

FINANCING OF INVESTMENT PROJECTS IN SMALL MANUFACTURING COMPANIES IN CROATIA

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Abstract

The role of financial managers and financial management in making investment decisions is increasing. The role of finance is incorporated into all business processes and financial decision in the long term affects the total businesses enterprise.

This paper investigates and analyzes the way in which small enterprises that manufacture furniture in Croatia prepare themselves for financial decision-making and how they prepare themselves for financing investment projects. An empirical research was conducted among small enterprises that manufacture furniture in Croatia on the extent of their use of financial pre-accession funds of the European Union and preparations for project funding from the Structural and Cohesion Funds of the European Union. In this context, the contribution of financial resources from these funds on the market competitiveness is described.

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1. Introduction

Today's economy can be described as an economy of constant changes, innovations and market uncertainty. In such environment, small enterprises should represent economic growth and development generators and they should, via their growth, development and employment promotion, create economic growth. Manufacturing industry is one of those industries that allows and promotes creation of new values and creation of domestic products via its development. By developing manufacturing industry, better macroeconomic indicators and stable economic cycles in a given economy are ensured.

Share of manufacturing industry in the GDP of the Republic of Croatia has decreased by 3% during the last 10 years and is one of the reasons why small manufacturing enterprises are the subject matter of this paper.

This paper focuses on the role of small enterprise financial management during a process of making investment decisions. For the purposes of this paper, existing studies regarding small manufacturing enterprises have been examined and a research was conducted among small manufacturing enterprises that manufacture furniture in the Republic of Croatia.

2. Role of financial management in small enterprises

Financial theory and practice during the 20th century has been the subject of constant changes caused by globalization processes and other market changes. Together with dynamic economic development, finances also developed and business finances have mostly been developed during the 20th century. At the beginning, business finances mostly dealt with financial institutions, instruments and were equated with accounting. Economic development in modern times demanded concentration of financial assets, so concentration and centralization of capital became the levers for development of modern market-oriented economies. Soon after that, financing problems became more complex. The question of external business financing grew in its importance due to a growing number of new innovations, increased number of newly-opened enterprises and changes in economical structures (Veselica; 1995, p.23).

After the great economic crisis during 1923-1933, which encompassed all field of economic theory and practice, and especially business finances system, there was a need for solving problems of liquidity, insolvency and reorganization which focused business finances towards saving existing enterprises. Until the 1950's, finances were dominated by a traditional approach that looked at enterprises from the outside, from investor's point of view, while decision making process within the enterprises was not specially emphasized. Profound changes in the development of finances were brought about by a publication of two books: "The Theory of Investment in the Firm" (1951) by Friederich and Vera Lutz and "Capital Budgeting" by Joel Dean (Veselica; 1995, p.24).

Computers and complex information systems allowed financial managers to access data that contributes to increased efficiency of financial markets. Financial

analysis and financial planning were developed, which allowed better understanding of financial problems which in turn resulted in making better financial decisions.

Further contribution to development of financial analysis and financial management came from works in the second part of the 20th century. Special contribution was given by Harry M. Markowitz in his work „Portfolio Selection: Efficient Diversification of Investment“, William F. Sharpe in his work „Capital Asset Prices: A Theory of Market Equilibrium under Conditions of Risk“, John Lintner in his work „Security Prices, Risk and Maximal Gains from Diversification“, and Eugene F. Fama and Merton H. Miller in their work „The Theory of Finance“ (Veselica; 1995, p.24). The development of finances strengthened the role of financial management whose scope of work was broadened from its original role of studying data to overall financial analysis that encompassed both external and internal analysis.

The definition of financial manager changed during time as its role in business finances changed due to complexity of financial manager's responsibilities and obligations. Financial manager actively manages financial activities in various types of organizations: financial and non-financial, small and big, profitable and non-profitable, private and public. It performs various tasks such as budgeting, financial forecasting, cash and credit management, investment analysis (Ekonomski leksikon, 1995).

There are different types of financial managers, but regardless of the type and scope of their work, they all deal with:

- assets earmarked for property investments
- creating the best combination of financing and
- making investment decisions

Since financial managers make investment decisions, it is necessary to define them for the purposes of further understanding of this paper. Investments are used for expanding or restoring manufacturing potentials, converting financial assets into real capital elements. There is a difference between financial and real investment. Financial or portfolio investments are just a transfer of financial assets between economic subjects. Real investments are investments into equipment, facilities and supplies and are divided into investments into basic assets and investments into working assets (Ekonomski leksikon, 1995). Broadly speaking, investment is an accumulation in the present with the hope of future gains.

Investment can be performed in various forms, but it is mostly performed via cash assets, for the purposes of gaining certain economic benefits, i.e. profit (Orsag&Dedi, 2001, p.15). The same authors claim that while doing so it is possible to invest in financial forms of property and appropriate investment or into real form of property that allows the realization of economic benefits, i.e. profit created via certain productive business activities.

Large enterprises have financial departments in which financial managers are responsible for making all financial decisions. But, in small enterprises in most cases only one person makes all decisions and that person is simultaneously operative and financial manager, and very often the owner.

Due to that fact, this paper describes the role of financial management in small manufacturing enterprises during a process of making decisions regarding financing of a certain investment project. One of the forms of financing is using pre-accession and Structural Funds of the European Union. That is why a research was conducted among small manufacturing enterprises that manufacture furniture to determine how much financial assets are they using from pre-accession funds of the European Union and whether they intend to use financial assets from the Structural and Cohesive Funds of the European Union that will be available to Croatian entrepreneurs after the Republic of Croatia becomes a member of the European Union.

3. Small manufacturing enterprises in the Republic of Croatia

Manufacturing industry is a part of an industry that mechanically, chemically or otherwise processes various raw materials and intermediate goods. It encompasses manufacturing branches that process products of extractive industry, agriculture, forestry and various synthetic raw materials (Ekonomski leksikon, 1995). Manufacturing industry is, alongside financial intermediation sector, real estate sector, renting and business services sector, a sector with the highest share in the GDP structure and overall employment in the Republic of Croatia and has by far the biggest share in overall export of the Republic of Croatia (Ministry of Economy of the Republic of Croatia).

In order to define manufacturing enterprises that manufacture furniture in the Republic of Croatia, we first need to examine the National Classification of Activities 2007 that came into force on 1st of January 2008. According to the National

Classification of Activities 2007, industrial policy sector is amenable for the following manufacturing industry sectors (National Gazette, 58/2007):

- manufacture of textiles, clothing, leather and associated products
- manufacture of chemicals and chemical products, pharmaceutical products, rubber and plastic and other nonmetal mineral products
- manufacture of metals and metal products
- manufacture of electronic and electric products and machinery
- manufacture of food products and beverages
- manufacture of wood and products made of wood and cork and manufacture of furniture, paper and paper products

Manufacturing furniture implies manufacturing furniture and associated products using any materials apart from stone, concrete and ceramics.

The total enterprise sector in Croatia is composed of 168,931 productive units. Within this enterprise universe, the SME sector (1 to 249 persons) comprises 168,443 productive units. There are 155, 828 micro-enterprises which account for 92.5% of total SMEs (76.665 legal entities (including cooperatives) and 79.163 crafts); 10,599 small companies or 6.3% of all SMEs, comprise of 8791 enterprises and 1808 crafts, and 2015 (0.2%) are medium sized enterprises, comprising 1954 enterprises and 61 crafts. The leading productive sectors are: the wholesale and retail trade sector (24.35% of enterprises); manufacturing (13.27%); construction (13.07%); accommodation and food service activities (10.67%); and, professional, scientific and technical activities (10.38%). These five sectors represent contain 72% of all SMEs (The Croatian SME Observatory Report; 2012.).

The SME sector (including crafts) contributes significantly to the development of the Croatia's economy in terms of employment generation (50%), exports (40%) and value added (56%). SMEs employ 35.7% of total labor force, with crafts employing a further 14.6%; together they employ 50% of the total labor force (The Croatian SME Observatory Report; 2012.).

According to the data presented by the Croatian Chamber of Economy, small enterprises make 21.37% of all enterprises within manufacturing industry. Due to that fact, and a fact that manufacturing industry should be a generator of economic growth and development of every county and a main employment sector, this paper is focused on small enterprises within manufacturing industry and the possibility of their further growth and development.

During the period 2008-2010, the number of enterprises in manufacturing industry has increased despite the economic crisis that dominated Croatian economy during the said period. In 2008, share of manufacturing industry enterprises in the overall number of enterprises was 11.83% and in 2010 that share was increased to 11.87%. The increase of manufacturing enterprises was 7.78%, while the overall growth of number of enterprises was 7.44%. Despite the aforementioned growth, the number of small enterprises has decreased during the said period by 1.8%., while the number of micro and medium enterprises was increased by 11% and 2% respectively.

According to the data of the Croatian Chamber of Economy (Croatian Chamber of Economy, 2012) and the Register of Business Entities, annual financial report for 2011 was submitted by 3 large, 20 medium and 561 small manufacturing enterprises whose principal activity was manufacturing furniture. This data is mentioned since a research was conducted among small manufacturing companies that manufacture furniture in the Republic of Croatia for the purposes of this paper.

4. Investment project financing in small manufacturing enterprises

A precondition for creating investment climate in a given economy is to create a legal frame and institutional support.

One of the most important acts aimed for promoting investments in the Republic of Croatia is the Investment Promotion Act (National Gazette, 138/2006) and the Promotion of Small Enterprises Act (National Gazette, 29/2002, 63/2007) that define promotion measures for investments in the Republic of Croatia. These measures concern investment projects in: manufacturing-processing economic activities, technological development-innovative activities and strategic activities of business support. In order to increase entrepreneurship capacities and promote investment in the Republic of Croatia, since 2004 several main institutions which act as a support to investment development were established and linked. Those institutions include Ministry of Economy, Croatian Agency for Small Enterprises, Croatian Bank for Reconstruction and Development, Croatian Chamber of Economy, Croatian Chamber of Trades and Crafts, Croatian Employers Association, various entrepreneurship centers, entrepreneurship incubators, technological centers and parks, regional development agencies, private consultants and many other institutions and legal entities.

According to the data stated in The Croatian SME Observatory Report 2012, investments in small enterprises have decreased during 2008-2010. Data regarding investment amounts are presented in Table 1.

Table 1: Manufacturing industry enterprise investments in the Republic of Croatia in 2008 and 2010

Year	Micro	Small	Medium	Large	Cooperatives	Crafts	Total
2008.	7.774.388,48	18.972.366,40	8.617.570,93	20.102.756,47	39.180,46	61.758,96	63.350.054,51
2010.	4.018.181,20	6.684.953,32	10.269.445,77	21.078.594,62	301.090,34	360.116,41	45.421.231,60

Source: Data processed by the author based on the data stated in The Croatian SME Observatory Report 2012

Investments in micro enterprises were reduced by 48.3%, while investments in small enterprises were reduced by 64.76%. Investments in medium and large enterprises were increased by 19.2% and 4.8% respectively. Presented data is alarming for micro and small enterprise sectors, since their share in overall number of enterprises in manufacturing industry was 94.90% for 2010.

That raises a question regarding the manner in which financial management and personnel responsible for making investment decisions in small manufacturing enterprises make decisions regarding financing investment projects and what sources are they financed from.

The usual manner of financing investments into real property in small enterprises in the Republic of Croatia is from own sources, via banking credit, co-financing via non-refundable incentives issued by the Ministry of Entrepreneurship and Crafts and from pre-accession funds of the European Union.

With the frame of a project titled "Improvement of Administrative Efficiency on National Level" a qualitative research was conducted regarding support programs issued by the Ministry of Entrepreneurship and Crafts and experiences of small and medium enterprises regarding application procedures for receiving support. Results indicated that the most frequent reason why entrepreneurs did not apply for a support in the last 4 years were: they did not know that ministries are issuing supports (26%), they did not know when to apply (20%), that they do not believe in the fairness of selection (15%), that they did not meet the criteria (14%) and that they did not apply because of complicated application process (10%). Enterprises that used the aforementioned support, when asked how significant was the support,

stated that: the support was a huge help (9%), the support had significant positive impact on their business activities (22%), the support has slightly contributed to their business activities (32%), while 12% of enterprises stated that given support did not at all contribute to their business activities (The Croatian SME Observatory Report 2012, p. 158-161).

The manner in which small manufacturing enterprises used funds from pre-accession funds of the European Union and a manner in which they prepare their business activities regarding financing investment for accession into the European Union are reflected in obtained data from research among small enterprises that manufacture furniture. Phone survey completed during September 2012 included 42 small enterprises out of 561 total small enterprises that manufacture furniture in the Republic of Croatia. They were asked about their usage of assets from pre-accession funds of the European Union. Only 4.76% of enterprises uses such assets and are readying themselves for using assets from Structural and Cohesion Funds, 33.33% do not use assets from pre-accession funds, 40.48% are readying themselves for using assets from Structural and Cohesion Funds and 19.05% do not intend to use assets from the aforementioned funds of the European Union after the accession of the Republic of Croatia.

Based on the data we can conclude that in the Republic of Croatia investment project financing of small manufacturing enterprises from non-refundable funds and pre-accession funds of the European Union is still inadequate. Significant changes on Croatian market will start with the accession of the Republic of Croatia into the European Union and that will surely change competitive position of Croatian enterprises. They will be able to seek new markets for their products, and in order to achieve competitiveness it is mandatory to change existing investment attitudes and approaches.

Possible restrictions for further investments are human potentials and technical-technological potentials of enterprises. According to the results of this study regarding the volume of financial decision making methods utilizations when making decisions regarding the efficiency of investment project in manufacturing enterprises in the Republic of Croatia, conducted for the purposes of Master thesis (Štavlić, 2012) it was concluded that in almost 62% of surveyed enterprises there is no additional employee training in the field of financial management and that a third of enterprises does not utilize a single method for making financial decisions when making investment decisions. Furthermore, according to the same research, almost

85% of enterprises do not intent to educate their employees about the methods used for making financial decisions in the near future. Only 16.67% of enterprises are focused on future employee educations and on utilizing method for making financial decisions, while 64.29% believe that financial decisions are the responsibility of the owner and they will not opt for additional employee education that would allow them to use methods for making financial decisions. Current and future investments in the enterprises that participated in this study are in most cases earmarked for equipment, manufacturing facilities and introduction of new products on the market, while none enterprise that participated in this study does not invest, nor has a plan to start investing, in patents in the next two years. This fact does not go into favor of compositeness since innovation process should accompany investment process. Such results prove the fact that inadequately developed human potentials represent a limitation to promoting investments in small enterprises.

5. Conclusion

Financial management and financial managers have increasingly important role in small enterprises during the process of making investment decisions. On the basis of a research conducted among small manufacturing enterprises it was concluded in this paper that small enterprises should invest more effort in educating their managing structures (in most cases the owner is also a financial manager) regarding making financial and investment decisions, because of the increasing role of management and ownership structure in the process of making investment decisions. Reduced investments in small and micro enterprises can be alarming since small enterprises represent 21.37% of all manufacturing enterprises. Analyzed results indicate still inadequate utilization of secondary financial sources (apart from own sources and bank credits). Financing real investment from non-refundable assets pre-accession and Structural Funds of the European Union allows more successful business activities and competitiveness on the marker, which is the precondition for maintaining successful business activities after the Republic of Croatia becomes a full member of the European Union.

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