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## **Microresource Support for the Development and Growth of Small Business Entities in Krasnodar Krai**

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### **Abstract**

This article brings to light the major issues in providing microresource support to small business entities in the form of microfinancing and microlending. The paper identifies and substantiates the need to develop strategy and tactics for the financial regulation of small business entities as part of the “State Support for Small and Medium-Sized Businesses in Krasnodar Krai for 2014–2018” subprogram. The author proposes a model for the organizational-economic mechanism for microresource support for the development and growth of small business entities.

**Keywords:** small business entities, microresource support, financial regulation, microfinance institutions, mechanism for providing microresource support.

### **Introduction**

In present-day conditions, one of the key focus areas in stimulating Russia’s economic growth is the issue of boosting the activity of small businesses.

Despite the fact that the development level of Russia’s small businesses is still significantly behind that of their counterparts in countries with a well-developed market economy, we have been witnessing steady growth in their development over the last few years.

Entrepreneurial initiative in the system of small business can help speed up structural transformations in the national economy, ensure healthy competition, create new jobs, and generate additional budget revenue. The activity of small and medium-sized businesses helps ensure social and political stability. These entrepreneurial entities are capable of adapting promptly to the changing needs of the market and have the capacity to mitigate the consequences of structural changes in the economy. Small businesses contribute significantly to regional development. They employ the latest technological and organizational innovations. Today, it is a relatively independent sector of the present-day market economy.

### **Results**

Small businesses are crucial to the development of competition. Amid a high degree of monopolization of a significant number of regional and food markets, dynamic small businesses can ensure the economy the necessary flexibility, since they are the ones that can react the fastest to the emergence of new needs and new market niches.

In present-day conditions, Russia’s small business is distinguished by a complex and inconsistent nature. Small businesses with stable and sustainable growth could serve as an instrument for the advancement of regional economies.

The activity of small businesses is expected to be primarily oriented towards the satisfaction of local needs, development of the region, and resolution of social-economic issues. This is what makes small business both economically *and* socially significant.

It is worth noting that the timespan of 2014–2015 has been quite a tough period for small businesses in Russia. A series of controversial legislative changes, including those in the area of taxation of sole proprietors, have had a highly negative impact on small businesses, affecting their entrepreneurial and investment activity.

On one hand, there are certain proposals (e.g., tax holidays) that could potentially make life easier for most existing and newcomer small business entities. But, on the other hand, they have launched the process of re-empowering law enforcement agencies to open cases on tax offences independently from tax agencies.

These incompatible initiatives have taken a toll on small business, causing a decline in its investment activity, which has forced a significant portion of individual entrepreneurs to look for better luck in the shadow sector of the economy and triggered growing mistrust on the part of small business for the authorities. Sadly, small business has so far seen little to no support in the way of investment and lending.

Currently, the highest priority issue in the development of small business is its financing. To ensure their activity, small enterprises use 30% of their assets on the average, which is their starting capital. To be able to expand their production potential, they are trying to attract stable, long-term resources.

Based on data from a report by the *Expert RA* rating agency, in 2014 the portfolio of loans to small and medium-sized businesses was down 1% to 5.12 trillion rubles (Fig. 1) [4].

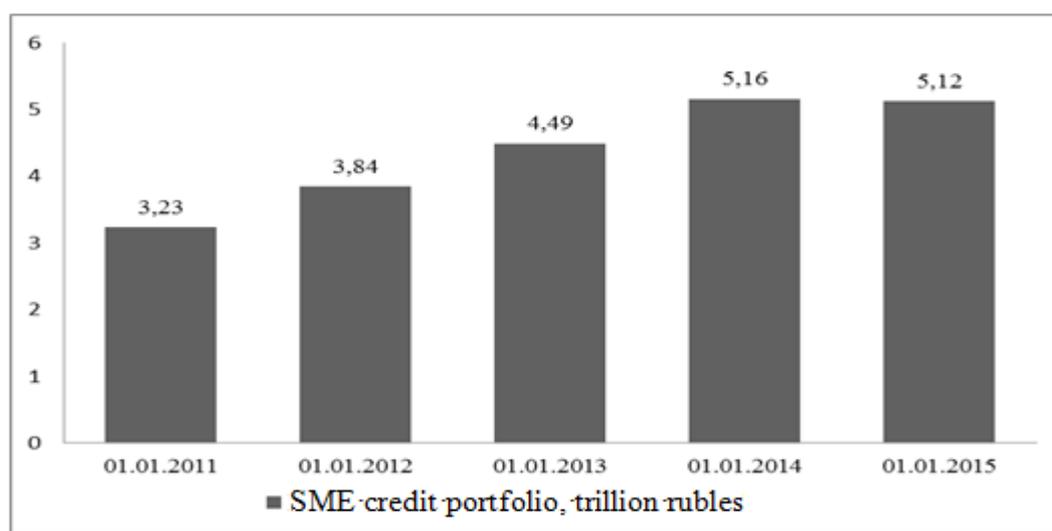


Figure 1. The dynamics of the changes in the credit portfolio for small and medium-sized businesses for 2011–2015 (Source: *RBC*)

This decline is due to, above all, an increase in the key rate of the Bank of Russia. The other reason is the reorientation of the market's top participants towards the financing of large Russian companies which virtually have lost access to Western capital markets due to financial sanctions.

The dynamics of lending to small and medium-sized business has been affected by the tightening of credit policies by banks in a climate of growing overdue debt. Additional pressure on the market's growth rate has come from a 1.5–2 percentage point increase in loan interest rates associated with an increase in the cost of funding for banks themselves amid an increase in the key rate of the Central Bank of the Russian Federation [5].

In analyzing the dynamics of indicators for 2014–2015, it is worth noting that the structure of credit portfolios for small and medium-sized business has been well affected by macroeconomic factors. By tradition, in a climate of slow economic growth and declining revenue growth rates for small and medium-sized businesses, banks tend to lend to businesses within less risky sectors, such as, above all, trade. Despite the fact that its share, compared with 2013, has gone down a bit (1 percentage point) amid a drop in unsecured lending and a decline in consumer purchasing power, it is borrowers like these that banks seem to favor the most at the moment, due to higher loan turnover rates. Among industries that have had trouble attracting bank funding are the construction and process sectors – there is a 2 percentage point decline in the share of each of the sectors in the sectoral structure of lending to small and medium-sized business.

The government regularly comes up with measures for financial support for small businesses. However, the lack of long-term credit resources in the market of lending to small and medium-sized business continues to be one of the key factors curbing economic development.

Issues related to the lack of funds for investing in the business to help it conduct its day-to-day operations, as well as those related to seeking sources of funding, appear to be of paramount relevance to small businesses in Krasnodar Krai and are increasingly gaining momentum amid the development of this sector of the regional economy.

In 2014, the number of small and medium-sized businesses increased by 10,337 entities and totaled 282.8 thousand entities as of June 10, 2015. The combined turnover of small and medium-sized businesses in 2014 rose 5.8% and reached 1 billion 600 million rubles. Currently, the SME sector accounts for 35% of the population engaged in Kuban's economy.

The hassle-free operation and rapid growth of small businesses in Krasnodar Krai cannot be achieved without having an efficient system of financial regulation and state support in place.

Most of the time, the major sources of funding are the owners' own assets, as well as revenue gained as a result of entrepreneurial activity. A small business entity appears to experience the lack of personal assets both when the business is starting out and when it is already running.

The low growth rates and minor fiscal contribution of small businesses to the region's development indicate that Russia's current system of financial support for small business is not effective enough, both as a whole and with a breakdown into its elements.

The amount of hard time small businesses are having looking for sources of funding is quite substantial, and these issues cannot be resolved without support from state and regional authorities.

A total of 366.3 million rubles was allocated in 2014 towards activities related to providing financial support to businesses in Krasnodar Krai under the "State Support for Small and Medium-Sized Businesses in Krasnodar Krai in Krasnodar Krai for 2014–2018" subprogram of the "Economic Development and an Innovation Economy" state program for Krasnodar Krai, approved on October 14, 2013 via a resolution (No. 1201) of Head of the Administration (Governor) of Krasnodar Krai [3].

As part of the subprogram, 797 small and medium-sized businesses have received state support. Out of them, 406 have received financial support in the form of subsidies across various areas, a total of 193.1 million rubles.

To facilitate the sustainable growth of small businesses, it makes sense to adopt and apply a holistic concept of financial regulation of small business in a climate of building a competitive innovation economy.

In present-day conditions, mechanisms for implementing strategy and tactics for the financial regulation of small businesses ought to be developed with emphasis on the development of a system of guarantees (sureties), mass assimilation of microfinancing and microlending, effective use of financial leasing and franchising, creation of relevant elements of infrastructure, including business incubators and science, techno-engineering, and innovation parks; promotion of inter-department coordination and control in the area of small and medium-sized business at a federal level.

Among the above strands of resource support, a key role is played by microresource support for small business entities in the form of microfinancing and microlending, which is intended to provide them with working funds, as well as "protective" funds to help them withstand the risks of non-payment on the part of clients that purchase their products and services.

The infrastructure of support for small and medium-sized businesses in Krasnodar Krai features the non-profit institutions "The Foundation for the Microfunding of Small and Medium-Sized Businesses in Krasnodar Krai" and "The Guarantee Foundation for Support for Small and Medium-Sized Businesses in Krasnodar Krai".

"The Foundation for the Microfunding of Small and Medium-Sized Businesses in Krasnodar Krai" was launched in April, 2014. As of June 10, 2015, the foundation has provided 179 microloans to small and medium-sized businesses in Krasnodar Krai to the tune of 135.3 million rubles.

The organizational-economic mechanism for providing microresource support is based on the following two types of elements:

1) basic elements, which determine favorable conditions for conducting entrepreneurial activity as a whole;

2) variable elements, which determine the principal form of individual support for the development of small businesses through the provision of microresource support.

The organizational-economic mechanism for providing microresource support comprises the following levels: (1) the macrolevel, (2) the mesolevel, and (3) the microlevel.

At the macrolevel, issues related to providing financial support to small and medium-sized businesses are handled by the Government of the Russian Federation, the Central Bank (CB) of the Russian Federation, and other government agencies. Their functions, depending on their scope of responsibility and function, include drafting, validating, and instituting laws and regulations aimed at exploring new dimensions in the development of the microfinance market. These bodies can also handle issues related to removing current restrictions that are hindering the development of non-profit microfinance institutions (MFI) and implementation of federal programs for the development of the microfinance sector.

At the mesolevel, funds are accumulated and redistributed into “grassroots” MFIs by “second-level” cooperatives. We get a redistribution of credit risks and a boost in the accessibility of microresource support through sureties ensured by “second-level” MFIs, or by a specially formed foundation for mutual sureties. At the mesolevel, one puts together a registry of the credit histories of microfinance borrowers. In the event that international donor institutions and investors express an interest in investing, information support can be provided to facilitate the assimilation of best microfinance practices and organization of training and counseling for MFI personnel.

The microlevel is associated with the development of microfinance institutes in the financial service market. The MFI system does not require much initial funding and can develop locally – in the form of separate institutes with a business legal structure provided for by Federal Law No. 151-FZ [1]. At the microlevel, MFIs interact “horizontally” in the way of information, methodology, and technical documentation exchange.

There are four common approaches to arranging the ways to enter the microresource support segment, which are based on the practice of banks entering this segment.

The first approach is based on creating an integrated establishment or an internal business unit. Semi-dependent microfinance units can give out loans directly or through special windows at each of the bank’s branches where there is a microfinance credit inspector on staff. The functions of the unit’s administrative, financial, HR, and information departments are integrated into the common structure of the principal bank.

The second approach implies the operation of an independent retail center that is affiliated with the bank and has its own policy, staff, and information system. Among institutions that could act as such subsidiary financial organizations are also joint ventures involving other investors. The bank’s administration licenses and regulates the activity of the subsidiary microfinance company, which, in turn, has to meet the requirements set for it by the bank (e.g., meeting the requirements for the size of one’s fixed capital).

Under the third approach, an operating microfinance institution functions as a retailer that acts based on simple credit relations with the bank. This particular form in this dimension has been the most widely used. A more complex form of alliance can be implemented based on an agreement between the bank and the microfinance institute. In this case, the function of the microfinance institute is activity related to approving loans and managing bank credit processes. Knowledge of the market and credit methodology applied by the microfinance institute can facilitate effective partnership.

The fourth approach is about the operation of a servicing company which is a non-financial company that provides the bank with services related to managing loans and granting loans, whilst the loan funds are in the bank’s accounts. The servicing company gets commissions for its services. This kind of partnership is one of the novel forms of interaction between banks and MFIs. The purpose of this interaction is to help overcome barriers that block the access of commercial banks to the area of microfinance.

## Conclusions

The development of the microfinance sector ought to be monitored at all levels of state government. To assess the parameters of the social effectiveness of microfinance programs, there need to be set up supervisory bodies at the various levels of state and municipal government.

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