Project Agreement number 2022-1-MT01-KA220-ADU-000086969
Financial Skills foR busiNEss Startups Smes - FAIRNESS

MODULE No: 4

Responsible Partner: Vernian RTI

Title of the Module: Access and use of level financial products

Module Title	**M4: Access and use of medium level financial products**
EQF-Level	**4**
Duration	**6 hours**
Unit 1 Title	**Introduction to medium level financial products**
Learning objective	The learning objective of Unit 1 is to clarify the terminology and definitions regarding medium level financial products, what products are considered as medium level and the importance of medium level financial products. To comprehend the relationship between medium level financial products and the financial stability these products provide to an SME and how medium level products help ensure an SME's existence.
Knowledge	The learners will comprehend the different terms and definitions involving medium level financial products, the different categories of these products and how important these products are to an SME. To comprehend the relationship between medium level financial products and the financial stability these products provide to an SME and how medium level products help ensure an SME's existence.
Skills	The learner will be able to analyse and interpret medium level financial products (loans, grants, guarantee schemes, venture capital). The learner will be able to explain the differences between the products and when each product can be used. The learner will be able to state the advantages and disadvantages of each product. The learner will be able to analyse the importance of medium level financial products, how these products help SMEs to overcome funding constraints and how the use of medium level products ensures an SME's survival.
Competence	The learner will have the capability to effectively recognise what medium level product is more suitable in any case. The learner will have the capability to effectively analyse financial information regarding medium level products to make informed

	business decisions, aligning strategies with financial realities. The learner will have the capability to communicate financial information to all interested parties, addressing their unique information needs and concerns.
Further information	Links, books, papers etc. *Please insert all relevant sources, which you have used for this module(to be completed in later stage)*
Unit 2 Title	**What the research has shown us**
Learning objective	The learning objective of this unit is to understand the results and the analysis of the questionnaire.
Knowledge	The learner will acquire knowledge as to how the participants of the questionnaire classify financial products regarding the financial stability (short term, medium term, long term) that financial products provide to an SME.
Skills	The learner will be able to analyse and interpret medium level financial products (loans, grants, guarantee schemes, venture capital). The learner will be able to explain the differences between the products and when each product can be used. The learner will be able to state the advantages and disadvantages of each product. The learner will be able to analyse the importance of medium level financial products, how these products help SMEs to overcome funding constraints and how the use of medium level products ensures an SME's survival.
Competence	The learner will have the capability to effectively recognise what medium level product is more suitable in any case. The learner will have the capability to effectively analyse financial information regarding medium level products to make informed business decisions, aligning strategies with financial realities. The learner will have the capability to communicate financial information to all interested parties, addressing their unique information needs and concerns.
Further information	Links, books, papers etc. *Please insert all relevant sources, which you have used for this module(to be completed in later stage)*
Unit 3 Title	**Information on how to apply for medium level financial products**
Learning objective	With the completion of this unit, learners will develop a comprehensive understanding of all the requirements for applying for medium level

	financial products, where and how to apply/acquire each product and the benefits and risks associated with medium level financial products.
Knowledge	The learner will be able to state the basic requirements apply for an SME to be eligible for funding. The learner will be able to state where and how an SME can apply for each of the different type of medium level financial products. The learner will be able to state the needed steps an SME must follow to be eligible for different types of funding. The learner will be able to identify the benefits and risks associated with each medium level financial product.
Skills	The learner will be able to state the basic requirements apply for an SME to be eligible for funding. The learner will be able to state where and how an SME can apply for each of the different type of medium level financial products. The learner will be able to state the needed steps an SME must follow to be eligible for different types of funding. The learner will be able to identify the benefits and risks associated with each medium level financial product.
Competence	The learner will be able to state the basic requirements apply for an SME to be eligible for funding. The learner will be able to state where and how an SME can apply for each of the different type of medium level financial products. The learner will be able to state the needed steps an SME must follow to be eligible for different types of funding. The learner will be able to identify the benefits and risks associated with each medium level financial product.
Further information	Links, books, papers etc. *Please insert all relevant sources, which you have used for this module (to be completed in later stage)*
Unit 4 Title	**Internal Structure Analysis**
Learning objective	With the completion of this unit, learners will develop a comprehensive understanding of what are the various factors that can affect an SME's ability to secure funding, what are the different types of internal/business structure and what are the requirements for each structure type to acquire a medium level financial product.
Knowledge	The learner will be able to analyse the different types of internal/ business structure types. The learner will understand how the business structure of an SME can determine the activities that it can undertake. The learner will gain knowledge on how the type of internal structure

	affects the SME's responsibility for financial obligations. The learner will be able to analyse what are the requirements for each structure type to acquire a medium level financial product.
Skills	The learner will be able to analyze the different types of internal/ business structure types. The learner will understand how the business structure of an SME can determine the activities that it can undertake. The learner will gain knowledge on how the type of internal structure affects the SME's responsibility for financial obligations. The learner will be able to analyse what are the requirements for each structure type to acquire a medium level financial product.
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Further information	Links, books, papers etc. *Please insert all relevant sources, which you have used for this module (to be completed in later stage)*

Introduction

General Overview

SMEs are considered to be the driving force of the economy both at national and european level. They play an important role in contributing to the country's GDP, in creating new jobs and in boosting innovation and competitiveness. However, their survival is not easy. To ensure its existence, an SME must be able to keep up with the continuously changing competitive environment. Modernising production processes, adopting advanced technologies, data utilisation, innovative products and services and various collaborations are some of today's requirements an SME must adopt. All these actions require funds. Often, SMEs are having difficulties in receiving funds from banks due to various factors that affect their credit capability and medium level financial products help them to obtain the funds they need. To overcome these funding constraints, SMEs must undertake alternative financial products – medium level financial products.

Financial products or financial instruments are products provided to businesses and individuals by financial institutions, such as banks and investment/ finance companies, to meet their financial needs.

There are different funding opportunities available for SMEs. What is important is to define which one is best suited for each type of SME and what is the best option of funding to cover their needs taking in consideration each product's benefits and risks.

Objectives of the Module

This training module offers a comprehensive overview on medium level financial products. Participants will gain a deep understanding of the key concepts, features, and benefits associated with these products. The module covers various aspects, such as description of the products, information as to how to apply and acquire them, as well as the benefits and risks associated with each product. Participants will also learn effective strategies for utilising medium level financial products and how to navigate financial challenges to avoid default.

TOPIC 1:

Title of Topic 1

Introduction to medium level financial products

Main point 1.1. Title

Medium Level Financial Products: Terminology and Definitions

1.1Main Content

Financial products or financial instruments are products provided to businesses and individuals by financial institutions, such as banks and investment/ finance companies, to meet their financial needs.

Financial products are usually a contractual agreement between two parties that determines the terms and conditions of their financial relationship for a pre-defined period of time. Products that provide access to capital and funds and are registered as financial products are bank loans, bank overdrafts, public grants, capital market equity, capital market bonds, venture capital, guarantee scheme and crowdfunding.

According to the duration of financial stability that these products provide to an SME, they are classified in three categories: short – term, medium – term and long – term products. Financial stability is the ability that an SME has to endure various problems that may occur. In other words, is the ability to maintain a steady income while avoiding debt.

No formal definitions regarding the duration of the financial stability that financial products provide exist, however, short – term financial stability usually refers to a period shorter than two years, medium – term refers to a range between two to five years and long – term covers a period longer than five or ten years.

Financial products that provide short – term stability are typically used to cover short – term needs such as cash flow fluctuations, material and inventory purchases, payroll, payment of trade credit and taxes. Medium – term financial stability products are usually obtained for expansion or growth of the company by machinery, equipment and vehicles purchases whilst long – term financing products are used for higher expenditure expenses such as land, buildings, and assembly lines purchases.

Main Point 1.2 Title

What products are considered as medium level

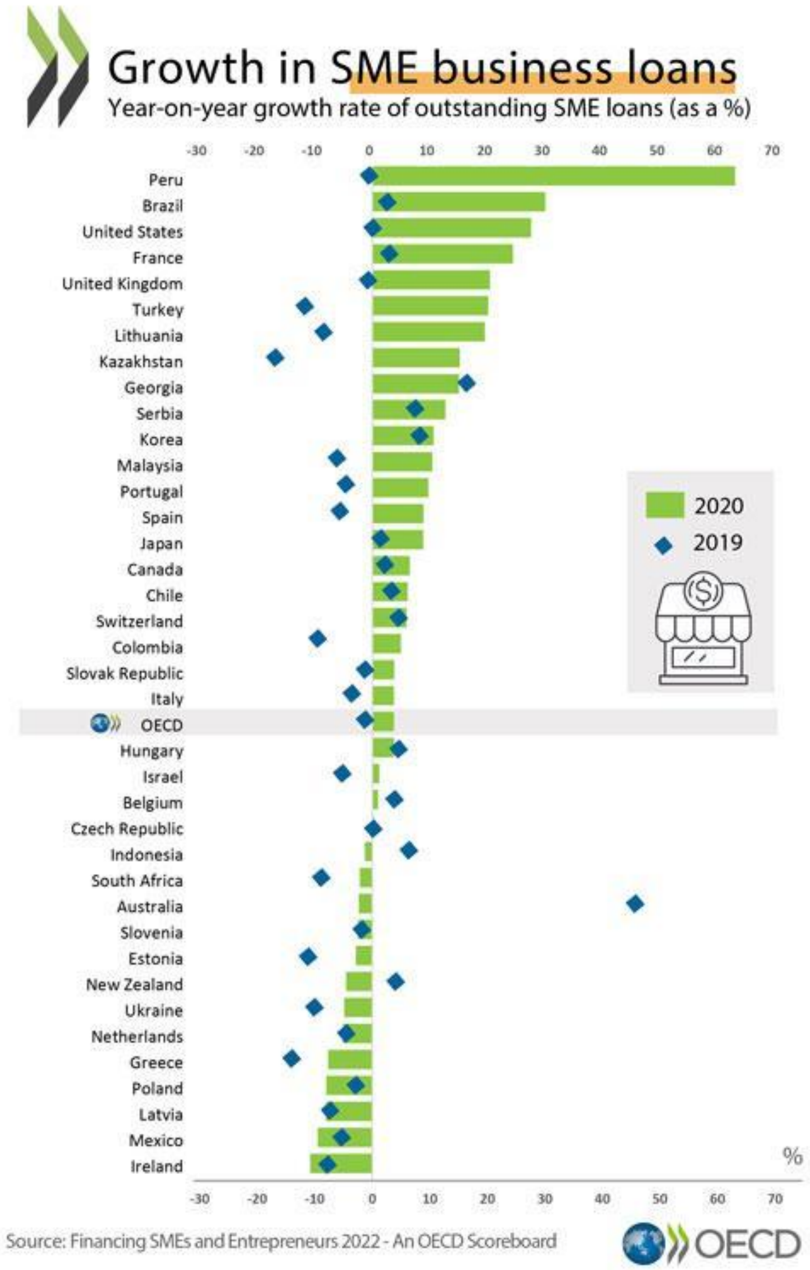
1.2. Main Content

Medium level financial products are defined as the products that provide the needed financial resources to an SME to cover its medium – term needs. These funds are mainly used for lower capital expenditure expenses such as purchases of equipment and machinery, vehicles, computer and software, office furniture and office equipment.

Medium – term financial products usually refer to a period range between two to five years and are considered as a good funding option for an SME as they balance risk and return. Medium – term financial stability products are loans, grants (public, EU, national) venture capital and guarantee schemes.

- **Loans**

Loans are the most common form of funding for an SME. According to the "Financing SMEs and Entrepreneurs 2022: An OECD Scoreboard", loans obtain by SME have increased significantly during the first year of the Covid – 19 pandemic. The median stock of SME loans increased by 4.9%, the highest upturn registered since the OECD Scoreboard was created 10 years ago.

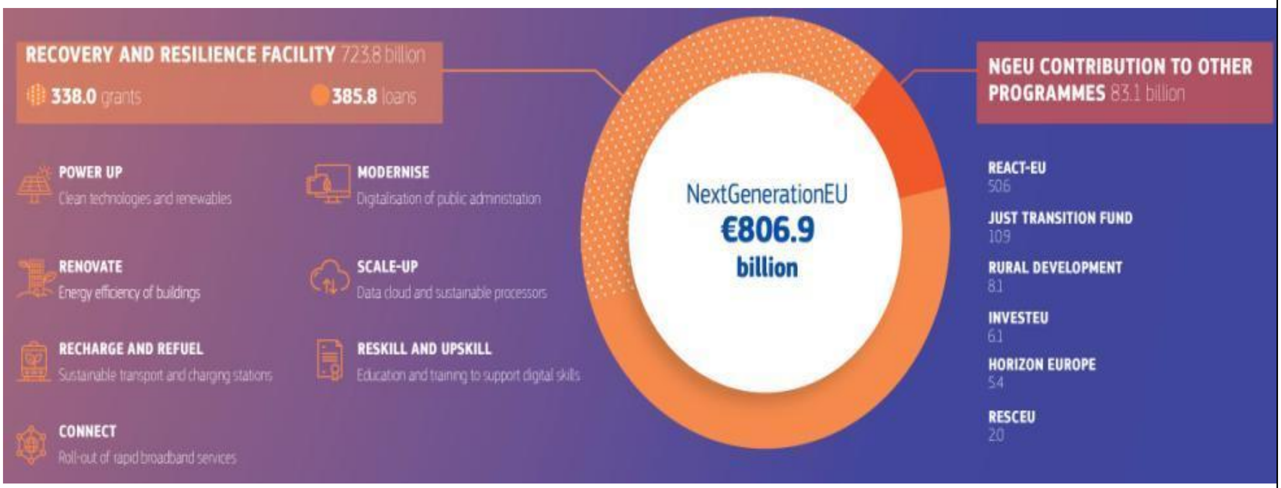


Loans can have short, medium or long – term repayment periods depending on the type of loan, the owner's needs and the financial institute providing the loan. One of the benefits of obtaining a medium – term level loan is that the repayment terms and conditions can be adjusted to the ability of the SME to repay the loan. This can be very useful for an SME especially if the company decides to invest in new projects or initiatives or if it experiences income variations.

Medium – term loans provide to SMEs the ability to purchase equipment and machinery, leading to the improvement of their productivity, growth, and competitiveness. These types of loans are also used for purchasing computer equipment and software, thus improving processes and methods which will eventually lead to improved efficiency. Proper loan handling can lead to increased market share, to the development of new products and services and the creation of new job opportunities.

- **Grants – Public, EU, National**

Most of the time, a grant is financial assistance given to businesses or individuals by the government to encourage investment, employment, and economic growth. Grants may be also given by various organisations and foundations to serve different purposes such as research and development, education, innovation, art, economic growth, or environmental purposes. Grants are considered as a medium – term financial product due to the low risk they present.
One of the biggest advantages of grants is that, unlike loans, they are not repayable and can be used to fund projects and initiatives that otherwise could not be funded. However, grants must not be considered as gift money, since they are given on a competitive basis with no guarantees that the applicant will receive the grant.
In their efforts to support and to strengthen the competitiveness of SMEs, governments often announce grant schemes for various sectors of the economy. These grants may apply for start – ups, expansion of the existing business, education of human resources and developing new products and services.
Additionally, grants given by the European Union are often available to SMEs. The purpose of EU grants is to finance projects and initiatives that support EU's target goals. Usually, EU grants cover a broad range of projects such as research, education, innovation, humanitarian aid, social inclusion, environmental development etc. Some of the grant programs of the EU are the Erasmus+, EU4Health and Horizon Europe.
According to NextGenerationEU, as shown below, European Union has included in its budget up to **€338 billion** that will be provided to Member States in the form of grants.



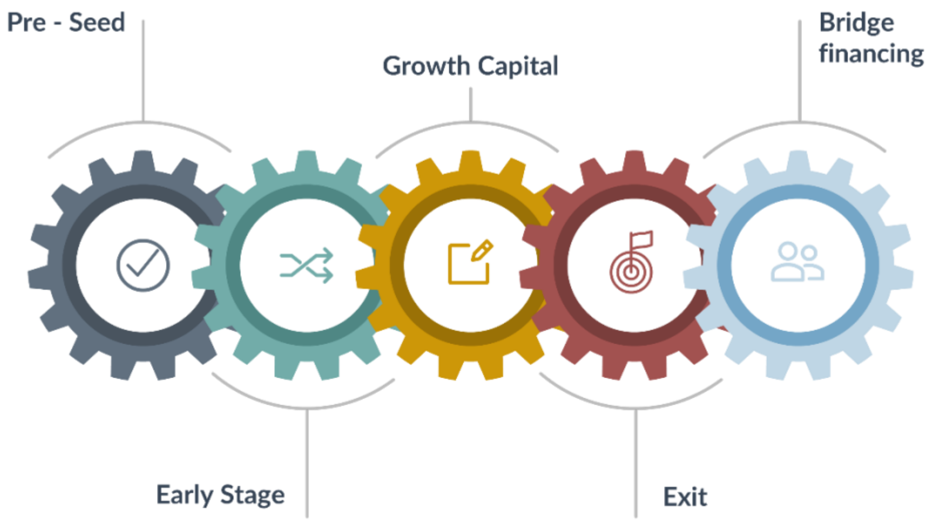
Source: NextGenerationEU (europa.eu)

- **Venture Capital**

Venture capital is money invested in a business, usually a start-up, that investors see it as having strong growth potential. Usually, other financial institutions, such as banks, are not investing in these SMEs start – ups due to the high risk they present.

According to Wikipedia, the financing stages of venture capital are:

1. Pre – seed funding: The funds that allows an idea, a new product or a business plan to be developed
2. Early stage: Funds are used for product development and initial marketing strategy
3. Growth capital: Larger financing rounds than the previous stages. The SME has completed the product development stage and needs additional funds to prove traction and re-risk the investment.
4. Exit of the venture capitalist: The SME has reached a steady growth rate and has achieved its milestones. The venture capitalist can exit through a secondary sale such as an initial public offering or an acquisition.
5. Bridge financing is when a start – up is asking for funding between full venture capital rounds. SMEs use bridge financing to "bridge" the gap that is created when current funds are expected to run out prior to planned future funding.



A start – up SME can utilise the venture capital market to set up its manufacturing/ production operations, to design and develop its products and to set up its sales and marketing strategy. Moreover, using this capital, SMEs can hire and/ or educate their employees, meet customer needs and develop their business model so that they achieve high – growth.

- **Guarantee schemes**

SMEs remain vulnerable to rising costs, reduced revenues, managing funds, shortage of employees, unexpected disasters and unpredictable pandemics! All these may damage their credit capability making them unable to provide security as collateral for bank loans. In such cases, guarantee schemes are suitable for these businesses.

According to the European Association of Guarantee Institutions a guarantee scheme is defined as "A guarantee provided by a guarantee society on behalf of the SME to the bank replaces this missing collateral and enables the bank to grant the loan. In essence, the guarantee is a financial commitment by the guarantee society to repay up to a certain percentage of the loan to the financial institution in case the SME customer should not be able to honour his payments."

Guarantee schemes can be generated by the government or other private financial institutions and companies. These schemes are considered beneficial for SMEs since they provide the capital an SME needs to grow, expand and achieve financial stability.

Main Point 1.3 Title

Importance of Medium Level Financial Products

1.3. Main Content

SMEs are considered to be the driving force of the economy both at national and european level. They play an important role in contributing to the country's GDP, in creating new jobs and in boosting innovation and competitiveness. According to the European Commission, **SMEs "represent 99% of all businesses in the EU and they employ around 100 million people and are accountable for more than half of Europe's GDP. They are essential to Europe's competitiveness and prosperity, industrial ecosystems, economic and technological sovereignty, and resilience to external shocks."**

However, their survival is not easy. To ensure its existence, an SME must be able to keep up with the continuously changing competitive environment. Modernising production processes, adopting advanced technologies, data utilisation, innovative products and services and various collaborations are some of today's requirements an SME must adopt. All these actions require funds. Often, SMEs are having difficulties in receiving funds from banks due to various factors that affect their credit capability and medium level financial products help them to obtain the funds they need. To overcome these funding constraints, SMEs must undertake alternative financial products – medium level financial products.

Medium level financial products are a key factor for SMEs funding and survival and can be used in various ways:

1. Financing a start – up
2. Access to capital that otherwise couldn't be obtained
3. Expanding existing premises
4. Investing in new projects and initiatives
5. Obtaining new equipment
6. Creating new job opportunities
7. Hiring new employees
8. Educating existing employees
9. Improving processes and methods
10. Developing new products and services
11. Improving efficiency
12. Improving credit capability
13. Increasing market share

TOPIC 2:

Title of Topic 2

What the research has shown us

Main point 2.1 Title

Description of the research

2.1 Main content

A questionnaire was sent to participants from different business sectors and different countries, asking them to classify the financial products by the duration of the financial stability that they provide. The question used was "Which of the following products will mostly provide a) short term, b) medium term or c) long term, financial stability?"

The products included in the questionnaire were:

- bank overdraft,
- bank loan,
- public grant,
- capital market equity,
- capital market bond,
- venture capital,
- guarantee scheme and
- crowdfunding.

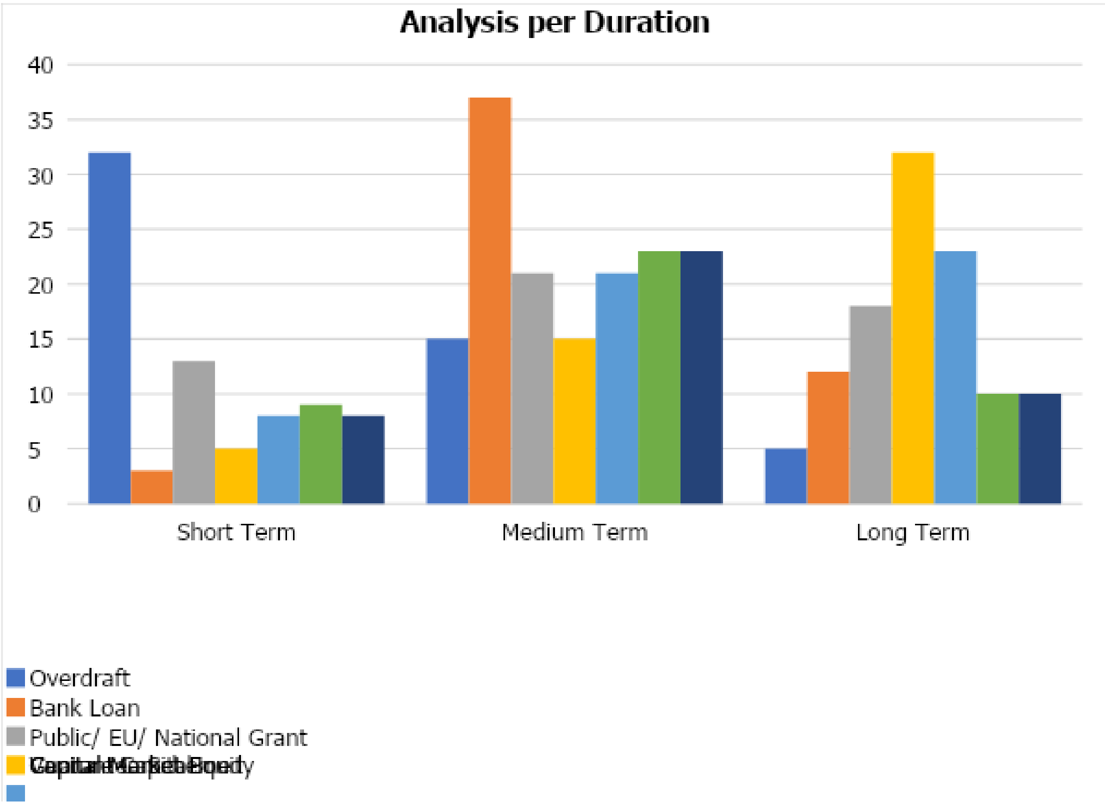
The countries participating in the questionnaire were Austria, Bulgaria, Cyprus, Italy, and Malta and participants came from the following business sectors:

- Academia and Education
- Banking and Credit Institutions
- Business Support Associations
- Capital Market Institutions
- Financial Advisors
- Management and Corporate Advisors
- National and Regional Bodies
- Other

Main point 2.2 Title

Research analysis

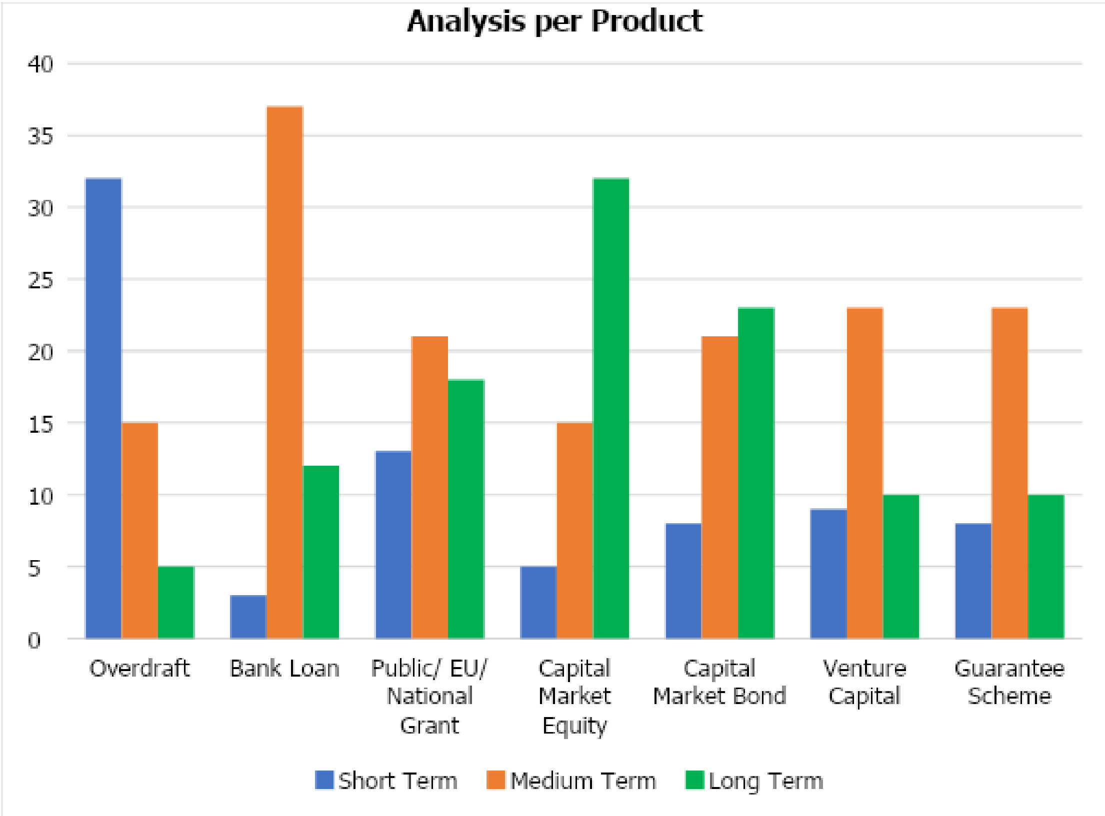
The following graph shows how the participants have answered regarding which of the following products will mostly provide a) short term, b) medium term or c) long term, financial stability.
Overdrafts are mostly thought to provide short – term financial stability, bank loans, grants, venture capital and guarantee schemes provide medium – term financial stability while capital market equity and bonds provide long – term financial stability.



Indeed, overdrafts provide short – term financial stability and are especially practical for SMEs that the scope of their work is seasonal or by contracts and payment is on completion of each project. Overdrafts can be used to pay wages, buy inventory, or pay rent. However, overdrafts and short – term loans may have higher interest rates which worsen the cash flow problem and create debt traps.
As mentioned in the previous section and as shown in the above graph, bank loans are top ranked as a product that provides medium – term financial stability. Loans facilitate financing projects in any sector. Some of the risks that an SME may face in taking up a loan is that interest rates, fees or penalties can be higher than alternative financing methods, there is an additional monthly payment in the company's budget and most importantly there could be potential credit damage in case of repayment failure.
Capital market equity has been selected by the participants as the financial facility that provides the long – term financial stability to an SME. Usually, SMEs use equity to raise capital to invest in projects, fund other business operations and purchase assets. Equity financing means that the SME

does not have a loan to repay therefore no monthly payment which means more available funds to finance other business ventures. Additionally, equity does not require interest payments, however, the greatest risk of it is the ownership dilution. Ownership dilution may occur when there is a reduction in the percentage of existing shareholders' ownership in a company when it issues new shares of stock.

The following graph shows how the participants have marked each financial product according to the duration of financial stability it provides.



Overdrafts are top ranked as a short – term financial stability product whilst banks loans, grants, venture capital and guarantee schemes as medium – term financial products. Capital market equity and bonds are categorised as long – term financial stability products. Equity and bonds are considered long – term products since they generate noteworthy returns in the long run.

TOPIC 3:

Title of Topic 3

Information on how to apply for medium level financial products

Main point 3.1 Title

Requirements for applying for medium level financial products

3.1 Main Content

The requirements for applying for medium level financial products vary depending on the product, the financial institution, and the regulatory system of each country.

However, some basic requirements apply for an SME to be eligible for funding:

1. Business and personal credit scores: A business creditworthiness measures its business credit score, and it consists of various factors to determine the level of its financial risk in relation to its financial position. On the other hand, personal credit score shows an individual ability to repay personal debts. The lowest the credit score, which implies low risk, the easiest is to apply and obtain financial aid.

2. Business plan: A well-structured and detailed business plan, stating the need for funding as well as the strategy to increase revenues using these funds, will encourage lenders to provide the needed capital.

3. Annual revenue statement: A clear statement of the company's annual revenue, which shows the income that the company receives from sales, products, assets and interest during a fiscal year, demonstrates the company's ability to repay any loans.

4. Collateral or personal guarantees: For an SME to qualify for a loan, it must present collateral to the lending financial institute, usually a high value asset such as equipment or land, so that in case of the SME's inability of loan repayment, the financial institute can seize and sell the asset.

5. Business registration: A business license shows that the SME is a legitimate entity.

Furthermore, to the above-mentioned basic requirements, more documents may be needed regarding the business size and sector, the number of years that the company is operating, legal agreements and other financial documentations.

Main point 3.2 Title

Where and how to apply/acquire each product

3.2 Main Content

There are different funding opportunities available for SMEs. What is important is to define which one is best suited for each type of SME and what is the best option of funding to cover their needs. SMEs can apply to different financial institutions to obtain fundings. Such institutions are central banks, commercial banks, investment companies, retail banks, credit unions, mortgage companies and loaning associations.

- **Loans**

One can apply for loans in various places such as banks, credit unions, government agencies, non – profit organisations both at national and European level.

According to someone's personal or business needs, there are different types of loans. Individuals may apply for student loans, housing loans, auto loans, mortgage loans and personal loans.

On a business level, there are many types of loans where each one is designed for specific purposes. According to Forbes, some of the types of business loans are:

1. SBA Loans: SBA loans are loans that are guaranteed by the US Small Business Administration (SBA). Because these loans are partially guaranteed by the government, they present lower risk and which makes it easier for SMEs to qualify for. SBA loans can be used for start – ups, business expansion, land and premises purchases etc. The basic procedure an SME must follow to apply for an SBA loan is to choose the type of SBA loan that is best suited for the SME, to find an SBA Lender (usually banks) and to prepare and submit the SBA application.

2. Term Loans: Term loan is a loan that is given for a fixed period of time and must be repaired in regular instalments. There are short – term, intermediate – term and long – term loans and are provided by banks, online lenders and credit unions. To apply for a term loan, an SME must prepare and submit the loan application, present the needed financial documents (as mentioned in 3.1), undergo the credit analysis that will be done by the lender and wait for the loan approval/ disapproval.

3. Short – term Loans: Short – term loans are given to SMEs to cover a temporary business need and mostly are provided by online lenders and sometimes banks. The procedure for applying for a short – term loan is the same as mentioned above.

4. Startup Loans: These loans are obtained by SMEs that their operating cycle is less than a

year and are used to startup a business or expand an existing one. Due to the high risk that start – ups SMEs present, these types of loans are primarily provided by online business lending companies. The procedure of obtaining a startup loan is the same as other loans, except that the procedure is not so time consuming.

5. Microloans: Microloans are small amounts of money lent to a new business at low interest rates and are mainly used for purchasing machinery, equipment, supplies and inventory. Microloans are offered by microlenders who each have its own application procedure.

6. Working Capital Loans: A working capital loan is a loan that is used to cover SMEs daily operations. Working capital loans are offered by financial institutions and online lenders and the procedure of obtaining a loan is the same as mentioned above.

- **Grants – Public, EU, National**

Grants are given by various organisations such as public bodies, institutions, non – profit organisations, foundations, and individuals. Grants are also given by the European Union.
The application process is usually the same when applying for a grant. What differs, is the success criteria that each grant provider applies. The steps an SME has to follow to apply for a grant are the following:

1. Eligibility

Before applying for a grant, an SME must check whether it is eligible for the grant. Every funding opportunity comes with terms and conditions, including legal eligibility requirements that must be checked before applying.

2. Registration

Before submitting a proposal, the SME must register to the providing institution.

3. Finding partners or applying as an individual

Most of the time, grants are collaborative, and each funder's requirements include the type and number of partners that are required. Finding the right partner is important for the application acceptance and the project's success.

4. Prepare and submit the proposal

Before submitting the proposal, an SME must conduct detailed research regarding the grant subject, list objectives and goals, describe the methodology, explain the proposed strategy, provide a detailed plan of evaluation, include budget details, and provide the needed organisation information.

5. Admissibility

To submit a proposal, certain criteria must be met: it must be completed, including all the documentation mentioned in the requirements, it must be submitted at a certain date, and it must be concise with the maximum number of pages stated in the call.

A grant application is evaluated as successful when the criteria set by the provider are met. Different criteria apply in each call, depending on the grant provider, the subject etc. Some basic success criteria are the following:

- Is the proposal aligned with the requirements of the call?
- Does the proposal provide potential impact?
- Does the proposal provide realistic numbers, methods, budget?
- Etc

- **Venture Capital**

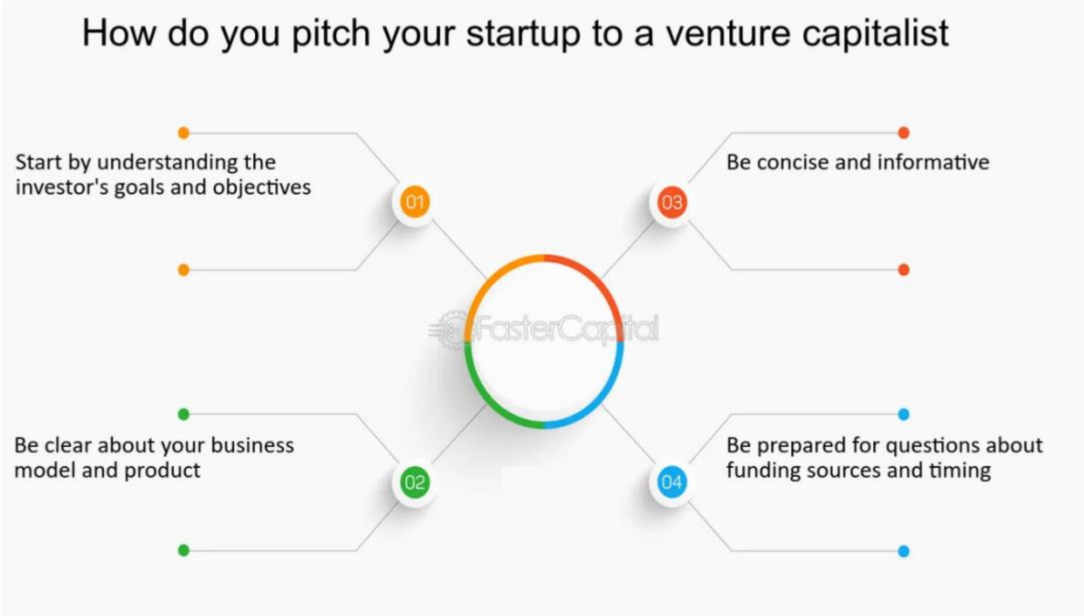
Venture capitalist companies invest usually in start-ups that present strong growth potential. To invest in a SME, venture capitalists usually look for:

- a complete business plan which includes detailed company information,
- industry analysis,
- customer analysis to show how the SME handles and satisfies its customer needs,
- competitive analysis clearly stating the SME's competitive advantage,
- a strong marketing plan and
- a realistic operations and financial plan.

Furthermore, venture capitalists look for a strong management team who can work and execute towards the common goal which is to achieve high growth. If an SME checks all the above, then it becomes attractive for investment by venture capitalists.

When an SME is interested in venture capital funding, there are few things that it can do to increase its chances for success. Attending industry events and networking is the best way to approach investors. It is important to find the right venture capitalist as not all candidates can lead to a good investment opportunity. Some key factors to consider are the company's investment strategy, its location and size.

Once an SME finds potential venture capitalists to approach, the next step is to contact and approach them. Once the interaction is initiated, the SME representative must be well prepared to present the idea and themselves.



- **Guarantee Schemes**

Guarantees are necessary to access funding, especially amongst SMEs, hence the lack of guarantees is considered one of the biggest financial barriers SMEs are facing. The process of applying and getting a guarantee scheme is highly regulated to avoid improper functioning of the financial system. Guarantee schemes can be provided by banks, insurance companies, the government, and the European Union.

Banks receive the majority of guarantee applications and most of the time applications are approved. The process of applying for a guarantee is relatively easy, and it occurs when an SME applies for a loan. The needed paperwork are filled: details of the nature of the guarantee, the time duration, terms and conditions. The application is approved relatively quick, which makes guarantees a useful way to access urgent funds.

Main point 3.3 Title

Benefits and Risks associated with medium level financial products

3.3 Main Content

Financial products can offer many benefits to SMEs but at the same time they present various risks. Before applying for any kind of funding, one must weigh the benefits and risks that each product presents so that the right decision is taken.

According to Coyle (2004), "Financial risk is a broad term that is used to refer to multiple types of risks relating to credit transactions, liquidity and loans…There are several types of risk, for example, interest rate risk, equity risk, currency risk, commodity risk, credit spread risk, default risk, operational risk etc".

- **Loans: Benefits and Risks**

Benefits:

- access to the needed capital to start, grow and expand
- improved cash flow especially in seasonal businesses
- flexible and predictable repayment terms
- flexibility (different types of loans)
- convenience (online applications)
- boosted credit score
- SMEs maintain the ownerships of their assets
- the bank does not intervene in the investment the SME owner wants to make

Risks:

- SMEs must provide collateral to secure a loan
- some types of loan present a slow granting process making it difficult to implement the investment immediately
- the floating interest rate may cause increase in monthly payments if it floats upwards
- damage to the SME's credit score
- risk of foreclosure

- **Grants: Benefits and Risks**

Benefits:

- access to capital that otherwise couldn't be obtained
- non – repayable funding
- boost credibility
- widely available

Risks:

- uncertainty in gaining the grant
- loss of funding if terms and conditions of the grant provider are not met
- risk of auditing by the grant provider

- time – consuming for applying and reporting

- **Venture Capital: Benefits and Risks**

Benefits:

- access to larger amount of money
- provides business management assistance from the venture capitalist
- no monthly payments
- no need for collateral or guarantees
- increases networking opportunities

Risks:

- loss of control due to new investors
- creates high expectations for business growth
- increases the risk of losing the business if the SME does achieve the agreed goals
- minimises the SME’s negotiation power

- **Guarantee Schemes: Benefits and Risks**

Benefits:

- access to finance
- improved lending conditions
- require lower collateral requirements
- improved credit score
- lower interest rates

Risks:

- damaged credit score
- reduced flexibility due to the guarantee restrictions
- increased financial risk for the guarantor

Overall, medium – term financial products provide access to funding to start a business, to grow an existing business, to invest in new initiatives, to expand existing premises or to develop new products and services. However, an SME must carefully select a product, having in mind the benefits and the risks of each product, and consider its needs and goals.

Topic 4

Title of Topic 4

Business Structures

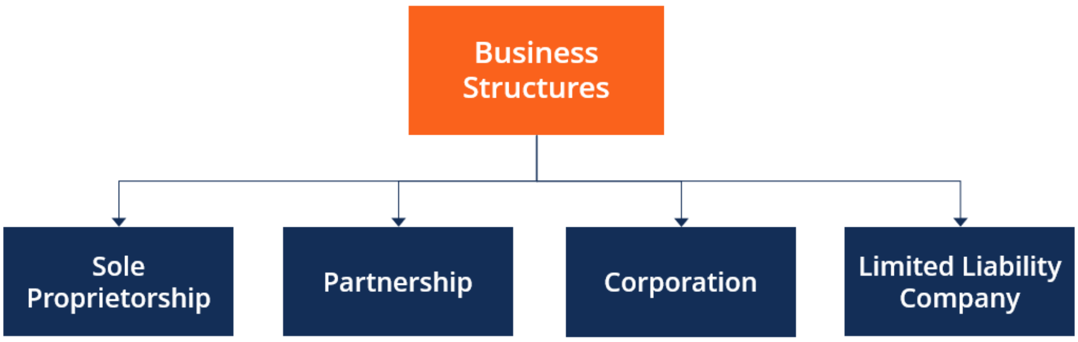
Main point 4.1 Title

Internal/ Business structure types

4.1 Main Content

Various factors can affect an SME's ability to secure funding such as its business structure, the size of the company, the industry in which it is operating, its financial state, the funding needs and more.

According to the Corporate Finance Institute (CFI) "Business structure refers to the legal structure of an organisation that is recognized in a given jurisdiction. An organisation's legal structure is a key determinant of the activities that it can undertake, such as raising capital, responsibility for obligations of the business, as well as the amount of taxes that the organisation owes to tax agencies." Stating it simply, business structure helps companies to manage its day-to-day operations and its employees effectively and efficiently.



There are four types of business structure:

1. Sole Proprietorship
2. Partnership
3. Corporation
4. Limited Liability Company

A sole proprietorship business is an unincorporated business owned and managed by one person such as plumbers, freelancers, photographers, and tutors.

A partnership is an arrangement where parties or business partners agree to cooperate to advance their mutual interests. Some examples are Uber and Spotify, Red Bull and GoPro, Louis Vuitton and BMW and Sherwin-Williams & Pottery Barn.

A corporation is an organisation, either a group of people or a group of companies who are authorised to act as a single entity and recognized as such in law for certain purposes. Some examples are Amazon, Domino's Pizza, Exxon Mobil and General Motors Corporation.

A limited liability company is a business structure that can combine the pass-through taxation of a partnership or sole proprietorship with the limited liability of a corporation, and it is a United States business structure. Pepsi Cola, Sony and Nike are some of the most known limited liability companies.

For an SME to be considered attractive and trustworthy for investors and financial institutions, business structure is a key factor. SMEs that are unstructured are not able to attract the needed capital.

Main point 4.2 Title

Business Structure Requirements for acquiring a medium level financial product

4.1 Main Content

Choosing the best suited legal entity from the beginning may make it easier to get access to funds.

- **Sole Proprietorships**

The sole proprietorship is the simplest business structure for an SME to have. In this structure, all the assets of the company belong to the owner which may make an investment by lenders or investors less attractive. Additionally, in order to obtain a loan, the owner must provide personal guarantees or collateral.

The best types of funding for sole proprietorship companies are term loans, personal loans, SBA loans and business credit card loans. Venture capital is not applicable for sole proprietorships since the owner cannot offer shares of the company.

- **Partnerships**

In partnerships, profits, losses and debts are divided among the partners which make it more attractive in terms of securing the funding. This also means that all partners must have strong credit profiles to be eligible for loan approval.

Some of the funding options for partnerships are equity financing, crowdfunding, venture capital, business loans and grants.

- **Corporations**

A corporation separates the business from the business owners which provides protection to investors against company's liabilities. The personal credit profile of the owners is not important as long as the corporation's credit profile is strong. This makes corporations attractive for investment by venture capitalists, banks, equity capital and capital market bonds.

- **Limited Liability Companies**

Limited liability companies provide limited liability protection to its members. Members can lose the funds that they have invested in the company and they are taxed on the profits and the losses the company makes.

A limited liability company can access funds in various ways such as bank loans, credit cards, government grants, personal funds, crowdfunding and investor funding.

Further reading

Resource name	Type	Link
• Official Website of European Union	Article	https://single-market-economy.ec.europa.eu/smes_en https://research-and-innovation.ec.europa.eu/funding/how-apply/application-process_en
• AECM – European Association of Guarantee Institutions	Article	http://aecm.eu/guarantees/what-are-guarantee-institutions/
• Wikipedia	Article	https://en.wikipedia.org/wiki/Venture_capital
• OECD Library	Article	OECD (2022), *Financing SMEs and Entrepreneurs 2022: An OECD Scoreboard*, OECD Publishing, Paris, https://doi.org/10.1787/e9073a0f-en.
• Research Gate Website	Article	Horcher, Karen. (2012). What is Financial Risk Management?. 10.1002/9781118386392.ch1.
• Forbes	Article	https://www.forbes.com/advisor/business-loans/types-of-business-loans/
• Growthink Consulting	Article	https://www.growthink.com/vc-funding#vcfunding05
• CFI – Corporate Finance Institute	Article	Business Structure - Overview, Forms, How They Work (corporatefinanceinstitute.com)
• Gartner	Article	Definition of Financial Risk Management - Gartner Finance Glossary

Assessment quiz

Question 1.

According to the duration of the financial stability that financial products provide, they are categorised in:

a. Short – term financial products (2 – 3 months) and long – term financial products (over a year)
b. Short – term financial products (a period shorter than two years), medium – term financial products (a range between two to five years) and long – term (a period longer than five or ten years.)
c. Long – term financial products (a period longer than five or ten years)
d. The duration of the financial stability of a product depends on how an SME decides to use it.

Question 2.

What is the importance of medium-term financial products for SMEs?

a. They can be used to finance various projects, such as start-ups, expansion of existing premises and new equipment purchases.
b. They help SMEs to create new job opportunities.
c. They help SMEs to improve their credit capability.
d. All of the above

Question 3.

Which financial product is considered as the most common medium-term financial product?

a. Loans
b. Grants
c. Venture capital
d. Guarantee schemes

Question 4.

What is the main benefit of obtaining a loan?

a. access to the needed capital
b. improved cash flow especially in seasonal businesses
c. flexible and predictable repayment terms
d. all the above

Question 5.

What is a guarantee scheme?

a. A financial commitment by a person to repay up to a certain percentage of the loan.
b. A financial assistance given to businesses or individuals by various institutions to encourage investment and economic growth.
c. An investment to a business, usually a start-up, that investors consider as having strong growth potential.
d. A type of loan that allows an SME to borrow money without having to provide collateral.

Question 6.

What is the main purpose of venture capital?

a. To provide guarantees for loans
b. To fund high-growth start-ups
c. To finance various short-term projects
d. To improve cash flow

Question 7.

A sole proprietorship is owned and operated by one person. The owner is personally liable for all of the financial obligations of the business. Which of the following statements is most accurate regarding funding a sole proprietorship?

a. Sole proprietorships have easier access to funding than other types of businesses.
b. Sole proprietorships are often required to provide personal guarantees or collateral when applying for loans.
c. Sole proprietorships are not qualified for venture capital funding.
d. Sole proprietorships are not suitable for government grants.

True/ False quiz

1. Medium-term financial products can be used to finance various projects, such as start-ups, expansions, and purchases of new equipment. (True)
2. SMEs are the driving force of the economy. (True)
3. The most common form of funding for an SME is a grant. (False)
4. Medium-term financial products are typically used to finance long-term projects. (False)
5. A well-structured and detailed business plan is not necessary for applying for medium-level financial products. (False)
6. Venture capital is typically used to fund high-growth start-ups. (True)
7. Guarantee schemes are typically used to provide collateral for loans. (True)
8. Medium-term financial products are a key factor for SMEs' funding and survival. (True)
9. Business structure is not an important factor for SMEs to consider when acquiring a medium-level financial product. (False)