

Chapter 10

Financial Innovation in Medium-Sized Enterprises Optimizes Their Gravitation Towards Capital Markets: Financial Future in Perspective

Milan B. Vemić

Higher School of Academic Studies “DOSITEJ”, Serbia

ABSTRACT

A major problem for medium enterprises is ensuring that their financial management exercises prudence in the attraction of alternative sources of financing in transition into middle tier, larger enterprise status and towards stock exchange. Difficulties in attracting capital, the high cost of bank credit, absence of robust financial and business information reporting capacities may represent obstacles. One partial solution is capacity development for access to stock exchanges and having these institutions with a strong allocation capacity to efficiently finance these businesses. Though underdeveloped in transition economies, they are potentially important institutions in successful financial performance of businesses. In a review of conditions for handling risk and uncertainty, developing capacity for access to stock exchanges through working capital combinations, this treatise demonstrates that medium enterprises could benefit from this approach. Regulatory reforms to facilitate the use of stock exchange financing and well-designed financial management models are recommended.

INTRODUCTION

Modern Small and Medium-sized Enterprise (SME) finance theory is unique in two respects. First, it incorporates sources of finance that differ completely from stage to stage of development in the firm life cycle which is both a constraint and an opportunity. Second, the role of exchanges and innovative sources of financing is much less pronounced than that required in corresponding problems of medium

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size enterprise financing. As a result, there has been a predisposition to suboptimal level of financing and financial market development. In this chapter, special emphasis is placed on developing the guiding financial principles that are useful not only to apply our ideas to a new SME problem, but also when we wish to discern the general properties of financial markets without performing complicated mathematical calculations. The development of special techniques of mathematical combinations in finance to obtain quantitative outcomes in complex financial problems is, however, also necessary. It is, therefore, assumed that the reader is reasonably familiar with basic concepts of advanced mathematics.

Following the elaboration of sources of finance as a factor of growth of medium enterprises, significant amount of attention is given to the steps by which exchanges could get involved in this process. Here, the determinants and risks are discussed that might lead not only to replacement but rather correspondence of different alternative sources of finance. Therefore, the practical and theoretical SME finance developments are presented in such a way as to point out this interconnection and to demonstrate that each new source of finance is either based on growth or innovation or else follows logically from the previous stage of development in the firm life cycle. In this manner, SME finance theory can be made to seem less like an odd and perhaps inconsistent recipe. An integral part of the author's concept for conceiving the theory on a basis that is not too abstract for practitioners includes an extension and completion of certain ideas on existing sources of finance and financial innovation. Moreover, following the discussion of potential financial innovation indices, broader financial innovation in the development of medium-sized enterprises is portrayed as an opportunity for their growth. Also discussed are some of the mathematical implications of SME finance theory showing that these might lead to a fascinating improvement in the proposed specific approach to medium enterprises as compared with that suggested by the general SME approach. The reader will notice that a proposed codification and typology of these modifications derives from this attempt to solve the problems of financing. The most significant benefit of this diversification is that it makes the reader think more specifically about the subject of medium size enterprise financing, thus furthering his comprehension of these businesses. Indeed, it is also hoped that the reader will thereby find help in the supplementary texts referred to throughout the different parts of this chapter.

BACKGROUND ON ACCESS TO FINANCE AS A GROWTH OPPORTUNITY FOR MEDIUM-SIZED ENTERPRISES

The author recognizes that various countries define SMEs differently and that cross comparison can be difficult. Medium-sized enterprises are defined as enterprises that employ fewer than 250 persons and either have an annual turnover that does not exceed EUR 50 million, or an annual balance sheet not exceeding EUR 43 million, which follows the European definition (European Commission, 2015a, p.11). The precise definition however, does not impact the overall findings of this treatise.

Compared to small firm financing medium-sized enterprises should be less risky due to lower levels of perceived risk and uncertainty. This is followed by their greater investment readiness. Although the standard measure of risk is the value of variance in relation to expected return (Eales, 1995, p.15) the basis for above is author's resource based view of a stronger financial base and market share of medium-sized enterprises.

Likewise, medium firms hesitate less in accepting qualified non-financial and more advanced management consultancy services that reduce the impact of risk. These independent and objective high-quality

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