises is an artificial and temporal solution of the problem with the unwillingness of Bulgarian commercial banks to grant credits for the small and medium size business, which is the backbone for the economic development of each country.

## **1.2 Financing with risk capital**

Financing with risk capital seems to be the basic alternative of bank credits. Investment Funds, which work in the field of risk crediting, do not extend credits, but participate with a minimal percentage in the business project. In that way the Investment Fund becomes a co-owner in the businessman's enterprise and has the opportunity for permanent control over his activities, which is a good guarantee of his investments. After a certain period of time (predetermined with a contract), the entrepreneur redeems the share participation of the Investment Fund at a preliminarily defined price, including the interest for the period. This is generally the scheme for financing with risk capital. Briefly, we will point out the activities and characteristics of some Investment Funds in Bulgaria, working in that field\*.

- **Program JOPP-PHARE and Euro Merchant Balkan fund**

*Program JOPP – PHARE has as a main objective support for small and medium size enterprises by the European Commission for creating a joint venture with local partners from Central and Eastern Europe. The newly established joint venture applies for financing of its project before one or more of the financial intermediaries of JOPP-PHARE program - these are banks and other credit institutions in the countries from EU, which have their agencies in the countries of Central and Eastern Europe. For Bulgaria these functions are performed by Sofia-branch of Global Finance – Athens, which is one of the three intermediaries of the JOPP-PHARE programs in Greece. If the project is approved, the financial intermediary extends a part of the necessary financial funds in the form of medium and long-term credits or in the form of share participation in the project. The other part of the funds is ensured from the European Commission, which also participates in the project financing to some extent. The credit contract is signed between the enterprise and the financial intermediary, who keeps an eye on the execution of the clauses and exercises a permanent control on the project implementation.*

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\* See also Stoyanov, K. *Alternatives for financial provision of Bulgarian entrepreneur firms, Company Finance, issue 8, 199, pp.21-29*

The main advantage of the JOPP-PHARE program is that the approved enterprises receive support through all the stages of the project – from making the first business contacts, collecting the necessary information, technological transfer and technological and economic research, to the real financing and project realization.

JOPP-PHARE program could cover part of the expenditures for a preliminary project research by extending the gratis subsidy up to 20 000 ECU, which is up to 50% of the reasonable expenses, concerning negotiations with the potential partners (travelling expenses on a business trip, taxes for consultancy services, experts evaluations etc.). The maximum of the interest-free credit in the program is 75 000 ECU. Technical assistance is actually a joint financing of training and now-how transfer. The whole amount of the gratis aid could not be over 250 000 ECU, which is about 50 % of the total reasonable expenses.

The JOPP-PHARE program is financing projects in all spheres of the economic sector, as well as in the field of services. Priority is given to the enterprises with annual income up to 20 millions ECU. Required condition is at least one of the partners in the joint-venture enterprise to be from a country of EU. Only projects, concerning distribution of goods, made by EU, could not expect a financial support.

**Euro Merchant Balkan Fund** has as shareholders International Financial Corporation (IFC) at the World Bank, European Bank for Reconstruction and Development (EBRD), Euro Merchant Bank, foreign institutions and individuals. The registration of the fund is in Luxembourg, which has a status of international bank and offshore center. The constituent capital of Euro Merchant Balkan Fund is 27,3 millions USD and is assigned for investments in Bulgaria in the form of share participation in enterprises in cooperation with foreign firms. The funds are managed by Global Finance – Athens. The amount, which the fund could grant for a project is between 500 000 and 4 millions USD. Global Finance, as a main investment intermediary of the JOPP-PHARE program, may assist for extending of supplemental financial resource from the European Commission or another financial intermediaries.

The enterprises applying for financing from Euro Merchant Balkan Fund, should introduced a brief description of the project, with enclosed information about their previous activities and market positions. In the financial plan should be pointed out the required sum of the funds for the project, the way of generating the incomes and project expenditures, and the term within the invested funds will be returned. The financial support for a separate project are not extended in the form of credit, but as a share participation in the amount up to 50% of the enterprises' capital. The owner of the majority share, in cooperation with the foreign partner, is managing the company. Euro Merchant Balkan Fund is investing in expanding of the activities of already running enterprises and in establishing of new ones. The Fund invests also in buying pools of shares in public enterprises with the purpose of their privatization. There are no particular preferences or restrictions for investment in one or another industrial sector.

- **CARESBAC – Bulgaria**

Promoters and shareholders in Caresbac-Bulgaria are the American Agency for International Development (USAID), European Bank for Reconstruction and Development and Bulgarian Agency for Foreign Aid. Caresbac is affiliated branch of the Fund for Assistance of the Small Business in Washington. The main objective of Caresbac is investing in projects, mainly of small and medium size enterprises.

*CARESBAC do not grant credits, but participates as shareholder in the firms, in which it invests.* That has advantages for both sides – the enterprise is not loaded with principal and interest payment, but Caresbac receives a certain guarantee and security for the granted funds. The amount of the sum, invested by Caresbac is between 50 000 and 250 000 USD. Bulgarian partners could participate in the joint-venture enterprise with land, buildings, machines and equipment, inventory etc.

Caresbac never owns more than 49% of the respective Bulgarian enterprise, because its aim is not to have a total control or to be a majority owner. The minimum of Caresbac's participation is 25%, which creates reliability for the investor, giving him the right to participate actively in the operational management. In this way the enterprise receive an additional benefit from the Caresbac investor – co-owner, as technical assistance, legal advice, marketing and accounting services. And because Caresbac is not a holding company, but an investment fund, its objective is not aimed at managing of constituent companies, but at formation of financial profit. For that reason after a certain period of time (3-5 years) Caresbac sells its share in the company to the Bulgarian owners or to a third party. It is expected that for the passed period of time the stocks of the firm will increase their market value, thus ensuring a return of the invested funds. Interesting fact is that Caresbac's profit is not divided between its shareholders, but is used for expanding of the investment activities.

The procedure to apply for financing is quite simple. A standard form, made by Caresbac's specialists should be filled in, in which briefly is described the history of the firm, partners, competitors, the characteristics of the manufactured good/service, the amount of the required investment and the purpose of its usage. If the idea is approved, the experts visit the enterprise, analyze the received information and prepare a detailed business plan. It should be pointed out that this process has duration of about three months.

The best chances for project approval have the enterprises with a potential for fast development in the period after investment. Of great importance is the personal qualification of the entrepreneur, his motivation for success and professional experience in that field. Inappropriate for investments are enterprises, producing or trading with weapons, alcohol, or enterprises polluting the environment.

- **Investment fund “Eurobalance”**

The founders and shareholders in Eurobalance are Lariv - Netherlands (international consultancy group), Mees Pierson (Netherlands commercial bank, specialized in managing of investment funds) and Parcom Ventures B.V. (experts in the field of risk capital management and establishment of joint-venture companies). The Fund is established in 1995 with the main objective to invest funds in projects, aimed at creating joint-venture companies with partners from Central and Eastern Europe.

Eurobalance invests in a project only to some extent, and a strategic western investor or a local partner should provide the rest of the financing. The amount of the sum, which the fund could extend for a project is between 2 and 5 million Netherlands guildens. *Control holding in the joint-venture is possession of the fund and the strategic western investor, but the management of the project is executed by a local management team.* The fund's consultants in Bulgaria are Lariv-Bulgaria. They have the rights of exercising a permanent control on the project development. The term for which Eurobalance participates in the project and the way of termination of this participation is defined in a contract between the Fund and the rest of the partners.

The western investor is supposed to ensure the know-how, the production facilities and the access to the international markets. The organization of a product manufacturing is a task of the local management team, which should be familiar with the business conditions in the respective country from Central or Eastern Europe.

The main criteria for evaluation of the investment projects are the following:

- Internal rate of return of the investment at least 20%;
- Personal qualities and professional experiences of the members of the local management team;
- A good interaction with the western company – strategic investor.

For evaluation of every project according to its specifics additional criteria are worked up and added. Eurobalance invests mainly in medium and large enterprises, which already have good market positions. Advantages are given to projects aimed at an increase of the volume of export-oriented production.

#### • **Bulgarian – American Investment Fund**

Bulgarian - American Investment Fund (BAIF) is established by USA Congress under the Law for support of democracy in Eastern Europe. The USA Government granted 55 millions USD for initial capital of the fund, designed for investments in the private sector. The chief office of BAIF is in Chicago, where the final decisions for financing of every project applied for funding are taken. *BAIF has the official permission of BNB to execute a limited bank activity, including granting of credits for investment projects, but not collecting of deposit accounts of private and legal entity.*

The Fund is financing mainly small and medium size enterprises without any preferences to the economic sector they operate in. Only single commercial deals have no chance to receive a financial support. At the evaluation stage of the projects the

professional competence and management skills of the team, its responsibility for the project execution, are of great importance. A special attention is paid to firm's projects with a potential for growth, because of the future probability that they would ask for additional financing. The projects, which BAIF is directly financed, receive a sum for technical assistance. The whole information about the firm and its projects available at BAIF is kept in secret.

Every financing is performed at specific conditions, depending on the amount of the necessary sum, term of its repayment, the profit possibilities and the level of the risk. All funds are granted in US dollars and their refunding is in the same currency, which means the entrepreneur takes on the currency risk. These are some of the general criteria for evaluation of every project:

- Reality of the business idea and vitality of the business plan.
- Marketing positions of the firm in the country and its percentage share of the export-oriented production.
- Proofs for marketing demand of the product /service.
- Professional skills and personal motivation of the team's members and their willingness to take a part of the risk.
- The amount of the borrowed and equity capital used in the project and the sources of their receiving.
- The opportunity for realization of a reasonable rate of return of the invested capital.
- The duration of period, after which the results of the investment could be expected.
- The social effect and the ecological results of the project.

The procedure of applying for financing includes several stages. First, the representative of the project fills in a standard application form with a brief description of the business idea. If the offer is attractive enough, the experts from the Fund meet personally the candidate to discuss the project. If after that meeting the project is still attractive, the representative should prepare a detailed business plan with any other additional information. The collected information enclosed with the BAIF expert's opinion is sent to the Board of Governors in Chicago for a final decision. According to the amount of financing BAIF offers 4 investment-credit programs to Bulgarian entrepreneurs, which are the following\* :

#### **A. "Nachala" Foundation – a program for micro crediting**

"Nachala" Foundation is established and financed by BAIF. It has offices in Sofia, Plovdiv, Velingrad, Pleven. The amount of the credits, which the Fund is granted through "Nachala" foundation, is between 500 and 5000 USD and they are designed for small business. The foundation accepts the requests for credits, makes the selection

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\* See Stoyanov, K. *Alternatives for financial provision of Bulgarian entrepreneur firms*, *Company Finance*, issue 8, 1998, pp.21-29

and evaluation of the participants, prepares recommendations for financing and credit documentation of the project.

*For crediting by “Nachala” foundation could apply entrepreneurs intending to expand their activities or to start a new business.* The credit contract is made with the entrepreneur as individual, not as a firm. If the credit amounts from 500 to 2000 USD, it is required a personal warranty from 3 or 4 solvent third parties. If the credit is between 2000 and 5000 USD, the entrepreneur should mortgage his property or create a deposit with a marketable value, covering 150% of the credit amount. The interest rate of the granted credit is between 15-18% annually. According to the type of investment project the term of credit repayment is from 3 to 24 months. If the credit contract provides an initial gratis period, only interest fees will be paid out. The repayment fees are monthly. The currency, in which the credit is granted or refunded, is USD.

The process of applying for crediting starts with the filling in a request in the closest office of the “Nachala” foundation. The foundation’s credit experts consider the presented business plan, paying a special attention to the financial part – the amount and the way of spending of the funds, the forecasts for incomes and lose. Of great importance is the amount of investments already made by the candidate. If they decide that the project is a good one, the experts would visit the place of manufacturing and if the result of their evaluation is positive, the project is offered for considering to a credit committee. After the credit granting the foundation keeps the right to make a permanent control on the expense of the project funds and the execution of the project as a whole. The control is excised in monthly visits to the enterprise, while the credit is fully repaid.

## **B. “Compass” Program**

*The “Compass” program grants credits for Bulgarian small and medium size enterprises from the private sector.* The amount of a credit varies from 25 000 to 75 000 USD. Although the loans in the “Compass” program are designed mainly for the development of already running firms, newly established enterprises could apply for financing also. The program is easily accessible for a large number of entrepreneurs, because the requests and application forms could be found in any branch of Central Cooperative Bank and “Hebros”Bank. Credit experts from these banks select and verify the credit requests. The funds are granted by BAIF, as the corresponding bank guarantees a part of them. The lowest limit for candidate’s own participation in the credit is 30% of the necessary capital for the project – they could be deposited as land, machines or other assets.

The credits are middle term - for a period of 1 to 3 years, with interest -15% annually. A gratis period could be agreed. The repayment fees are monthly. At any moment the dept could be redeemed ahead of the schedule. The granting of credits and the payment of principal and interests are in USD, but there is no problem if it is in their lev’s equivalence. For collateral is accepted a mortgage of a real property, deposit of

machines and equipment or guarantee of a third party. The entrepreneur covers all fees connected with the registration of the collateral. He pays a single fee of 1% of the whole sum at the credit extension. The credit funds are not granted in cash, but in a special payoff account, from which they could be assimilated only after presenting an invoice for project expenses. The granted funds could not be used as a guarantee for other firms, for exchange or currency speculations or street trade.

For a credit in the “Compass” program the entrepreneur could apply in any branch of Compass’ cooperated banks. If the project meets the criteria of the program, the entrepreneur should give a request for granting a credit and represent all necessary financial documents – financial statement, contracts with clients and suppliers, rent and leasing contracts, pricing lists etc. A credit committee, including experts from BAIF and the corresponding bank takes the final decision for credit granting.

### **C. Program for assistance in private hotel business**

*BAIF grants credit for building and furnishing of small private hotels in Bulgarian Black Sea’s or mountain resorts.* The main requirements for credit granting are the building of the hotel to be partially or entirely finished in a rough structure. The granted funds for ending works and furnishing are guaranteed with a mortgage on the hotel and its adjacent land. The building should have at least 12 beds with separate bathrooms. The amount of the extended funds is between 3 000 USD and 300 000 USD and the interest on them is defined individually for each project. It is possible an initial gratis period to be agreed, having in mind the seasonal character of the hotel business. For project approval of great importance are the preliminary contracts with tourist agencies, presented by the candidate (if there are any), which will guarantee a reasonable occupation of the hotel during the tourist season.

### **D. Big investment projects**

BAIF invests also in larger projects and upper limit for investment here could be 2 500 000 USD. *BAIF grants funds for privatization of public enterprises, for creating joint-venture enterprises with foreign partners, etc.* The amount of the loans, which are credited to already existing and stable firms for expanding of their activities are from 200 000 USD to 500 000 USD. In case of investment of a large sum, it is granted as a combination of credit and share participation. The amount of the share participation of BAIF depends on the invested own capital of the candidate – monetary deposits, land, buildings, machines, know-how, management experience etc.

The Funds for risk capital management have a real future in Bulgaria and the benefits resulting from them have several aspects. On one side they are the only valuable alternative for the Bulgarian entrepreneur, who needs a financing. On the other side with their flexible investment policy they could create a real competition and even a threat for the commercial banks, which would increase the credit activity of the last ones.



### 1.3 Another alternative sources for financing

Creating joint-venture enterprises with the assistance of foreign companies could be provided by such institutions like the Agency for Foreign Investments, Bulgarian Industrial Association (BIA), Bulgarian Chamber of Commerce and Industry (BCCI) etc. An useful source of information are the monthly bulletins, published by these institutions, as well as the variety of catalogues and data bases of foreign firms, looking for partners for joint-venture in Bulgaria. BIA and BCCI offer an advertisement in their branch catalogue in INTERNET by a web side, in which the investment project could be described and even accompanied by colored pictures. In that way the chance for finding a suitable foreign partner is increasing rapidly.

Bulgarian government has founded and running the Agency for Small and Medium Enterprises (ASME) especially for assistance of the small and medium business\*. One of its main objectives is to assist the entrepreneur in preparing its business plan and ensure the necessary financial support for execution of the business project. In short time it is expected to start the Public Bank for Investment and Development, which is created by the government with a separate law and with the main purpose - crediting of a the small and medium business.

The special funds allocated at different Ministries and other public institutions should not be ignored as well. An example is the *fund "Agriculture"*, whose funds are used for target crediting of the entrepreneurs in agriculture business.

As a consequence of the inefficiency of our bank system (in particular in credit operations) it may be expected an increase of the number of alternative non-bank sources of financing. In this regard of great contribution is the fast development of INTERNET and the larger appliance of the network for establishing financial contacts.

## CONCLUSION

One of the main problems that Bulgaria met in the pre-accession period is focused at formation of well-developed and profitable sector of small and medium size enterprises. The benefits from such stable and fast growing private sector will be creation of new working places, activation of the export and an increased access to international markets and acceleration of the economic reform in the country. The creation of necessary conditions for development of SMEs depends mainly on the economic and political environment, legal framework and the free initiatives of the entrepreneurs in the country. However, the development of appropriate financial environment remains rather difficult task, particularly in respect of provision of financing for operating credit and working capital. Thus, the financial support provided by different credit institutions and international programmes and funds is turned out to

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\* See Mateev, M. *Small and Medium Sized Enterprises Development in Bulgaria: Problems and Perspective, Volume 1*, NOVA Science Publishers, USA, 1998, pp.157-174

be vital for the development of investment activities of the small and medium size enterprises. That means the Bulgarian entrepreneur should well know different alternatives for using of external sources of financing and the specific conditions for granting the credit.

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