

Management of the Process of Credit Support for Small Entrepreneurship at the Stages of an Independent Business Formation

Yuliia M. Melnychuk

Liudmyla A. Chvertko

Maksym A. Slatvinskyi

Tetiana O. Korniienko

Oksana A. Vinnytska

Department of Finance

Accounting and Economic Security

Educational-scientific Institute of Economics and business education

PavloTychyna Uman State Pedagogical University

Uman, Ukraine

Iryna G. Tkachuk

Department of Finance

Vasyl Stefanyk Precarpathian National University

Ivano-Frankivsk, Ukraine

Abstract

Today, small business is the socio-economic foundation without which no innovation-oriented, especially European, state can develop. Its development largely determines the rate of economic growth, structure and quality of gross domestic product. In addition, the main and extremely important function of small business is the social function, so the interaction of such business with the banking sector is an integral part of business development in each country. The purpose of the article is to substantiate the areas of improvement of mutual processes that arise during the lending of small enterprises in the conditions of formation of their independent activity. To achieve the goal of the study, the following methods were used: description, system-structural, theoretical and analytical analysis, observation and comparison, experimental, synthesis, grouping and generalization, statistical and financial analysis. The article identifies the problems that hinder the management of small business lending processes, as well as highlights the features of small business that affect management decisions. Given that small and medium-sized enterprises, especially start-ups, need institutional, technological and financial support, the need to unite small businesses into craft chambers is justified. It is also proved the expediency of consolidation of large entrepreneurs with regional chambers of commerce and industry, which participate in the formation of budgets at all levels, development of construction and industry, legal preparation of projects governing small and medium-sized businesses. It is determined that chambers of commerce and industry have a great influence on all aspects of life of local communities, participate in local self-government, thus influencing important decisions on socio-economic development of certain regions and the country as a whole. It is established that the main task of credit process management at the stages of independent business formation is to provide comprehensive support and assistance to small and medium enterprises. The directions of the decision of problems of management of business for creation of an independent climate of their activity by means of bank and private crediting are offered.

Keywords: Credit Process Management, Small Business, Small Business Lending, Association of Small Business Enterprises, Credit Support, Financial Independence, Entrepreneurship.

Introduction

Problems of bank crediting development are multifaceted, necessitating a complex approach to their solution. The problem of negative factors overcoming, hindering the development of bank crediting of small business consists in the lack of proper management of this process and it is reflected in three aspects:

- 1) A difficult economic situation in the country causing the shortage of financial resources in a banking system and in a small business system functioning predetermines two other aspects;
- 2) A high risk of small enterprises crediting;
- 3) A low creditworthiness, on the one hand, and a high cost of credit resources for the subjects of small business, on the other hand.

If tasks of the neutralization of factors of the first group are more global, the minimization of the factors of two other groups is, in our opinion, quite feasible for the creation of a management system of the improvement of bank crediting of small business.

Literature Review

Summarizing the scholars’ opinions concerning the problems hindering the management of processes of small enterprises crediting, we consider it appropriate to unite them into three groups (table 1).

Table 1. The analysis of problems, hindering the management of crediting processes in small enterprises.

Small enterprises	Banks	State
<ul style="list-style-type: none"> – a low profitability of small enterprises, which does not cover the bank's effective rates (Veiga et al., 2019); – the lack of transparency of an economic activity of borrowers, a low tax culture, a low quality of drawn-up business plans and documents, the lack of credit history (Melnychuk et al., 2020); – lack or a complete absence of borrowers’ liquidity support (Koriakin et al., 2016); – risks of bankruptcy or a loss of the enterprise because of financial insolvency (Melnychuk et al., 2018); 	<ul style="list-style-type: none"> – high costs for consideration and execution of the loan for a short loan period, it does not allow to achieve the desired profitability of the loan operation (Volkova et al., 2017); – a difficult procedure of credit obtaining (Melnychuk et al., 2018); – a limited spectrum and the amount of banking credit services (Mac an Bhaird et al., 2016); – the difficulty in the management of a credit portfolio, containing a large number of various small loans (Mortaza, 2017); 	<ul style="list-style-type: none"> – imperfection of a regulatory frame work concerning the protection of creditors’ rights; the ineffectiveness of a judicial system (Promsaka, 2010); – imperfection of a state system of small entrepreneurship provision (Veiga et al., 2019); – underdevelopment of the system of information support of small enterprises (Chvertko et al., 2019); – monetary policy of the National Bank of Ukraine (Mac an Bhaird et al., 2016).

An increased level of strictness of banks concerning potential borrowers-small enterprises is predetermined by specific features of the activity of small business finding the expression in (Omelyanenko et al., 2019):

- The lack of fixed capital of small enterprises, the consequence of which is the reduction of mortgage opportunities. Only a small proportion of small enterprises own commercial real estate, the majority of them function in rented premises with the use of rented equipment;
- a small proportion of own resources because of small scale of sales and business scale;
- a short life cycle which is characteristic of small enterprises, consequently, the lack of reputation in the market of financial services, a credit history;
- insignificant, in comparison with large and medium business, the need for external debt financing, causing an increase in operating costs for financing;
- non-transparence of economic activity, associated with the presence of a shadow turnover;

- The discrepancy of the return on invested capital to the value of interest rates on credit operations, to which commissions are added;
- The lack of special knowledge in a financial and economic sphere, leading to problems in the preparation of financial documentation, necessary for financing, and also for an inefficient management of borrowed funds.

Another factor that negatively affects the interest of commercial banks in a small business crediting is a complexity in the management of a credit portfolio, containing a large a number of various small loans. A commercial bank cannot abandon such management because it is legally obliged to calculate and create reserves for covering possible losses on such credit operations. Even if a bank incurs losses from such credit operation, they will be so small (due to a small amount of loans issued to small enterprises that they won't affect a financial stability of the institution).

One of the most significant problems, hindering the activation of a small business crediting is high risk of credit operations, on the one hand, and the absence of effective mechanisms of its minimization, on the other hand. A main instrument in solving a problem is a flexible system of guarantees, according to which a credit risk is distributed in agreed proportions between the lender (a bank or a financial enterprise) and a guarantee organization, thus reducing the risks of creditors. In the opinions of scientists researching the issues of the formation of the system of guarantees for credits to small or medium businesses (Mac an Bhairet et al., 2016), nowadays a guarantee mechanism in Ukraine doesn't actually function. At the same time foreign experience shows the prevalence of the practice of guaranteeing as a way of a credit risk minimization. According to the data, presented in the work (Promsaka, 2010), the schemes of credit guarantee are used in many countries.

Data and Methods

Conclusions, formed in the works of domestic and foreign researchers, official statistics, reports on small businesses and banking institutions, form a real picture of the state of entrepreneurship in each country, are its economic indicator, and form the methodological basis of the study. The research uses methods of analysis, synthesis, formalization, logical abstraction, theoretical knowledge, monographic, systematized, abstract-logical and other methods.

For the purposes of the study, information and statistical indicators "UkrGasbank", "Megabank", "ProCredit Bank", "International Investment Bank" were used, and their loan programs were considered. The legal framework for small business lending is analyzed in order to find ways to improve business financing.

Results of the study

Taking into account foreign experience, as well as realities, the following managerial and organizational model of providing loans to small enterprises has been suggested (fig. 1).

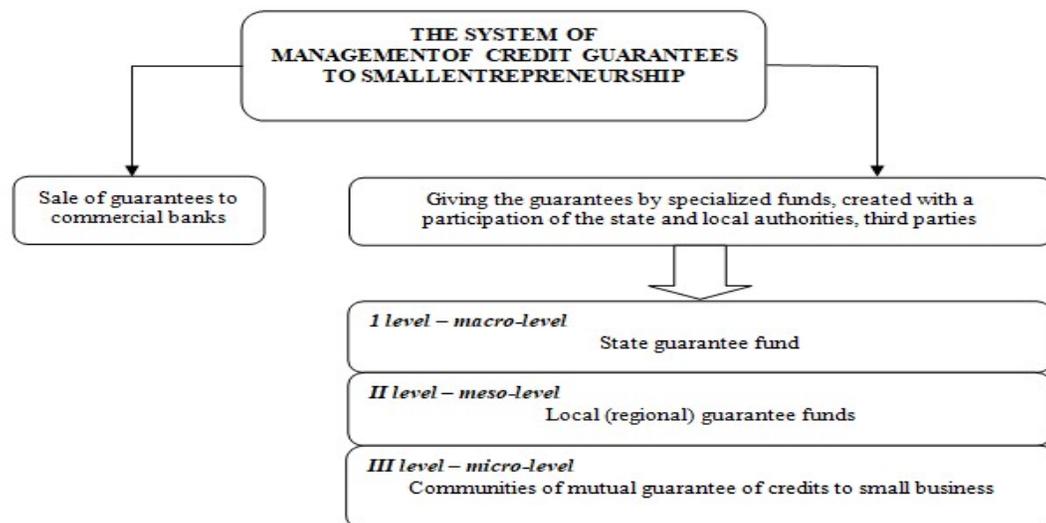


Figure 1. An organization model of giving credit guarantees to small business in Ukraine [developed by authors]

In the above model, there are three levels of guarantee institutions: national, local (meso-level) and micro-level (mutual guarantee societies). The importance of allocating a meso-level (a regional level) is explained by the fact that bank loan guarantees allow the “closure” of financial resources for local production, contributing to the growth of the real sector of the economy in the regions and at the same time strengthening a regional banking system. Thus, as a stakeholder, local governments make more efforts to improve the effectiveness of guarantee schemes at a local level.

An important condition for building an effective guarantee system is the distribution of guarantee obligations between different levels. Based on foreign experience, in modern developments of ukrainian scientists the following distribution is suggested (promsaka, 2010):

- at least 50% of the amount of the guarantee for the distribution of risk between the state guarantee fund and a local guarantee institution;
- coverage provided by the state guarantee fund 75% in the case of lending to small and medium businesses at the initial stage of activity (for startup loans)
- coverage provided by the state guarantee fund of 85% in the case of lending to small and medium business operating in priority (in terms of economic development of the country) (science-intensive) industries.

However, according to experts from the german advisory group, the loan guarantee may cover up to 100% of the loan amount, but usually it is limited to 50-80%, in order to share with the bank, the risk of default of the borrower in order to create appropriate stimuli for project selection and monitoring (koriakin et al., 2016).

The use of guarantee schemes will also help to solve the problem of lack or insufficiency of the borrower-small enterprise of liquid provision, problems related to the financial condition of the subject, including insignificant amount of own funds, bankruptcy risks due to financial insolvency, and create conditions for cheaper credit resources for small business.

Another problem related to the issue of minimizing credit risks for commercial banks is the creation of an effective mechanism for the repayment of loans by unscrupulous borrowers. According to bank representatives, the fact that the bill on protection of creditors’ rights has not been adopted yet is on the way to mass lending to small businesses. This draft of law №4529 “on amendments to certain legislative acts of ukraine (regarding stimulation of lending in ukraine)” was submitted to the verkhovna rada on april 26, in 2016. The bill provided: an increase in the criminal liability of legal entities, entrepreneurs and citizens of ukraine for unreliable documents that they provided to obtain loans from banks; speeding up the litigation against banks and borrowers; the right to apply the exchange rate that was in effect at the time of the loan.

The provisions of the bill were perceived ambiguously in various circles of scholars and practitioners. Thus, according to experts of the National Bank of Ukraine, the draft law №4529 contains effective tools for minimizing risks for banking institutions when lending to the following, in particular (Melnychuk et al., 2018):

- reduces the costs of debtors and creditors in debt settlement by improving out-of-court instruments;
- excludes deviations from the fulfillment of credit obligations when inheriting the property of the borrower or when recognizing the inheritance from the dead;
- reduces the risks of bank loss of the subject of the mortgage as a result of unauthorized construction;
- clearly defines the conditions for termination of the guarantee;
- reduces the financial burden on borrowers of banking institutions;
- coordinates the norms of banking legislation with the Civil Code of Ukraine on the procedure for observing the rights of heirs;
- cancels the requirement of notarization of the pledge agreement of the vehicle;
- makes it impossible to alienate collateral vehicles without the knowledge of the pledgee bank;
- introduces mechanisms for banks to access information on potential borrowers with the State Register of Civil Status Acts.

On the other hand, according to researchers from the Verkhovna Rada, the draft provides for a somewhat one-sided approach to stimulating lending, which is to provide additional rights, especially to creditors. However, it does not take into account the fact that for the real stimulation of lending it is equally important to protect the interests of the debtor in these respects, without which the purpose of the project is unlikely to be achieved (Mortaza et al., 2017).

According to the results of the vote on November 15, 2016, the bill was not adopted, and therefore the issue of regulating the protection of creditors' rights remains open.

When considering the issue of improving the credit security of small business almost the most concentrated attention should be given to two interrelated factors, which directly affect the volume of small business lending: the price of credit resources and the timing of loans.

It is a well-known fact that the rates on loans to small businesses are significantly higher than the price of credit resources offered to large businesses. At the same time, the profitability of small business activities is often lower than the profitability of large enterprises. As a result, there is a situation of mismatch between the profitability of small businesses and the size of interest rates on loans. This problem may be solved by combining a number of measures:

- 1) The use of credit resources of international financial organizations;
- 2) subsidizing the interest rate on loans from the state budget to small enterprises functioning in industries with a low level of profitability;
- 3) The activation of programs of regional support for small businesses in terms of partial compensation of the credit rate;
- 4) The use of marketing research mechanisms by banks, a targeted segmentation of small business customers;
- 5) The cooperation of banks and large enterprises for joint lending to small businesses.

Among the listed instruments, the practice of using credit resources of international financial organizations is currently the most actively used.

The most active in the field of microcrediting in Ukraine is the German-Ukrainian Fund (hereinafter referred to as GUF), which was established in 1996 within the framework of the "TRANSFORM" program, launched by the German federal government. The creation of the GUF took place after the signing of the Grant Agreement between the GBU and Kreditanstalt für Wiederaufbau (German Credit Institution for Recovery, hereinafter – KfW) with the aim of increasing the competitiveness of micro and small enterprises by providing them with the access to financing through authorized Ukrainian partner banks. KfW allocated grant funds in separate tranches to an interest account, which were submitted by the National Bank of Ukraine.

There are four partner banks of the German-Ukrainian Fund, such as: a joint-stock bank "UkrGasbank", a public joint-stock company "Megabank", a public joint-stock company "ProCredit Bank", a public joint-stock company "International Investment Bank".

In addition to the Draft Resolution of the Board Project GUF implements three programs, aimed at financing the development of small and medium-sized businesses:

- 1) The microcredit program is the first and largest in terms of volume of the National Bank of Ukraine program with minimal restrictions for International Health Regulations;
- 2) The program for lending of International Health Regulations in Ukraine offers preferential terms for lending to enterprises operating in certain industries, considered by GUF as important.

Negative tendencies, in our opinion, are to a certain extent related to the "loyalty" of the program. As noted above, the National Bank of Ukraine microcredit program is characterized by the least number of restrictions, in particular:

- loans can be provided to all small and medium-sized enterprises, while the other two programs provide for loans to enterprises with up to 250 employees and a turnover of up to 5 million euros;
- the interest rate on microcredit is determined by partner banks, while the maximum allowable rate level is set in the International Health Regulation lending program in Ukraine for priority industry areas.

On the other hand, GUF microcredit program provides for the differentiation of the maximum loan size depending on the organizational and legal form of doing business and the size of the enterprise. In particular, if micro-enterprises or sole proprietors under GUF microcredit program can receive a maximum loan of up to 25 thousand euros, then under the program of refinancing measures to support the lending system in rural areas, the maximum possible loan amount is ten times more and amounts to 250 thousand euros.

One of the most significant sources of lending to small businesses is the EBRD's lending resources. The EBRD focuses primarily on projects that are designed to improve the efficiency of the energy, transport and utilities infrastructure markets. However, the financing of small and medium-sized businesses in Ukraine does not remain without attention (Rudyk, 2016).

Scientists studying the EBRD's activities in Ukraine note that long-term lending to Ukrainian companies under EBRD programs for small and medium enterprises has a long and positive history in the Ukrainian financial market (Rudyk, 2016).

Among the current programs is the Ukreximbank financing program, which is aimed at achieving two main goals:

- 1) Encouraging the investment financing to improve energy efficiency;
- 2) Assistance in the resumption of lending to the small and medium business sector in Ukraine.

In 2017, the Ukrainian Lending Program for MSMe (Lending Program for Micro, Small and Medium-sized Enterprises) was approved, the aim of which is to increase funding for MSMe and promote the development of new credit products, including for financing rural enterprises and agribusiness. Under this program, it is planned to allocate \$ 10 million by the USA public joint-stock company "Credit Europe Bank".

In the context of the project implementation, the following goals are expected to be achieved (Melnychuk, 2020):

- 1) facilitating the recovery of MSMe lending and market expansion, the project is expected to help increase demand in the domestic market, as it will improve MSMe access to finance; the program assisted local banks in rebuilding lending operations and long-term private sector financing;
- 2) the implementation of the program will help to improve the skills and knowledge of local banks in the field of MSMe financing, broad integration of MSMe financing into the operational structure of banks, as well as improve the functions of corporate governance, risk management and internal control;
- 3) the implementation of the program will help expand the range of products offered to MSMEs as sub-borrowers, including in the field of lending to agribusiness, which will facilitate access of private agricultural enterprises to financing.

Despite the significant impact on microcredit processes, there is a number of shortcomings in cooperation between Ukraine and the EBRD. According to N. Rudyk, it is a rather long period for the bank to approve the loan (taking into account the procedure for approving the project directly at the EBRD, it is about 1-1.5 months), a high level of red tape in the preparation of a loan application, little support for small businesses (2016).

The areas of activity of both the GUF and the EBRD are constantly being transformed in relation to changes in the economic and political situation in the country. Therefore, strengthening of the reform processes in Ukraine may stimulate cooperation in financing small enterprises. In this direction, the state cannot remain an ordinary observer of the process, but must create all conditions for activating the process of lending by international organizations.

In general, it may be argued that small business lending in Ukraine would hardly be possible if it was not for the financing of international financial organizations. A vast majority of banks' lending to small and medium-sized businesses operate under international programs. Participation in such programs is beneficial for commercial banks, as they receive financial resources for active operations. In addition to available credit resources, Ukrainian bankers receive time-tested lending technologies that reduce the standard costs and risks associated with working with small and medium-sized borrowers.

The expansion of the range of credit services, as well as the improvement of small business lending technologies can also have a significant impact on the intensification of small business lending processes.

Today in Ukraine microcredit is developing in only two directions:

- in the framework of cooperation with international financial organizations (GUF, EBRD);
- provision of microloans to small businesses (with reimbursement of part of the interest) in the framework of cooperation of commercial banks with local authorities at the regional level.

Many commercial banks offer a microcredit service, but most of them identify it with the standard process of lending to small and medium-sized businesses. Therefore, we take into account only the microcredit services offered by partner banks of the relevant small business financial support programs and provide for certain preferential lending conditions (reduced lending rate, speed of credit resources, loyal collateral conditions, etc.). Comparing the state of microcredit in Ukraine with the possibilities of using this tool in general, we believe that today the potential of microcrediting is not even half used. We have suggested a model of management and organization of microcredit in Ukraine (Fig. 2).

A suggested model for organizing microcrediting in Ukraine provides that in practice, microfinance institutions may use the methods of both individual and group microcrediting. It is worth noting that if individual microcredit is used in practice, then group microcredit is a new form of credit provision for small businesses in Ukraine. The use of this lending methodology has its advantages and disadvantages.

Among the advantages:

- 1) no need for collateral (joint liability of the borrowers acts as security);
- 2) a high level of coverage of small businesses (using the principle of a group guarantee instead of collateral allows financial institutions to lend to the least wealthy micro-enterprises that do not have the ability to provide collateral);
- 3) effective selection and monitoring (the credit group provides control over its clients: since the members of the group are better informed about each other, such control is more effective than the control of a financial institution);
- 4) low costs of conducting a credit operation (since the group performs some of the administrative work in the process of issuing loans, due to which certain savings are provided);
- 5) A mutual support of group members, reduces the need for consulting services from the financial institution).

Considering the possibilities of creating such credit groups, we note that the options may be both horizontal (small enterprises of the same industry or a specific area) and vertical (small supplier-consumer enterprises). At the same time, in this context, certain disadvantages of group microfinance should be taken into account, in particular:

- a) group financing schemes do not always meet the needs of borrowers;
- b) if any of the members of the group has a need for large amounts of credit, then the group cannot act as a guarantor, respectively, there is a possibility of “fluidity“ within the group;
- c) fairly high initial costs; group microcrediting has a significant payback period and becomes payback only with a large number of clients.

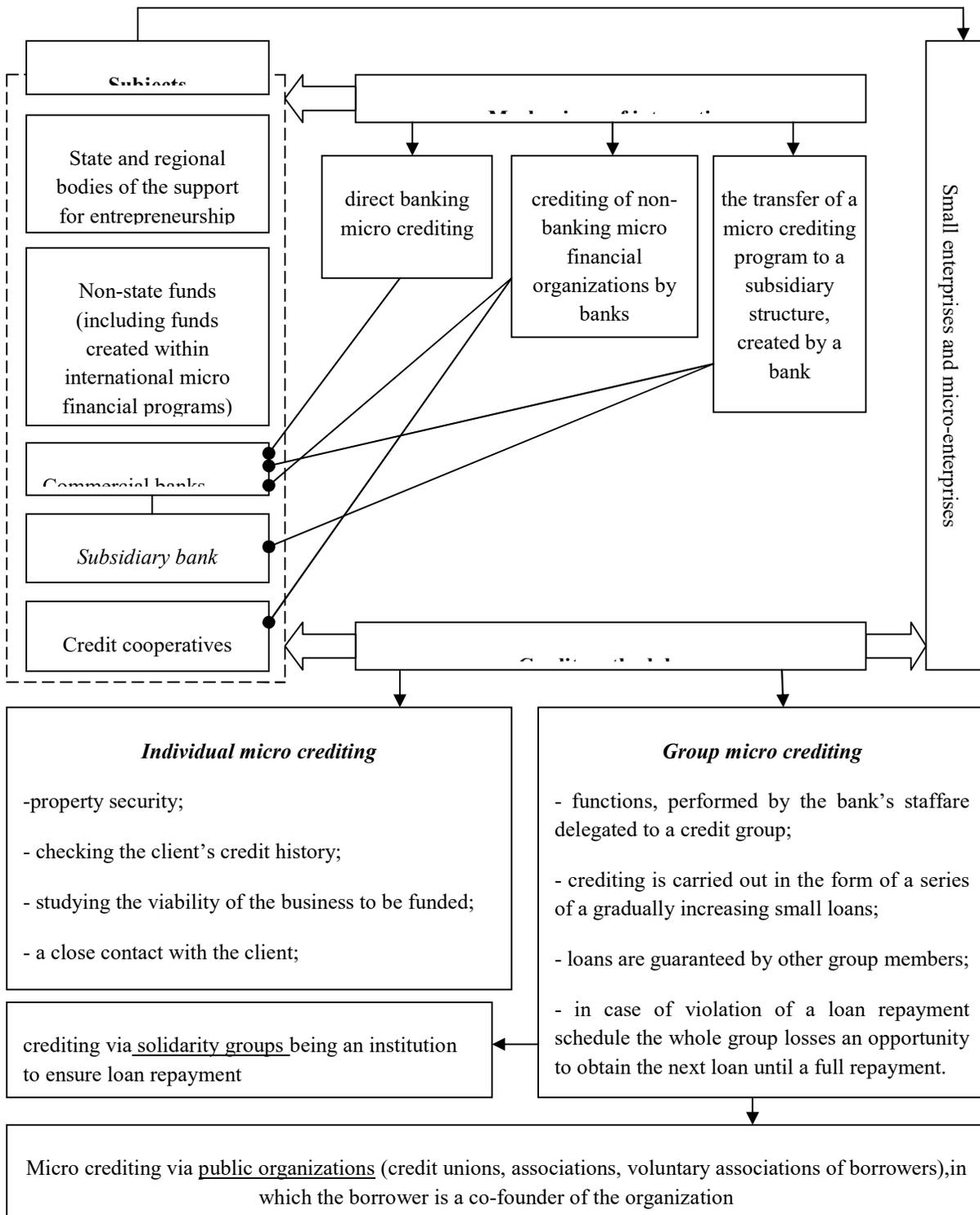


Figure 2. A model of management and organization of microcrediting in Ukraine [developed by authors]

Despite the listed disadvantages, in a today's environment, in our opinion, a quite significant practice of group lending has allowed and minimized some of the problems of lending to small businesses.

In addition to using the microcredit model, a certain effect in activating the lending mechanism may be achieved by introducing and developing alternative sources of financial and credit support such as factoring, leasing, crowd funding, etc. We consider the advantages and possible disadvantages of their use in practice.

Both credit and factoring often compare both products related to working capital financing. At the same time, from the point of view of the creditor, the factoring instrument is more protected: instead of the funds issued, the factor (bank or factoring company) receives the right to claim receivables, and the debtor company is usually more reliable than the supplier of goods and services. For borrowers of small businesses, the benefits of factoring are reduced to (Volkova et al., 2017):

- opportunities for prompt replenishment of working capital;
- opportunities to increase sales;
- no need to provide collateral;
- risk reduction with non-recourse factoring;
- accounts receivable management;
- ease of design.

The disadvantage of using factoring by small businesses is complex tariff plans with hidden interest fees for arrears. Despite this disadvantage, for many small businesses, factoring may be an alternative to bank loans. It is especially true for trading companies that do not have quality collateral and credit history. Their main asset is receivables arising from the shipment of goods with deferred payment. It is in these cases that factoring is indispensable as a way to obtain timely financing to reduce the cash gaps of a small enterprise.

Another, no less important direction of small business lending is financial leasing. The benefits of leasing are valuable for those small enterprises that are in the general system of taxation, because the use of leasing achieves savings from income tax by including lease payments in the cost, as well as the possibility of accelerated depreciation. There is also no problem of availability, quality and sufficiency of collateral, as collateral is property transferred under a lease agreement. In addition, the use of leasing may provide opportunities to subsidize the interest rate on leasing, and also allows you to renew fixed assets without significant own funds. The advantages of leasing include decision-making, which is several times less than when lending. At the same time, for small businesses, leasing remains a more expensive source of financial security than lending.

For enterprises with a simplified taxation system leasing loses its main tax benefits, moreover, it actually loses the credit, because leasing will cause the incur of a tax liability for VAT which a leasing user will be forced to pay as part of the leasing payments. Notwithstanding it, leasing will remain relevant for enterprises-payers of a single tax if the amount of financing significantly exceeds the assets of the borrower (which is impossible while obtaining a loan). A combination of leasing with cooperation with international financial organizations is optimal. An example of such cooperation is the attraction of financing for OTP Leasing from EBRD and subsidiary bank for the support of small and medium enterprises in Ukraine. Under the terms of the agreement, signed on October 15, 2017, the EBRD in Ukraine provides a company OTP Leasing with a credit in national currency in the amount of UAH 514 million (equivalent to USD 20 million) with the purpose of providing financial leasing in the national currency for small and medium enterprises throughout the country (Rudyk, 2016).

Discussion

Based on the study, the need for bank lending and leasing was investigated and established. The specifics of the work of financial enterprises with small, which is due to the presence of additional risks, is associated with a high assessment of inaccurate probability of inaccurate assessment of the probability of inaccuracy of small enterprises and their solvency. In order to ensure the complexity of assessing the condition of small entrepreneurship without increasing the risk of default, a leasing company may introduce additional collateral or a guarantee of third parties, as well as to increase the sum of advance payment.

Taking into account the specificity and needs of small business, leasing companies may suggest express-leasing, presupposing a quick application review (from one hour to one day) and immediate information receiving by a client concerning the readiness for financing; after sending all the necessary documents a leasing provider gives a final answer with the stipulation of the rate, the amount of the advance, term and other conditions. A peculiarity of the scheme of express leasing is that the state of a leasing user is not estimated or estimated improperly which is predetermined by an aspiration to the fastest possible conclusion of the agreement, and to reduce the risks of default, the leasing company may require life insurance and disability of the owner and manager of a small business or a guarantee from the latter. That is why this issue is important and necessary for countries where development priorities are given to small and medium-sized businesses.

Conclusions

So, a necessity in the management in the system of crediting of a small business consists in the search for alternative traditional bank crediting services making it possible to avoid the most widespread problems and barriers to credit development (the absence (lack, an unsatisfactory quality) provision, the speed of giving a credit, a necessity in the preparation of documents for applying for a credit, etc.).

Alternative financing resources may be represented by the following crowd funding forms, such as:

- crowd funding (a mass popular form of financing with the aim of supporting creative projects, startups, business and charity events by means of internet-platforms);
- crowd investing (by its economic essence it is a form of collective investment, the main aim of which is to obtain a part of the profits of a funded enterprise).
- crowd lending (internet-crediting of enterprises or individuals via crowd lending platforms); it exists in two forms of p2p-lending (individuals), p2B (subjects of small and medium enterprises).

Thus, the management, realization and formation of a financial support by an effective system for the activity of small enterprises at the stages of an independent business formation are preconditions for their effective development. It must be determined by a state policy in a mentioned sphere and it must provide a legal regulation process and the regulation of organizational principles connected with a financial provision of their activities on the stage of management, including the creation, registration, formation, choice of the system of taxing of the subject – small entrepreneurship and carrying out various activities.

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