

ACCESS TO FINANCE FOR SME'S

CASE STUDY

"Can an SMP assist an SME to access
finance ?"

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IT DEPENDS !

- ▣ **Professional factors** such as independence limitation or type of service provided to the SME that does not offer you the global picture (i.e. only fiscal consultancy on specific issues)
- ▣ **Economic factors** such as economic sector hit by banks' reluctance in granting loans or whether the sector the SME is operating-in grows and implies a stronger need for detailed reporting and/or specific financial services
- ▣ **Social factors** such as the need to have an external view on ones' accounting so to trust their own accountants
- ▣ **Legislation factors** such all business in the sector are obliged to audit their annual financial statements, as changes in legislation or a very changing legislative environment that compels the SMEs to ask for help from SMPs.
- ▣ **Subjective individual factors** such as empathy with an SMP and their services – basically DO I TRUST THESE GUYS ?

EU Market – 27 countries



- **In March 2009 the Moody's report entitled "Emerging' European Sovereigns: The Case for Risk Differentiation" split the Eastern Europe into 4 categories:**
 - the **first** category includes countries whose rating is well anchored (Czech Republic, Slovakia and Poland),
 - The **second** category, including Romania, Bulgaria and Croatia, that of countries whose credit fundamentals are resilient but which could be subject to some rating volatility should assumptions of support prove unfounded.
 - the **third** includes countries whose relative credit fundamentals are being eroded but for whom external support provides a rating floor (Estonia, Lithuania, Latvia);
 - and the **fourth** category includes countries whose credit fundamentals are eroded and support is less likely (Ukraine).

- "These indicators show that the most vulnerable countries are those that have been undergoing a rapid process of financial deepening -- namely Latvia, Lithuania, Romania and Ukraine," says Dietmar Hornung, Vice President --Senior Analyst in Moody's Sovereign Risk Group.
 - As such in this report **Romania, Croatia and Bulgaria were rated Baa3 by Moody's.**

- According to Moody's, the Romanian government should provide in 2010 a gross supplementary financing of **EUR 14.9 billion**, representing 11.2% of the GDP, and 33.3% of revenues, respectively. Romania's adjusted external financing need is at EUR29 billion, or 21.8% of the GDP, according to the report.

After that ... Romanian Government undertook external financing in 2010 from IMF
so deepening financing for us !

So...thanks Moody's for second place

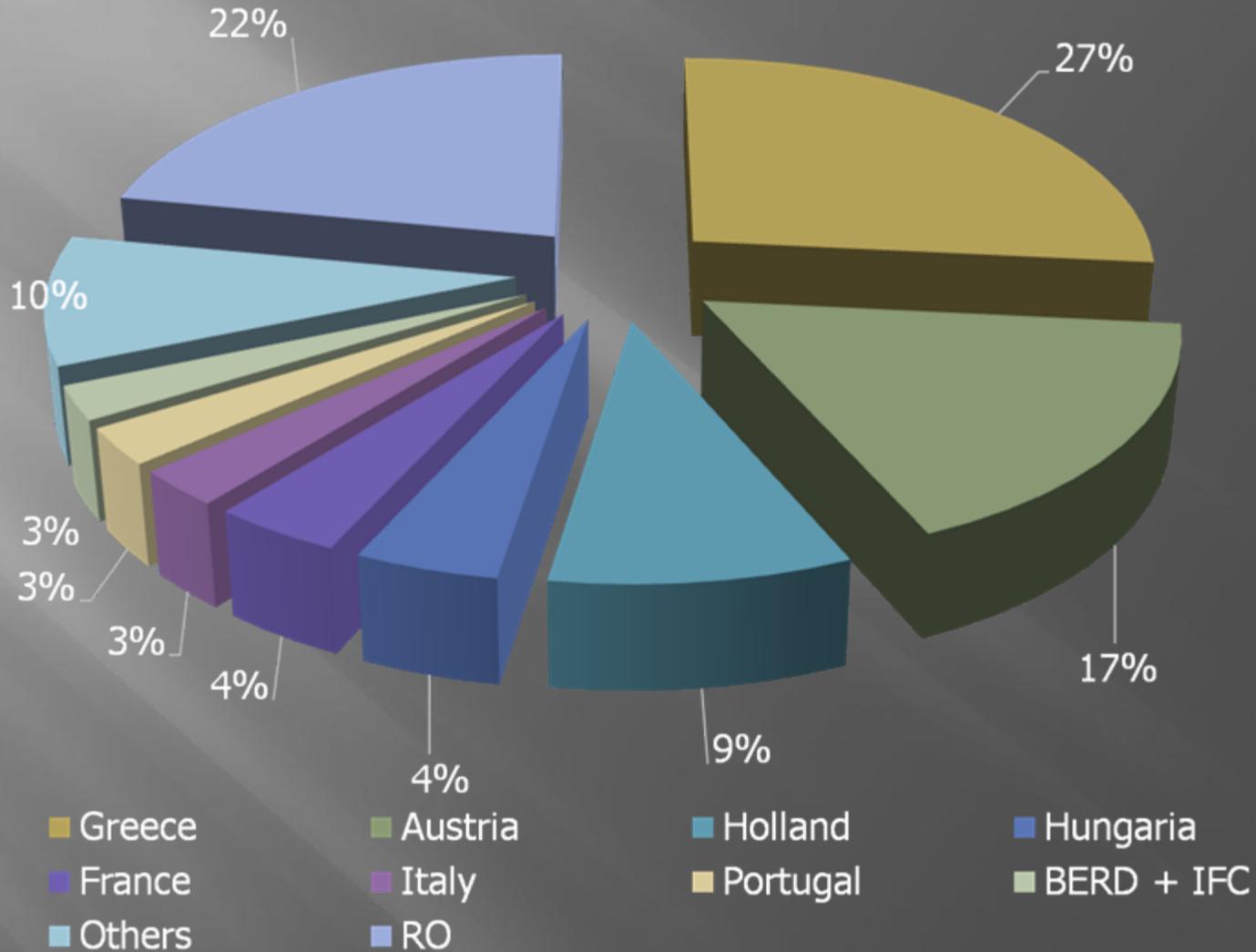
Macroeconomic Status -beginning 2010-

- ▣ IMF negotiations critical to the economy state; 20 billion EUR joint IMF-EU loan granted.
- ▣ Political turbulence after the incumbent president was reelected
- ▣ Country rating and indicators worsening

Financing on the Romanian Market

- Currently on the Romanian market there are functioning **41 banks**, out of which 25 banks with foreign capital and 10 subsidiaries of foreign banks, mainly EU resident banks. They alone represent over **85%** of the banking system.
- To be mentioned that Romania is aligned in terms of banking regulations with the Basel II stipulations
- There are still major players on the banking sector that did not enter yet the market – such as HSBC, BNP Paribas, Deutsche Bank
- More often than not the lending policy in Romania is established at Group level and the lending decision is ultimately taken outside Romania thus not much flexibility in negotiation process.

Banking Market Share



What is an SME ?

OTHER THAN A NIGHTMARE FOR BANKS ?

- ▣ EU defines an SME as a company that:
 - ▣ Employs less than 250 persons (i.e. 1-9 micro, 10-49 small and 50-249 medium)
 - ▣ and an annual turnover < 50 mio EUR
 - ▣ And/or have annual assets < 43 mio EUR

- ▣ IFAC chose to define SME as entities of small and medium sizes, referring to quantitative criteria (assets, turnover and or employees) and/ or qualitative criteria (proprietors' implication and number of persons implicated in management).

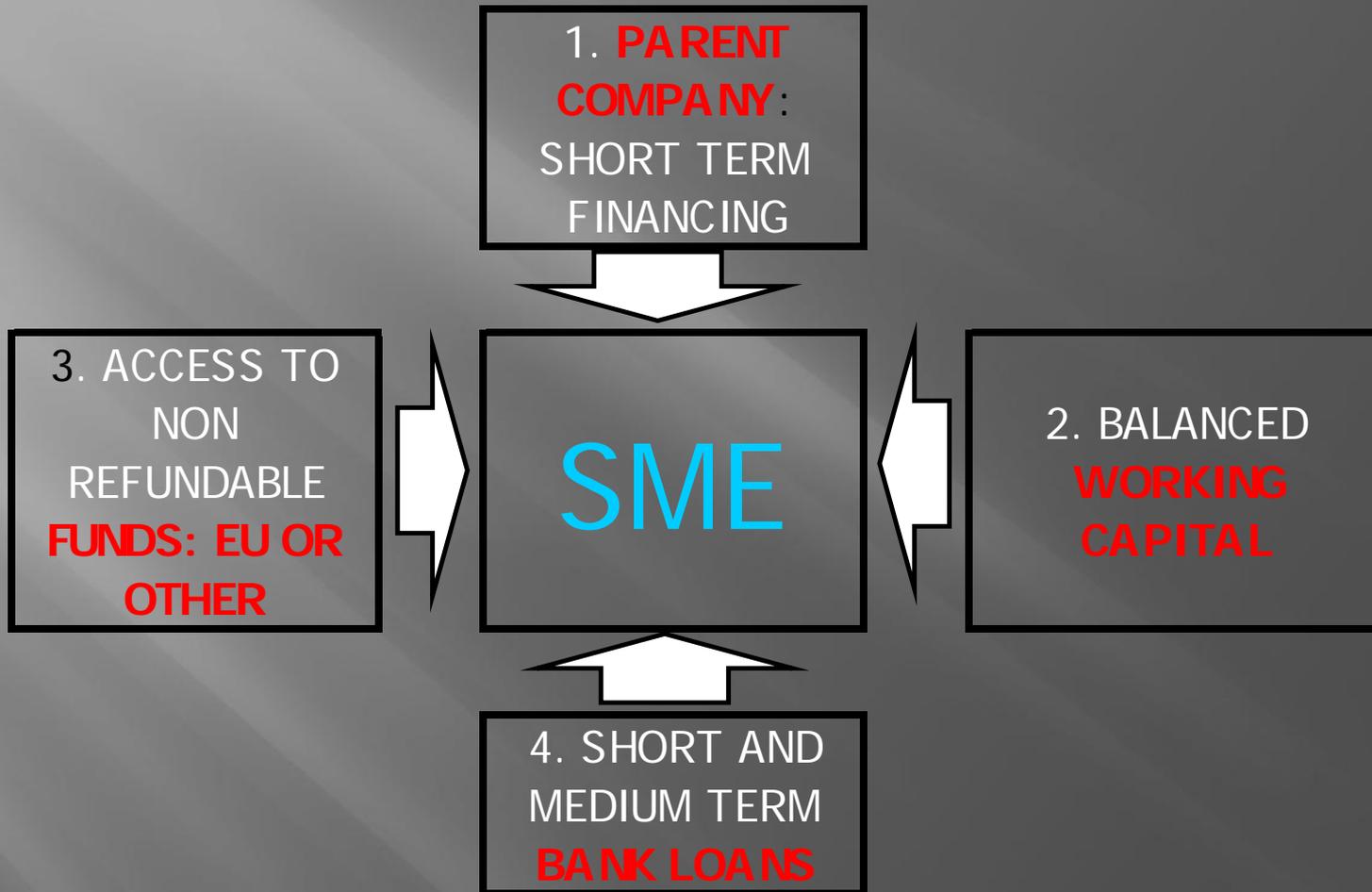
Romanian Definition and Interesting Stats

Company Size	Nb. Staff	Sales	Total Assets	%GDP Affected	% in Registered Companies Total	RO - Got Credit?	EU - Got Credit?
Medium	< 250	< 50 mio EUR	< 43 mio EUR	70%	98%	15%	77%
Small	< 50	< 10 mio EUR	< 43 mio EUR			1-	
Micro	< 10	< 2 mio EUR	< 2 mio EUR			2%	

SME Dynamics

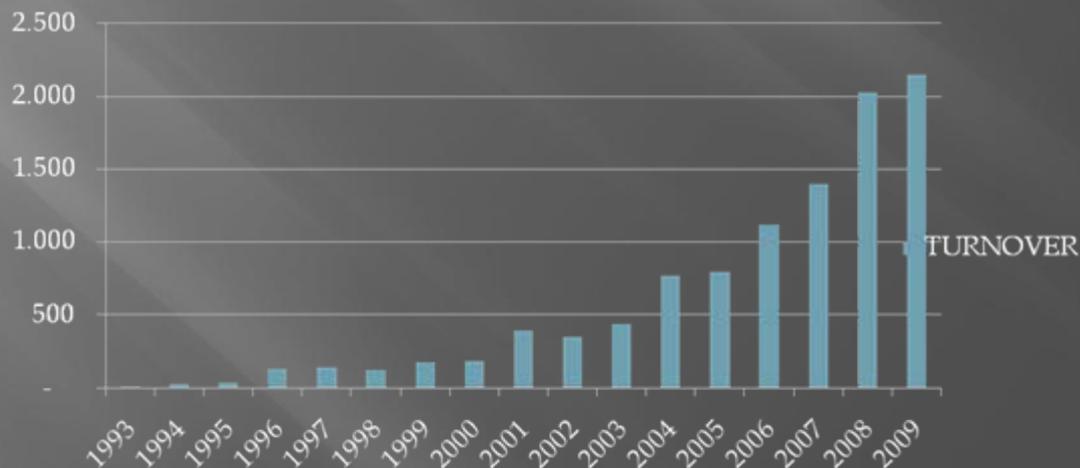
When?	What?	Where's the problem?	By how much?
Sem 1 2009	Number of registered SME's	↓	-20%
	Number of voluntary cessations of activity	↑	26%
	Number of SME employees	↓	-9%
	SME investments	↓	-10%

How can an SME survive ?



SOTER & PARTNERS

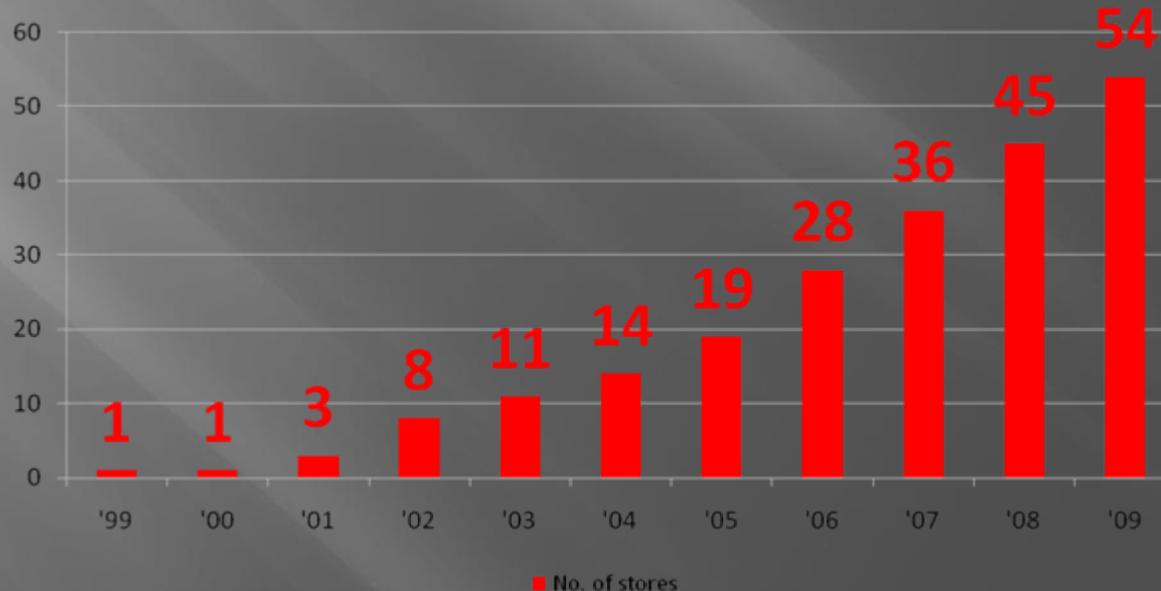
- Established in 1993 as a SRL (limited liability company), starting with only 2 employees and reaching 68 employees and collaborators at the time.
- Offering a wide range of accounting and fiscal services, the "one-stop shop" type, comprising: audit, accounting, fiscal consultancy, payroll, expatriate taxation, other financial services.
- The core business is represented by accounting and fiscal consulting services.
- Network of 2 main offices – one in Bucharest and a very small and promising one in Chisinau.
- A large portfolio of clients, only privately owned companies, counting up to near 400 companies, out of which 75% acquire mainly accounting and fiscal consultancy services.
- Turnover (in mio EUR): 2.026 (2008), 2.153 (2009), near 2.202 (mid 2010)
- In 2009, ranked second in the national top of the SMP's, established by Romanian Chamber of Chartered Certified Accountants.
- 75% of the personnel of audit team are ACCA members or affiliates (enrolled students).



ELMEC ROMANIA

- Established in 1999 as a SRL (limited liability company)
- One of the largest retailers and wholesalers of clothing, footwear, accessories and jewellery in Romania
- Distributor of both sport brands: Nike and Converse; fashion brands as well: CK, Ralph Lauren, Pepe Jeans London, Marlboro Classics etc.
- Network of 54 stores (32 Nike and Converse stores, 17 fashion stores) at the end of 2009
- A portfolio of 50 wholesale customers, including key accounts such as Intersport and Hervis
- Turnover (in mio EUR): 41 (2008), 37 (2009), 17 (mid 2010)

No. of stores



A short lending evolution?

- 1. At the beginning of the business, the Greek management arranged with the parent company for support in the form of **supplier credit**. Elmec benefited from favorable payment terms and consequently, became flexible with its clients. Returns were also accepted by the parent company.
- 2. During its expansion, an option was to undertake working capital loans, however the loan market in Romania in 1997-1998 went into a hyper inflationary stage and local loans were hard to obtain; so the entity applied to the parent again for **shareholder financing**.
- 3. In 2008, a shift in management enabled Elmec to act more independently, so local management raised from within negotiated bank terms, but under the supervision of the parent. Initially loans were guaranteed with pledge on inventory, receivables and also by letter of support/corporate guarantee (CG) from parent company.
- 4. Effective 2009, Elmec negotiated its own loans with the banks, without parent company direct supervision, using as collateral only the CG and the financials submitted to the statutory bodies and the group. No more pledges were taken on stock or other assets.

Initially as outsourced accountants

Then as fiscal consultants and external auditors for reporting purposes, up to Sept 2007.

We only remained as consultants due to independence reasons, up to June 2009.

Now as auditors and fiscal consultants again

Loan under analyses

LOAN PRELIMINARY REQUIREMENTS

- Amount targeted **3 mEUR**
- Period of the loans initially desired **1 year**
- Interest margin **2.7% p.a.**
- Guarantees to pledge **CG**
- Initiated discussions with the banks (3 banks) : period **6 mths**
- Negotiations and discussions ~ **6 mths**

LOAN CONTRACTED

- Amount obtained **3 mEUR**
- Period of the loans eventually desired **1 year**
- Interest margin: **mixed 3.0% p.a. for EUR and 2.25% p.a. for RON**
- Guarantees pledged: **CG**
- Interest obtained: **Euribor 1M**
- Other taxes, fees or penalties **n/a**
- Final contracts signed with UNICREDIT on: **February 2010**

ISSUES WITH THE BANKS

BANK's issues raised:

- ▣ **Volatile economic environment** (including a resounding insolvency request of a large white goods retailer, high political turbulence, lower country ratings)
- ▣ **High level of inventories** (positive growth rate for the previous two years)
- ▣ Request for **real collaterals**

ELMEC's issues raised:

- **Lack of trust** from the banks side
- Difficult to obtain **fast answers** from local bank management due to decision at top level
- Relatively **high risk margins** not correlated with the business growth
- **Bank's low understanding** of the financial statements

Relevant Market Status

- ▣ Retail market shrinking compared to the 2008 boom that also induced a massive base effect, nevertheless shocking to the market makers
- ▣ Consumer basket shrinking, compared to previous years, more prudent behaviour and spending patterns
- ▣ Insolvency requests (invoked as a tool against bankruptcy) 2-3 times more frequent than 2008 and 2007

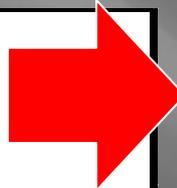
How did we help ELMEC ? Part 1

- ▣ Dully and carefully carried out **audit** of the statutory statements and quarterly reportings for Group purposes
- ▣ Analyses of the implications of the loans **on the profitability and gearing ratios** of the business – in order to asses the going concern and respectively the business implications (as part of audit procedures).

How did we help ELMEC ? Part 2

- Analytical review of the stock variation, based on the historic figures for the past two years:

ELMEC ROMANIA SRL			
Inventory evolution by quarter			
2009 vs 2008			
RON			
Quarter	2008	2009	chg%
Q1	48.050.115	73.097.927	52%
Q2	43.976.876	71.961.579	64%
Q3	55.090.082	79.482.334	44%
Q4	57.730.082	65.406.605	13%



ELMEC ROMANIA SRL			
Inventory evolution by quarter			
2009 vs 2008			
EUR			
Quarter	2008	2009	chg%
Q1	12.890.362	17.261.247	34%
Q2	12.056.717	17.106.420	42%
Q3	14.755.218	18.932.930	28%
Q4	14.486.119	15.469.137	7%

- Can you spot the differences?

So ... can SMP's help SME ?

- **Auditors** can verify and certify historic information. Audit opinion is relevant for bank, because it might prove that the information submitted to them is accurate and reflects in all material aspects the economic reality of the SME.
- **Outsourced accountants**, that do not come into direct contact with the business, can manipulate, to a reasonable extent, the **statutory financial statements**. However this is not a long term viable solution because eventually the business may suffer if loans are too high or heavy to sustain. So sooner rather than later ... accurate data will be necessary.
- An accountant within organization may be far more involved in management decisions, unlike the external auditors or the outsourced accountant. The latter can only suggest that there might be a problem, but cannot be **involved** in the business decisions for independence reasons
- Thirdly as an external **consultant on specific services** – such as payroll or tax advise or tax review, the solutions will strictly be related to the areas envisaged by these services, and not the full picture. Any advise on one area might determine problems in other areas
- And last, the **real forecast of the business** and the trend of the business is generally best undertaken **at management level** - they can feel the market, the competition, the products the market forces, etc. Management consultants or business strategy advisors may attempt to advise in this area, but they are outside the scope of accounting practitioners !

CONCLUSION

Generally Banks expect SME's to be trustworthy and reliable partners and SME's expect Banks to be flexible, fast and offer suitable financing schemes (especially at reasonable costs).

None of the parties meet these "expectations" unless the other one ..gives something away !

Somehow this **vicious circle** needs to be broken if SMEs are to be sustained for Macro-economy's sake