Paper Code : SME1 – 31

CROWDFUNDING - A NEW FORM OF CAPITAL MOBILIZATION FOR SMALL AND MEDIUM SIZED ENTERPRISES (SMES) IN VIETNAM

Phung Thanh Loan
Academy of Finance, Hanoi, Vietnam

Abstract
Numerous studies have confirmed the crucial role of SMEs in Vietnam. They stimulate economic growth and generate employment. The global economic integration and Industry 4.0 have opened up ample opportunities for Vietnam's SMEs. However, the current difficulties that SMEs have encountered in mobilizing financial resources for their business activities have become tremendous obstacles that remain unsolved to most SMEs. This is the reason why this research presents an overview of financial resources of SMEs; challenges facing Vietnam's SMEs in capital mobilization as well as innovation in using crowdfunding to mobilize financial resources. This research aims to supplement academic materials for the implementation of experimental researches in crowdfunding of SMEs in VN. Besides, the research also provides important information that helps businesspeople realize the critical role of crowdfunding in mobilizing financial resources and improving business outcomes of SMEs.
Keywords: SMEs, crowdfunding, financial resources

Introduction

The majority of enterprises in the world are of small and medium size. The enterprises are considered the cradle nurturing business dreams of start-up entrepreneurs, and also contribute to employment creation. Globally, SMEs have recorded higher growth rate than other enterprises in recent years. Economic growth in developed countries such as Japan, South Korea, Taiwan and many other countries have been significantly generated by SMEs activities. SMEs account for 65% of industrial production in Japan, while in Germany this percentage is 48% and in America this is 45% (Ngui, T., 2014). However, SMEs encounter a number of difficulties in terms of product marketing; technology; human resources; and especially financial resources mobilization.

Capital is one of the prerequisites for the existence and operation of enterprises. Enterprises can mobilize capital from internal sources such as owners' equity or from external sources such as debts. Internal sources of capital help enterprises to operate independently; however, these sources are limited and fail to meet all demands of enterprises. While external sources of capital are of larger scale, they are harder for SMEs to get access to. According to Beck, Demirguc-Kunt and Maksimovic (2006), SMEs experience more difficulties than big enterprises when accessing financial resources. Malhotra, Chen and associates (2006) point out some difficulties facing SMEs when accessing credit capital, such as: inadequate information, high-risk loans, lack of information about SMEs and ambiguity in financial policies.

In Vietnam, SMEs account for more than 97% of the number of active enterprises, contributing about 45% of GDP and 31% of Government budget, creating more than 5 million jobs (MPI, 2004). Vietnam's SMEs encounter similar difficulties like other SMEs in the world when accessing external sources of capital, especially credit capital. This study discusses financial resources of SMEs, mobilization of financial resources, difficulties facing SEMs, and recommendations for financial innovation for SMEs.

Definitions of SMEs

Economists tend to classify enterprises according to scale, based on a number of specific indicators such as number of employees, turnover or total assets. The most common criterion used to distinguish between big enterprises and small enterprises is the number of employees (Hatten,2011). According to the European Commission, the number of employees should be the main criterion for classifying enterprises. However, some financial indicators should also be supplemented to identify the real size of an enterprise, its performance and its rank against competitors. SMEs definition of the European Commission is presented in the following table:

SMEs definition of the European Commission

Enterprise Size	Number Of Employees	Annual Turnover	Or	Total Annual Assets
Medium-sized	<250 people	≤ € 50 million		≤ € 50 million
Small	< 50 people	≤ € 10 million		≤ € 10 million
Micro	< 10 people	≤ € 2 million		≤ € 2 million

Source: European Commission (2005)

The World Bank uses three quantitative criteria, which are number of employees, annual turnover and total assets to define SMEs. According to the World Bank, an enterprise must meet the criterion of number of employees and at least one financial criterion to be considered an SME.

SMEs classification criteria of the World Bank

Enterprise SIZE	Number OF EMPLOYEES	Annual TURNOVER	Or	Total ANNUAL ASSETS
Medium-sized	50-300 people	$3-15 million		$3-$15 million
Small	10-50 people	$100,000 - $3 million		$100,000-$3 million
Micro	< 10 people	< $100,000		<$100,000

Source: Independent Evaluation Group (2008)

Some countries have their own definitions of SMEs. In Canada, the term SME refers to businesses with fewer than 500 employees. Whereas Chile and Russia use annual turnover to define SMEs. China, Japan and South Korea define SMEs according to the sector that enterprises are operating in (OECD, 2015). On 12 June 2017, Vietnam's National Assembly ratified the Law on Support for SMEs. According to this Law, SMEs are enterprises that meet one of the two following criteria:

- Sales revenue of the previous year does not exceed VND100 billion.
- The average number of employees of the previous year is not more than 300 people.

However, in this study, the researcher uses the SMEs definition according to Decree No 56/2009/ND-CP by the Government to make it compatible with data about SMEs.

"SMEs are registered businesses, which are divided into three sizes: micro, small and medium-sized according to total capital (equalling total assets identified in the balance sheet total of the business) or the average number of employees (but total capital is prioritized), specifically as follows:

SMEs classification criteria in Vietnam

	Micro	Small		Medium-sized	
	Number of employees	Total capital	Number of employees	Total capital	Number of employees
1. Agriculture, forestry and fisheries	≤ 10 people	≤VND20 billion	10-200 people	VND20-100 billion	200 – 300 people
2. Industry and construction	≤ 10 people	≤VND20 billion	10-200 people	VND20-100 billion	200 – 300 people
3. Trade and service	≤ 10 people	≤ VND10 billion	10-50 people	VND10-50 billion	50-100 people

Source: Decree 56/2009/NĐ-CP

Financial resources of SMEs

There are various ways to categorize financial resources of SMEs Working capital can be divided into short-term and long-term capital; owners' equity and liabilities; or internal and external sources of capital. In this research, the author divided the capital of SMEs into owners' equity and liabilities.

Owners' equity is the amount of money business owners spend in the establishment of the enterprise, and this is supplemented in the course of business activities. This is an important source of capital for the existence and development of enterprises as well as business plans. Owners' equity is supplied by the owners of enterprises and is added from business profit. External capital is mobilized by issuing stocks or attracting investment from investment funds, especially venture capital fund. SMEs operate in small scale so their owners' equity is often limited. Mobilization of additional owners' equity is not easy for this kind of enterprise. Therefore, in addition to owners' equity, loan capital is an important financial source of SMEs.

Liabilities are loans that enterprises obtain from official and unofficial markets. Official loans are often obtained from commercial banks or corporate bonds. Unofficial loans are often obtained from families, friends or loan sharks. Loan capital is divided into short-term and long-term one. Short-term loan is loan that is scheduled to be repaid in less than a year. A number of studies point out that small businesses often have to approach and use short-term loans with high costs such as short-term bank loans, commercial credit (Eniola, A. A. &Entebang, H., 2015). Long-term loan is loan that is scheduled to be repaid in more than a year. SMEs can mobilize long-term loan in many different ways, such as issuing bonds, obtaining long-term loans from banks or other credit institutions. As regards credit capital, SMEs often encounter difficulties concerning fulfilling collateral and transparency requirements in financial statements or proving effective business plans. As regards capital mobilized through bond issuance, SMEs generally do not meet the standards concerning scale of capital and level of confidence.

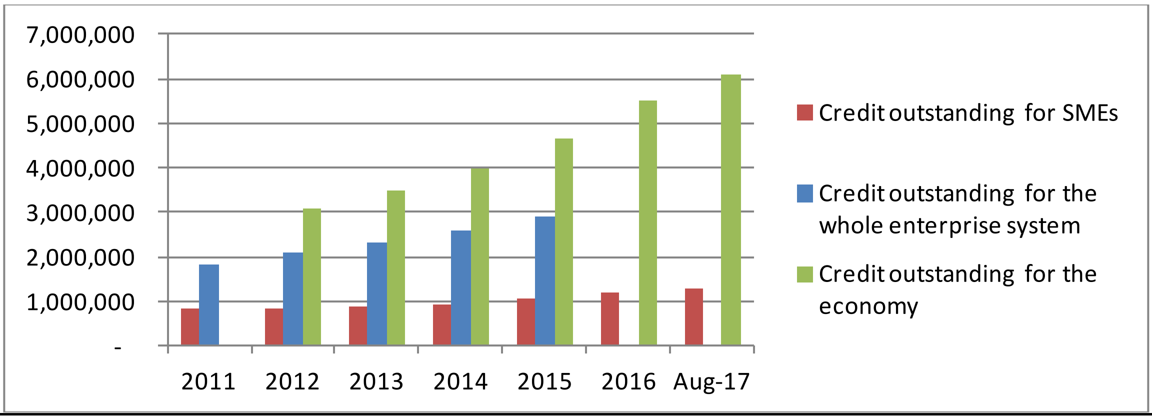
The reality of mobilizing financial capital of SMEs in Vietnam

According to VCCI, the period 2007-2015 witnessed many enterprises had to rely heavily on debts. The debt ratio of Vietnam's enterprises is always higher than the expected value. Although debt ratio of enterprises reduced from 2.3 to 1.9 in the period 2011-

2014, but then increased to 2.1 in 2015. Debt ratio is in direct proportion to the size of businesses. Big enterprises have the highest debt ratio, ranging from 3.5-3.6 in 2015, while that of small and micro enterprises is 1.7 and 2.8 respectively in 2015. It can be seen that small enterprises encounter more difficulties than big enterprises when it comes to access and use of credit.

Figure 1 Credit outstanding balance of Vietnam's SMEs in the period 2011-2017

Unit: VND billion



Source: State Bank of Vietnam

The proportion of credit outstanding balance of Vietnam's SMEs in the period 2011-2017

Unit: %

Target	2011	2012	2013	2014	2015	2016	8/2017
Proportion of credit outstanding balance of SMEs/credit outstanding balance of the enterprise system	45	40	37	36	36		
Proportion of credit outstanding balance of SMEs/credit outstanding balance of the economy	-	27	25	24	23	22	21

Source: The State Bank of Vietnam

In the period 2011-2017, the credit outstanding balance of Vietnam's SMEs increased by 1.6 times. As of 31 August 2017, the credit outstanding balance of SMEs reached VND1,292,182 billion, up 7.49% compared to the end of 2016. This increase was higher than that of 2016 and representing 21% of the total credit outstanding balance of the economy. However, the proportion of credit outstanding balance of SMEs/credit outstanding balance of all enterprises and the proportion of credit outstanding balance of SMEs/credit outstanding balance of the economy tends to decrease. This shows that a large amount of credit capital in the economy is still preserved for big enterprises, state-owned enterprises and non-manufacturing businesses; while SMEs have difficulty in accessing credit capital.

There are three main causes leading to the fact that credit capital of SMEs is not up to expectations: (i) macro environment; (ii) SMEs themselves; (iii) commercial banks.

Firstly, causes related to the macro environment in general include:

- The impact of economic crisis in recent time
- The limited government budget, causing some ineffective programs and aid packages.
- The lack of information about SMEs
- The low efficiency of credit guarantee for SMEs
- The unresolved issue of bad debts of commercial banks
- The lack of support services such as consulting, training, etc for enterprises.
- The small and undeveloped capital market; the dependency of the financial system on the banking system
- The complex and cost-ineffective business environment, even though there are some improvements.

Secondly, causes related to SMEs themselves include the following:

SMEs have limited management capacity, low-skilled labour, poor information transparency, limited ability to meet eligible bank loan records. A number of SMEs do not have business strategies, and feasible business plans. Their products lack the competitive edge without any position and brand on the market. Most payments are made in cash so banks have difficulty controlling the flow of money. In particular, SMEs often lack collateral, yet have the habit of buying risk insurance, lack understanding about mechanisms, policies, products, services and credit packages of credit institutions, guarantee programs and support program of the Government.

Thirdly, causes related to commercial banks include the following:

Even though some commercial banks have introduced credit programs dedicated to SMEs, many commercial banks still do not consider SMEs potential customers. One of the reasons for this is that the size and efficiency of credit of this group is not high, coupled with high risk and operation cost. There are not many products-services dedicated to SMEs by credit institutions. In particular, the complex and cumbersome credit procedure is one among many barriers to SMEs accessing bank credit capital.

Financial innovation

Crowdfunding is a new form of raising capital and has become increasingly popular in the world. This creates favourable conditions to help investors and project managers reach out to each other. Crowdfunding differs from traditional forms of capital mobilization in that it can mobilize the assistance of not only a handful of investors but a large number of investors including both professional and amateur ones.

Crowdfunding is a form of raising capital from the community or the crowd, and this is a method for everyone. Crowdfunding asks for help from the community to help a project manager or a product owner complete their project or products because they have the ideas but they don't have the money to implement the projects. This method can help small businesses who are denied loans by commercial banks draw capital from small investors (from the community). Through various small investors, crowdfunding provides fund for commercial projects or venture projects (Pierrakis& Collins, 2013).

It is the gap in finance along with the emergence of social media and other interactive online platforms that has led to the popularity of crowdfunding as a potential alternative capital raising method. Crowdfunding is an effective alternative method for capital raising to fund creative projects. It involves attracting and collecting a relatively small amount of money from a large number of investors. Belleflamme, Lambert &Schwienbacher (2014) stated that the purpose of raising capital from community is to mobilize money for projects through the use of social media on the Internet.

Currently, crowdfunding is constantly developing in many countries in the world. Kuti&Madarasz (2014) said that $2.7 billion was raised through crowdfunding in 2012 worldwide. However, in Vietnam and other Southeast Asian countries, crowdfunding is still a novel concept to many people. One of the reasons why crowdfunding is not yet popular in Vietnam is that the legal system does not have any specific regulations regarding crowdfunding. In countries like the US, Canada, Turkey, the UK and some European countries - where crowdfunding is very much developed - the Governments have passed laws to guide crowdfunding activities. For example, in 2012, the Government of Italy passed a law which allows start-up companies to mobilize equity capital through platforms dedicated to crowdfunding (Quintavalla&Piattelli, 2014). Thanks to this law, the number of crowdfunding-related platforms has increased to 24 platforms and 1700 projects were implemented from October 2012 to June 2013. Pierrakis and Collins (2013) confirmed that technical advances have facilitated the development of crowdfunding. They argue that engineering and technological advances have created free online connections, safe online money transfer, free marketing tools to attract professional and non-professional investors worldwide. With a population of more than 93 million people, in which more than half of them use the Internet, crowdfunding is actually a very promising form of capital raising for SMEs and start-up companies in Vietnam. Crowdfunding can help overcome market obstacles that hindering SMEs in Vietnam to access traditional forms of capital mobilization, such as the lack of collateral or the lack of experience and skills of entrepreneurs in the early stages of starting a business.

Conclusion

The current financial market offers various financial resources providing capital for SMEs. It is important for SMEs to be flexible, and creative to grasp opportunity in order to choose the appropriate financial resources and resolve the difficulties hindering their access to capital. This paper analyses the current situation of official capital mobilization (capital mobilization from commercial banks) of SMEs in Vietnam, the inherent causes hampering SMEs' access to capital. Besides, the paper also recommends a new form of capital raising for SMEs. In the context of the industrial revolution 4.0, crowdfunding is a promising form of capital raising for SMEs in Vietnam. It is necessary for the Government to create a full legal environment to support crowdfunding activities of SMEs.

References

Beck, T., Demirgüç-Kunt, A., Laeven, Luc &Maksimovic, V. (2006), "The Determinants of Financing Obstacles", *Journal of International Money and Finance*, 25(6),932-52. doi.org/10.1016/j.jimonfin.2006.07.005

Belleflamme, P., Lambert, T., &Schwienbacher, A. (2014), "Crowdfunding: Tapping the right crowd", *Journal of Business Venturing*, Vol.29(5),585– 609. doi: 10.1016/j.jbusvent.2013.07.003

Eniola, A. A. &Entebang, H. (2015), "SME Firm performance-Financial Innovation and Challenges", World Conference on Technology, Innovation and Entrepreneurship. doi: 10.1016/j.sbspro.2015.06.361

European Commission. (2005), "The new SME definition: user guide and model declaration section", available at www.euresearch.ch/fileadmin/redacteur/Company_success_stories/SME_Definition_en.pdf.

Hatten, TS.(2011), Small *Business Management: Entrepreneurship and Beyond*, Mason: South-Western Cengage Learning, USA.

Independent Evaluation Group. (2008), "Financing micro, small, and medium enterprises: An Independent Evaluation of IFC's Experience with Financial Intermediaries in Frontier Countries", available at https://openknowledge.worldbank.org/bitstream/handle/10986/6485/448160PUB0Box327413B01official0use0only1.pdf?sequence=1

Kuti, M., &Madarász, G. (2014), "Crowdfunding", available at http://www.asz.hu/public-finance-quarterly-articles/2014/crowdfunding/a-kutimmadaraszg-2014-3.pdf

Malhotra, M., Chen, Y., Criscuolo, A., Fan, Q., Ilieva Hamel, I., and Savchenko, Y. (2006), "Expanding access to finance: Good practices and policies for micro, small, and medium enterprises", available at http://siteresources.worldbank.org/ICLP/Resources/sme_finance_final.pdf.

Ministry of Planning and Investment. (2014), White paper small and medium enterprise in Viet Nam 2014, Statistical Publishing House, Ha Noi, Viet Nam.

Ngui, T. (2014), "The role of SMEs in employment creation and economic growth in selected countries", *International Journal of education and research*, Vol.2 No.12 December 2014, pp.461-472.

OECD. (2015), *Taxation of SMEs in OECD and G20 Countries, OECD Tax Policy Studies*, No. 23, OECD Publishing, Paris.

Pierrakis, Y. & Collins, L. (2013), "Crowdfunding: A New Innovative Model of Providing Funding to Projects and Businesses", SSRN Electronic Journal. doi: 10.2139/ssrn.2395226

Quintavalla, L., &Piattelli, U. (2014), "Italy - The Italian Legal Framework of Equity-Based Crowdfunding", Derivatives & Financial Instruments, Vol.16 No 2.

VCCI. (2016), *Annual report of Vietnamese enterprises* 2016, Information and Communications Publishing House, Ha Noi, Viet Nam.