Determinants of Investment Decisions in Smes

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Abstract: Nowadays, the SMEs are the key drivers of economic development. They create new jobs, added value and SMEs increasingly participate in inclusion of the national economy in world trade through their internationalization. The development of enterprises is one of the basic business principles and the most important part of the overall process of development is investment. The process of making investment decision as a complex and dynamic process involves analysis of all factors (financial, market, technical - technological, location, social), forecasting various alternatives understanding and evaluating the effects. The procedure of evaluating the feasibility of investment projects is different in small and medium than in large enterprises.

The differences becoming from the possibilities to access to finance for SMEs, opportunities and capabilities for planning by the owners of small businesses, short-term orientation in the operation etc. Therefore, SMEs often avoid the process of investment decision or it's made only with cursory analysis of the business environment and some investment criteria. Considering all this, the main aim of this paper is to outline the factors which affect to the process of making investment decision in SMEs and showing some possible scenarios. Also an analysis of investment process in SMEs and large firms will be performed. For realizing the main aim, the survey will be conducted among the SMEs in Pelagonia region. And in the end of the paper we will propose many recommendations for improving the investment process in SMEs.

Key words: investment decision, determinates of investment, SMEs

Introduction

The increased interest insmall and medium sized enterprises as engines of the economic growth and employment from the 70's and early 80's of the 20th century, is due to several reasons, but predominantly to changes in the economic structure, development of new markets and improvements in the low cost industries. Although some theoreticians considered that the growth should be based on large enterprises, however the innovation and flexibility of the small and medium enterprises have proved considerably effective in the efforts to reduce costs.

Nowadays, the small businesses are disseminated into all sectors of the economic structure, and not solely as envisaged in the modern sectors but also into the traditional and primary sectors. In the beginning they were characterized with a greater representation in labour-intensive sectors with a smaller number of employees, less volume of capital,minor innovation and simple techniques and technologies, while later they also expanded in all sectors with greater investments, increased innovation and higher risk.

Certain studies (Best M, 1989) showed that small and medium enterprises are becoming an important precondition for functioning of markets. Considering the importance of SME's, significantly more credit is given to their development. Particularities of small and medium enterprises (previously elaborated), which represent their advantages or disadvantages compered to large enterprises and their significance for the economies, are making the process for investments decision making in these enterprises completely different. Likewise, the investment decision making is affected by numerous determinants which will be elaborated in the last section of the paper.

Literature Review

SMEs play a crutial role in economic growth. As Nelson said: SMEs have an important role on many aspects, such as employment, taxes or innovation. (Nelson Duarte, 2004, p.2). On a long term, compared to large companies, they contribute more to job creation and take a large share in the overall employment. Nowadays, two-thirds of newly created jobs in the EU are due to the sector of small and medium enterprises.

Investment decisions are made by investors. Investors commonly perform investment analysis by making use of fundamental analysis, technical analysis and judgment.

In periods of economic growth, SMEs will have easier access to debt and a higher level of cash flow thus stimulating investment (Fuss & Vermeulen, 2004), Investment decisions are often supported by decision tools. (A.Jagongo& V. S. Mutswenje). A large and growing empirical literature explains firm investment determinants and firm investment. In practice, an investment decision is often a combination of all three factors as complementary, although some may have priority. (M.Peric, J. Đurkin)

Furthermore, according to Mendes et al. (2014), firm investment theories can be divided into two major groups: theories considering that investment depends more on external conditions in which a company operates, and theories considering that investment depends more on a firm's internal conditions. Research in behavioural finance has developed rapidly in recent years and provides evidence that investors' financial decisions are also affected by internal and external behavioural factors (Shefrin, 2000; Shleifer, 2000; Warneryd, 2001).

Theoretical Framework

Considering that the process of making investment decisions has equal meaning for the future development of the large as well as small and medium enterprises, means that this process shouldn't differ depending of the company size. Based on the elaboration and considering the differences which exist in numerous segments of performance between different size enterprises and the analyses of research studies indicate the existence of certain differences. Mainly the differences in making investment decisions between large and SME's come out from two characteristics in the operation of these enterprises: firstly, the opportunities for providing the necessary financial resources for the implementation of investment projects, and secondly the method of implementation of managerial functions in these enterprises. The SMEs which are based on innovation (considering that by the number of innovation the SMEs are the main source of innovation compared to the large enterprises), have limited opportunities for securing necessary financial assets, because they are considered as more risky (Birch 1987, p.79.). Furthermore, with SMEs there is an overlapping of the ownership and management, or in the early stages the management concept is implemented by one person who makes all strategic decisions for development and operation of the enterprise. Therefore we divide the determinants of making investment decisions according to their influence on the first or second source of differences.

Determinants of assuring the necessary resources

The financing of small and medium enterprises is **o**ne of the main factors for their growth and development. The establishment of a small enterprise, the expansion of the business activities, the development of new products and investments in machinery, equipment and human resources, are conditions from the opportunities of the enterprise to satisfy the needs for a capital. The use of various sources should secure sufficient volume of capital as well as corresponding dynamics of its securing which would be adequate to the projected accounting value of investments as well as the dynamics for implementation of investment activities. Financial construction for investment projects can be a combination of different sources.

The provision of funds for new investment can be obtained from the following practises:

- the disposal of the equity, initial invested assets of the owner or through issuing of shares,
- the deployment of capital from the bank or other external source.

The participation of these sources is combined differently in any particular enterprise, where the ratios between them change over time. It is normal for each enterprise to have prevalence of own funds or through issuing of shares rather than use of other external sources.The management with own funds alleviates the implementation of the investment project while using funds from other sources creates a problem if the financial institution does not approve the requested funds and the entity is entitled to seek funds from other private sources. The acceptance from the private investor depends from his interest of achieving positive results of the business or have a wish to support the investment for a particular fee. This source is specia

l because private investors are making the financing in phases where at the beginning they would invest lower amount because of the higher risk and would wait to see the development of the investment in order to loose less if unsuccessful. The investors are using this way because of the small volume of information that can be obtained for the operation of the business. As the business develops, the uncertainty for its developmentwill be reduced, and that's why the delay of financing with higher amount or the time diversification, allows the investor to manage the risk.(Sorenson O, Stuart T, 2001.)

Finding the funds is quite a difficult task which primarily requires good planning in the enterprise as well as (Debelak D, 1997):

- the acknowledgement of the availability of the specific financial solutions,
- the suitability of each opportunity with the entrepreneur product,
- the adequacy of possible options with the existing phase of enterprise development,
- good knowledge of the conditions for financing before accessing them,
- preparation of the enterprise operations for financing,
- access to funding sources,

The particular characteristics of the small enterprises cause certain difficulties about securing funds from different sources. Those determinants are making the process of making investment decisions differentcompared to other enterprises. Primarily, the determinants of differences in the process of evaluation of the efficiency of investment projects according to their influence can be grouped in the following three groups:

- determinants of the calculation of equity cost,
- determinants of opportunities for use of different types of sources,
- determinants of liquidity of enterprise operations.

The use of various sources means combination of their prices in the process of making investment decision, because an important determinant when selecting the use of some source is its price, which is reflected on the overall investment decision. The connection of prices and shares of certain funding sources outline the so-called equity cost.The equity cost represents starting point for assessment of the project efficiency and the evaluation of the project. Certain techniques for calculation of the equity cost are used in which construction for calculation are imported the equity prices provided from any particular source (own funds, loan funds, assets provided through the issuance of shares). The calculation of the equity cost assumes that the used funding instruments by SMEs have active markets and transparent prices. Main determinants of the accuracy of calculation of the capital cost is the liquidity of the issued shares. It is known fact that due to multiple reasons the shares issued from the small enterprises are insolvent. The insolvency of their shares because of non-market value deters the investors to buy shares of SMEs, and that's why they are deciding to buy shares of larger rather than buying shares of unquoted enterprises.This is because the efficiency of the financial markets mainly refers only to those enterprises which have active organized markets, whilst the small and medium enterprises don't have such organized markets. Furthermore,in order have relevant calculation of the equity cost, it is necessary the prices of each particular source to be market determined and transparent. Even in cases where the prices are market determined and transparent, the calculation of the equity cost is complex and difficult. All this questions the relevance of the calculated equity cost in small and medium enterprises, thereby and the making of investment decision. This problem renders the process of making investment decision in these enterprises andusually the resolving of the problem comes down to comparison of equity cost with other enterprises or use of satisfactory rate of return on their own shares. However the both approaches would be more subjective. (Orsag,2002)

The majority of small businesses, in their early stages of development, usually rely on their own sources of funding, i.e. own equity, while in later stages of their life cycle, the equity needs exceed the internal capabilities of the owner, so that, he in order to provide the necessary funds for investments and business development, has to take into consideration the external sources of funding. For young enterprises and those into early stage of development, the financing from external sources can be particularly problematic. Although the founders of the new entity may be able to finance the initial activities, for them it becomes increasingly difficult to finance capital projects. The reason for this is the consideration that SMEs are riskier than large companies in a few things. As most common determinants of this problem are mentioned the lack of business history i.e. the lack of references for long-term business references, lack of funds which can serve as collateral and rarely have assets which can serve as a guarantee to the investor for the received funds, they commonly employ well trained and experienced management because in the early stages of development they use so-called management of one person - the owner which has general knowledge and limited authority and responsibility, they produce just one or have only several products in their production programme which are into phase of an occurrence that hinders the use of risk diversification principle (Kitchen, 1989).Because of this, the access of SMEs to various sources of funding, are the more rigorousand limited conditions for obtaining them, and the process of evaluation by investors in such enterprises is with a higher degree of risk. The potential investors primarily prefer to invest in already established companies with more experience in the industry where they invest (Shane,2003). Also it is noticeable that investors would accept funding ventures which achieved remarkable competitive advantage through intellectual property protection, rather than evaluating the ability to operate hard.(Bhide 2000.)

Due to such problems, as dominant and primary source in investment projects in SMEs is the self-funding, while as an additional source are used the credit lines of the banking sector for financing of these enterprises. In addition they rarely decide to access funds from some specialized financial institutions.

Determinants of implementation of the financial management

Apart from above mentioned determinants, in the process of making investment decision in small and medium enterprises, another group of determinants arises from the internal characteristics of the company. This group primarily arises from the implemented financial management techniques in SMEs or from the various aspects of their financial management. The characteristics of management of SMEs is that, first, the owner of these enterprises acts as manager of the company, second, the owner-manager manages the business and they lack with management body, and third, in these enterprises in their early stages is created so-called one-person management, frequently the owner with general knowledge which are not specialized. This frequently leads to lack of planning within small and medium enterprises. As most common reasons for this are (Scarborough,.Zimmerer and Naumes, 1991, p.52): lack of expertise with managers due to lack of particular abilities arising from the smatter knowledge of practical experience for investments decision which is directly correlated to the past experience, training, education and ownership of appropriate skills; inability to start with investment because of the lack of knowledge where to start from; dealing with many uncontrolled and untouchable variables which increase the uncertainty of planning; lack of time because they are mostly dedicated to everyday problems; lack of energy due to concentration on daily activities and misunderstanding of the importance of strategic planning. Such characteristics lead to situations where the owner-manager brings wrong financial decisions which consequently leads to enterprise failure. That means that these enterprises don't hire competent personnel acknowledged with the issues and technique of financial management, in particular the investment management.

Likewise there is an overlapping of the entrepreneurship and managerial function in a same person. Such condition can negatively influence the efficiency of the financial management as a consequence of inappropriate competence and expertise to these persons for making investment decisions. The owner-managers are not professionally trained to use of all techniques and methods of financial analysis of the investment projects. As a result, the investment decisions would be brought based on incomplete and non-complex research of all relevant assumptions for the particular investment project. Such approach canforce the objectives of the owners that would lead to questioning on the adequacy and the preparation of investment decision and its final choice.Namely, the preparation of the investment decision means engaging of an appropriate management team comprised of individuals who would have different management skills, instead of having all these skills into one individual. Several research studies show that significant for the success and growth of companies is whether they have individuals with an appropriate skills. (Deakens, Mileham, P. And O neill, 1998).

All these influences of external and internal determinants of the process of making investment decisions at small and medium enterprises would lead to incomplete operation of their business, continuous and specially documented, which would reflect toward the application of certain investment activities.

Such business entities have possibility timely to anticipate the unpredictable environment, to research and evaluate investment more actively as ways for exploring of the market changes. These enterprises are usually more successful and should be a role model for the other managers of small enterprises which would like to advance, but due to various reasons are abandoning or partially are implementing the necessary activities in the preparation of investment decisions.

Metodology

To give a new perspective to this issue, an survey of small businesses was conducted during the period of May to August 2016. The sample consisted of 120 small firms in Relagonia region. During the research period 93 valid questionnaires were obtained. The questions were divided in three groups.The first part of the survey includes the analysis of the firm and key problems with strating business and financial source. The second group of questions intends to determine the type of investment they have made and responsible person/s for making investment decisions. The third part of the study examines the impact of selected factors on investment decisions.

Descriptive statistics of the research

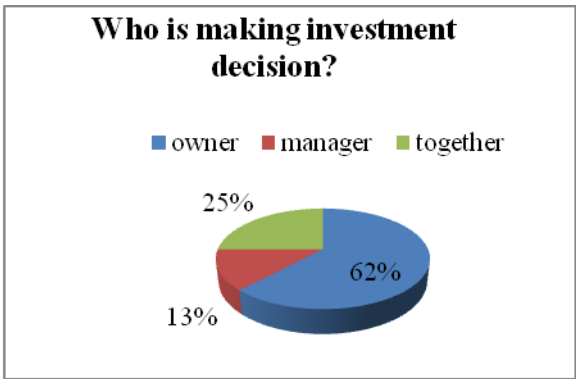
Based on the analysis of data from the first group of questions were obtained the following results:

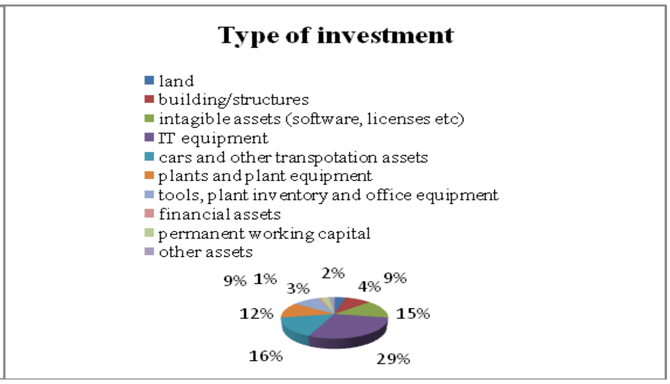
- From the surveyed businesses, 46 were established before 2000, and 47 have been established in 2000 which shows that approximately the same surveyed enterprises over ten years and companies that have formed over the past ten years. Most of the respondents ie 43% are small businesses, 30 micro and 27% of medium businesses.
- On the question: "What sources of funding have used in starting business", 59% used personal savings, 15% used credit 7% borrowing from relatives or friends, 10% personal savings and loans from relatives and friends, and 9% They used other sources.
- The most of the respondents have 59% used personal savings for starting business, 15% used credit 7% borrowing from relatives or friends, 10% personal savings and loans from relatives and friends, and 9% used other sources.
- the question *"What were the main problems that you face when starting a job*?", 19% cited lack of capital, 16% complex legislation, 15% of the high costs, 13% location, 12% gaining confidence among customers, 9 % shortage of working capital, 7% receiving loans, 6% of lack of experience, 3% problems with suppliers,.
- To the "*What are the most important issues in the running of your business*," 16% of respondents said taxes, 5% inflation, 10% weak sales, 32% recovery, 10% interest rate, 6% workers 11% regulations, 10% competition.

While, the second group of issues were related to investment decisions of businesses.

To the question „Do you plan the investment in future“ 81 % of the respondents sayed that they plan to expand their business, it confirms that small and medium-sized businesses inPelagonia Region have great potential for creating new jobs in the community and alleviate the problem of unemployment.

The analysis of 6 and 7 question gives the following results: 62 % of respondent responded that the owner is making investment decision, 13% the manager and 25% together the owner and manager. Usually SMEs invest in IT equipment (28%), cars and other transportation assets (15 %) and 12 % of respondents invest in plants and plan equipment.



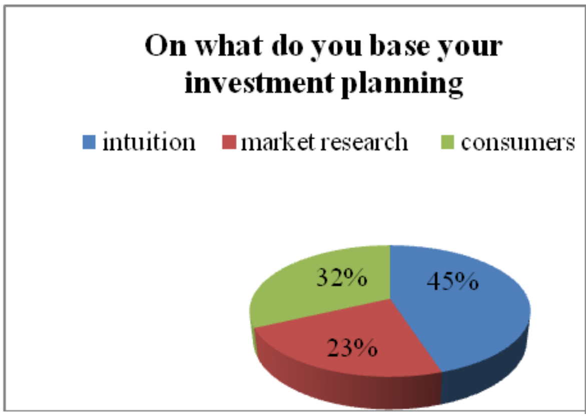


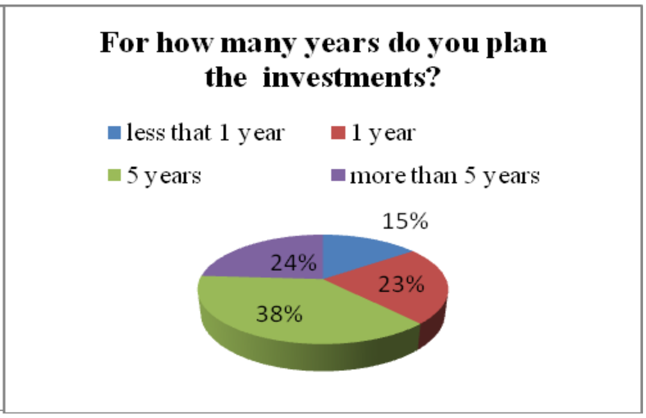
The question „On what do you base your investment planning ", has given the following result: 45% make the decisions based on intuition, 32% according to consumer and 23% through market research.

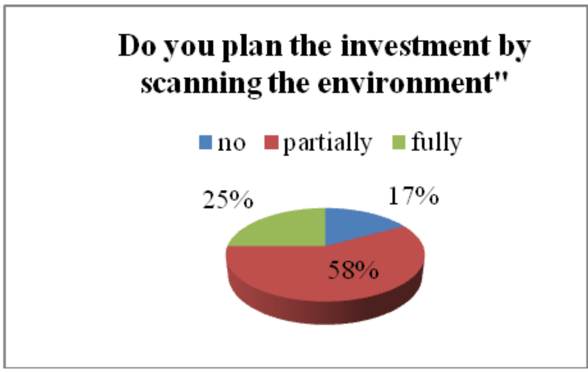
Considering the answers of the question it can be concluded that the most of the respondents i.e 38% plan the investment for 5 years, 24% for more than 5 years, 23% for one year and 15% for less than 1 year.

In order to see whether the environment affects to the planning of investments we asked the respondent the following question: "Do you plan the investment by scanning the environment" and the results are: 17% of respondents sayed no it means that they don't scan the environment , 25% with fully and 58% partially.

And on the question "Do you make a business plan or investment study before investment planning?, 39% of the respondents answered partially, 37% said no and 24% answered with fully.







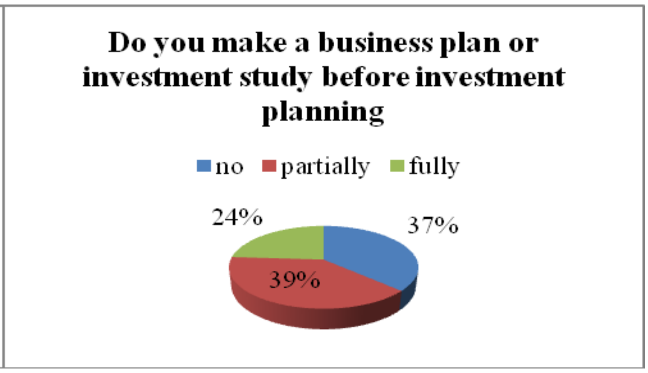


Table 1.

How do you evaluate (from 1-5) the influence of personal characteristics on investment decision					
	1	2	3	4	5
Who is making the investment decision manager/owner	6	9	16	37	25
Knowledge about the procedures for investment decision	7	8	10	42	26
The experience for making investment decision	5	7	10	47	24
Knowledge of procedures for making business plan or investment programme	3	2	10	24	54
Knowledge of methods and techniques for making investment decision	5	9	7	20	52

The next set of questions is related to the determinants of investment decision. Enquiries from Table 1 are based on the influence of personal characteristics on investment decisions and respondents were able to evaluated them by marks from 1-5. The results are shown in Table 1.

As can be seen from the results, the most of the respondents hightly have rated the following determinates: knowledge of procedures for preparing business plan and investment progaramme and knowledge of methods and techniques for decision-making.

As can be seen from the results the key determinates which have an influence of financing problems to investment decision are access to finance and knowing the techniques for calculating capotal cost.

Conclusion

From the preiviuous it can be concluded that Illiquidity of securities of SMEs, problems related with the exact calculation of the cost of capital, and limited access to other sources of capital in these enterprises are the main determinants for impeding and complicating the process of evaluating the financial efficiency of investment.

With that the process of making investment decision is less certain, more complicated and that lead to danger the efficiency of operation and the future development of the company. If SMEs are more focused on strategic planning and the process of investment decision, despite determination of multiple external or internal factors, they would increase the chances of success in the future and their own development.

Such business entities have possibility timely to anticipate the unpredictable environment, to research and evaluate investment more actively as ways for exploring of the market changes. These enterprises are usually more successful and should be a role model for the other managers of small enterprises which would like to advance, but due to various reasons are abandoning or partially are implementing the necessary activities in the preparation of investment decisions.

Table 2

How do you assess the influence of financing problems to investment decision (from 1 to 5)					
	1	2	3	4	5
Access to finance	3	7	11	14	58
Knowing the conditions for financing from other external sources	2	5	41	21	24
The problems with the calculation of capital cost	5	6	13	41	28
Knowing the techniques for calculating the cost of capital	3	8	15	24	43
Knowing the shareholding as a possible source of financing	8	5	9	43	28

As a result of the above mentioned we would like to cite the following recommendations:

- Increased representation of the formal planning of investment activities. The needs for making investment decisions as projection of the future inflows and outflows of funds impose the need for appropriate documentation of those cash flows.
- Acquisition of greater knowledge for financing of investments from an external sources of funding.
- Improved knowledge about the procedures for making investment decision and gaining of an experience.
- Application of wide range of investments criteria when evaluating of investment decisions and gaining knowledge of the techniques and problems in calculating capital cost.
- Planning of investments based on quality and effective scanning of the business environment factors, because in contrary the investment ambitions range only in the limits for smaller results, where their main concern becomes how to survive and not how to be developed.

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