

SME Lending in the Conditions of Economic Instability: Peculiarities and Development Prospects

Oksana V. Savchina^a, Olga V. Savchina^a, Alexander L. Bobkov^b,
Kristina U. Ezenkina^c and Iraida A. Kalashnikova^b

^aPeoples' Friendship University of Russia, Moscow, RUSSIA; ^bPlekhanov Russian University of Economics, Moscow, RUSSIA; ^cChuvash State University named after I. Ulyanov, Cheboksary, RUSSIA

ABSTRACT

Small and medium enterprises (SMEs) are the key to sustainable economic development and solution to a number of social issues in many countries. This is especially evident during economic crisis with the worsening of qualitative condition of individual sectors of the economy, the reducing competitiveness. The problem of financing and development of SMEs lending market is one of the most pressing in modern conditions. Lack of interest of banks in the development of credit relations with SMEs does not contribute to optimization and reduction of the cost of lending process. Successful development of SMEs requires effective public policies and favorable credit conditions to obtain sources of financing. The study analyzes the conditions and credit status of Russian SMEs in 2009 - 2016 period, as well as gives an assessment of its future prospects.

KEYWORDS

Small and medium business, SME, partner bank credit, arrears, interest rate, economic instability

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Introduction

As the economy overcomes the consequences of the global financial crisis of the 2008 – 2009, the small and medium-sized enterprises (SME) sector has demonstrated a stable production growth. However, due to the deteriorating external economic situation by the end of 2015 this figure had fallen to 20% of GDP (as of 2014 – about 50% of GDP) (Korolev, 2015). Despite active public support policy to the SMEs sector, this segment of the Russian economy is regularly faced with barriers of development and financing. Currently, in the Russian Federation the SME sector involves only about 25% of the economically active population, whereas in highly developed countries this figure ranges from 35 to 80 % (Wilkinson, 2016).

CORRESPONDENCE Oksana V. Savchina ✉ savchina_ovl@pfur.ru

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The importance of the study on SMEs problems in the Russian Federation is due to the fact that at the moment the strategic goal of the Government of the Russian Federation is to create a stable and a large middle-class population. The formation of market relations in the Russian economy, its sustainable economic growth is largely linked to the development of SMEs. The experience of highly developed countries shows that it plays a crucial role in the economic and social life. It accounts for 50-70% of the gross domestic product (GDP), while the share of small firms reaches up to 80-90% of the total number of commercial organizations (Li & Zhoe, 2014).

Theoretical and practical aspects of SME financing in Europe and in the Russian Federation in particular is addressed by a wide range of authors, including: R. DeYoung et al. (2015), A.L. Friedman, S. Miles & C. Adams (2000), F. Lopez et al. (2015), Y. Ma & S. Lin (2014), G. McGuinness & T. Hogan (2016), A.D. Medkov (2013), A.A. Saraev (2013), E.V. Tikhomirova (2014) to name just a few.

Results of the study of I.P. Vlasov (2009) reflect the state of the lending market of SME during crisis. The author highlights the main aspects of lending to SMEs based on three scenarios: optimistic, stable, and negative.

Pashcenco (2016) analyzed data on the types and amounts of financial support, as well as the estimated impact of the financial support on key performance indicators of the enterprise. The study provides an evaluation of the creditworthiness of SMEs and discusses the direction of its development.

A.I. Kartuesov and P.A. Samiev (2014) consider the practice of lending by commercial banks to SMEs, the main incentives and limit to the development of this segment, considering the state policy in the sphere of support of SME lending.

In the study of J.E. Wilkinson (2016) analyzes how the leaders of the SME segment strategically adapt to changing credit conditions in the context of globalization. The author presents data on how does the development of small and medium-sized businesses impacts the main socio-economic processes, pointing to the importance of this segment.

T. Wilson (2016), based on the analysis of the post-crisis situation, reveals credit control priorities with regard to political, economic and regulatory issues in general.

The findings of A.M. Abdulsaleh and A.C. Worthington (2013) reflect a significant difference between large businesses and SMEs, on the basis of which the author proceeds with a comparative analysis on the approach of funding of the given segments.

At the present stage of economic development and in the conditions of market relations in the Russian Federation SME is the most promising form of economic activity in a variety of sectors. It provides increased employment, reduction in unemployment and an increase in the number of employees who are socially and economically dependent on the sustainability of business enterprises. Given the importance of SMEs as an engine of economic growth, the basis of its successful development, it is required to offer favorable lending conditions in order to obtain funding. Subjects of SMEs are the middle class and part of the community, stabilizing the economy in crisis conditions (Wilson, 2016).

Lack of interest of banks in the development of credit relations with SMEs does not contribute to the creation of specialized loan products to optimize and reduce the cost of lending process and maintenance of SMEs activity. There is insufficient accumulation of information on SMEs, as well as specialized scoring methodology for assessing the creditworthiness risk, standardization and automation of credit process. Methods of working with SMEs are identical on the organization of relations with large corporate borrowers. This, on the one hand, leads to an increase in the term of processing of documents and the decision to grant credit, on the other – to the higher price of credit.

Financial support and infrastructure organization of SMEs

To date, the institute for SME support in the field of lending is JSC “Russian Bank for Small and Medium Enterprises” (JSC “SME Bank”). SME Bank is 100% subsidiary of Vnesheconombank organization that since 2004 implements the state program of financial support for small and medium-sized businesses, and from 2013 implements guarantee support for SMEs. The aim of SME Bank is the development of small and medium-sized businesses with the help of state support and target orientations set by Vnesheconombank (State Council, 2015). Second institute for SME support in the field of lending is JSC “Federal Corporation for Development of Small and Medium Enterprises” (SME Corp.) (Federal Corporation for the Development of Small and Medium Enterprises, 2016).

Currently, the market of SME lending has fairly narrow list of loans. Successful business prosperity is based on the right choice of the type and form of a loan, taking into account the aim to attract additional funds. The objectives of lending to SMEs are the investment, production activities or commercial mortgage (Pashchenko, 2016). In recent decades in the Russian Federation the widespread use have received various forms of state loan guarantees for SMEs, acting as an effective tool to support this sector. Since 2004, SME Bank actively pursued a program of financial support for SMEs. The number of partners of the bank is not permanent. Due to the dramatically changing conditions they change frequently. In early 2012, the number of partner banks, including regional branches totaled 897. This trend continued for several months, but there was a sharp increase in the middle of the year. As a result, by the end of the reporting period, the number of banks – partners reached 1102, despite the policy of many banks, aimed at optimizing costs and the closure of the regional offices. This evidenced the interest of the banking sector in supporting small and medium-sized businesses. Changes in the number of partner banks in 2013 remained relatively stable and varied within the range of 1070 – 1084. In 2014 was a declining trend in the number of partner banks, with the result that by the end of the reporting period the figure reached 809, with 172 partner bank less compared to 2013 (fig. 1).

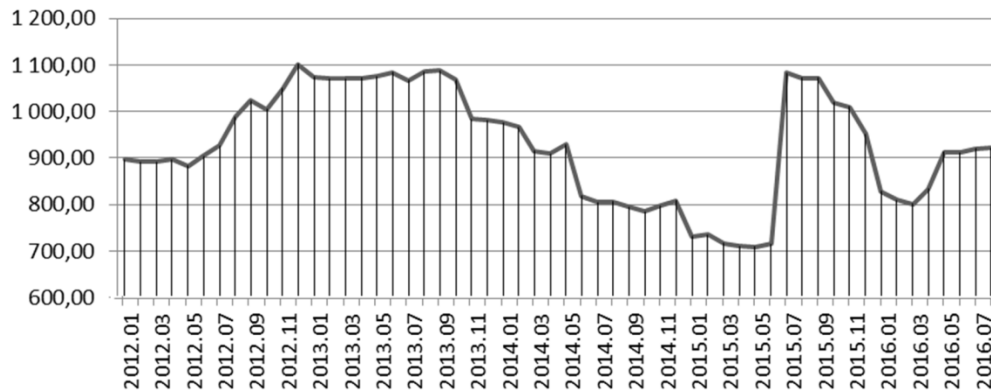


Figure 1. The number of partner banks (including branches of partner banks) in 2012 - 2016
Source: Russian Bank for Small and Medium Enterprises Support (2016)

Despite the continuing downward trend in the number of partner banks, in July 2015 there was a sharp increase of 368 banks, i.e. 51%. Such a sharp increase was primarily due to the signing of a cooperation agreement between SME Bank and the bank “Saint-Petersburg” on June 18, 2015 (Ministry of Economic Development of the Russian Federation, 2016). However, by the end of 2015 the number of partner banks reduced to 829. The reason for this were unfavorable conditions for cooperation. In addition, at the beginning of 2016 LLC “Interkommerts” license revoked, leading to a reduction in partner banks to 801 (by Ministry of Economic Development of the Russian Federation, 2010 - 2013). By August 2016 the number of partner banks has increased again and reached 920. To date, 40 banks are partner banks and are accredited guarantee organizations of “SME Bank”. The largest of them are: PJSC “Sberbank of Russia”, PJSC “VTB 24”, PJSC “VTB Bank”, PJSC “Rosselkhozbank” and PJSC “Bank of Moscow” (Pletnev & Barkhatov, 2016).

JSC “SME Bank”, together with the partner banks forms the infrastructure organization of SMEs (fig. 2). Analyzing their numbers, it can be noted that there is a steady trend towards an increase, as compared to partner banks. In early 2012, 119 infrastructure organizations provided factoring, leasing services, issued loans and microloans. By the end of 2014, 153 infrastructure organizations of SME support have been registered. Due to the deteriorating economic conditions in the country, the number of partners – infrastructure organizations in 2015 was reduced to 26 (from 153 in December 2014 to 127 in December 2015). The declining trend in the number of partners – infrastructure continued in August 2016.

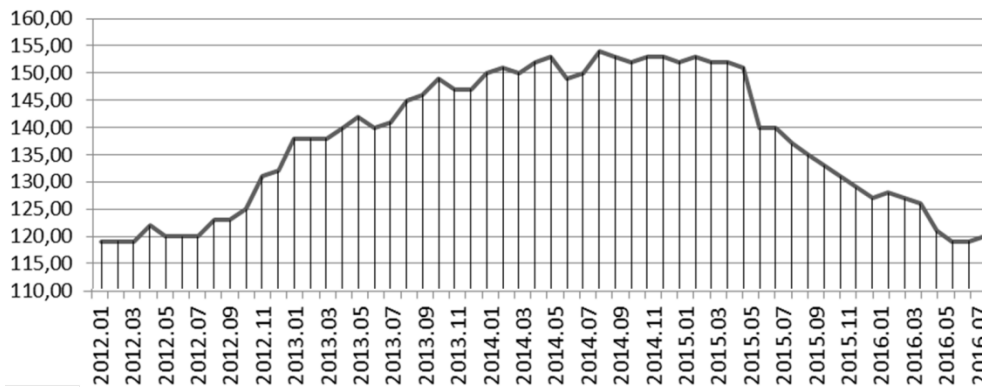


Figure 2. The number of partners - infrastructure organization in 2012 - 2016
 Source: Russian Bank for Small and Medium Enterprises Support (2016)

Analyzing the efficiency and interest of SMEs to the programs of “SME Bank” requires considering the number of SMEs that are members of the program (fig. 3). It should be noted that the dynamics of the number of SMEs that are involved in the SME Bank program is rather unstable. In 2012, there was a jumplike tendency of change in the number of SMEs, which are the participants of the program. As a result, in 2013 there has been a clear reduction in the dynamics. By mid-2016 the number of small and medium-sized businesses being participants of the program has reached 15,404, which is by 6559 subjects less compared to 2012.

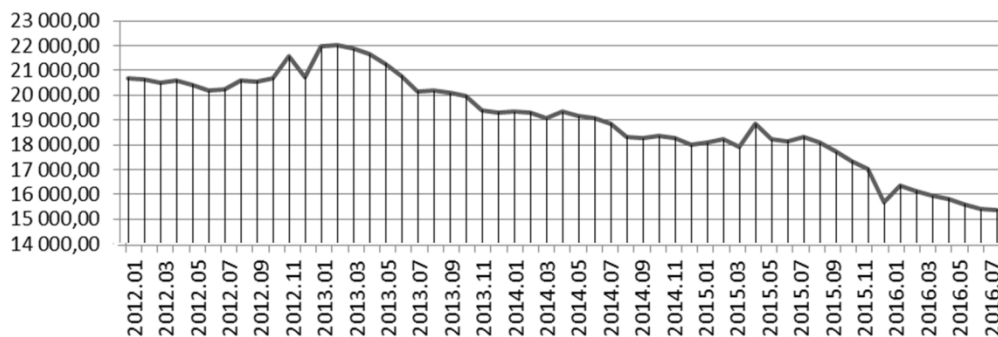


Figure 3. The number of small and medium-sized businesses that are members of the program in 2012 - 2016
 Source: Russian Bank for Small and Medium Enterprises Support (2016)

Credit programs of specialized banks, such as “SME Bank”, for small and medium enterprises in the period from 2009 to 2013 given the development opportunity to this segment. However, in the 2015 – 2016, in terms of economic instability the SMEs subjects are wary of loans, while credit institutions limit their application by establishing collateral surety and other precautions to avoid increase in arrears.

Dynamics of loans to small and medium-sized businesses in crisis conditions

The volume of loans granted to SMEs in the period from 2009 to 2014, as a whole, has a stable upward trend with the exception of 2014 (see Figure 4). In 2009, the volume of loans amounted to 3,002,887 million rubles. In 2010, this figure increased by 57%, amounted to 4,704,715 million rubles. The reason for the increase was the size of interest rates below market registered – they were reduced from 8.5% to 6.25% per annum.

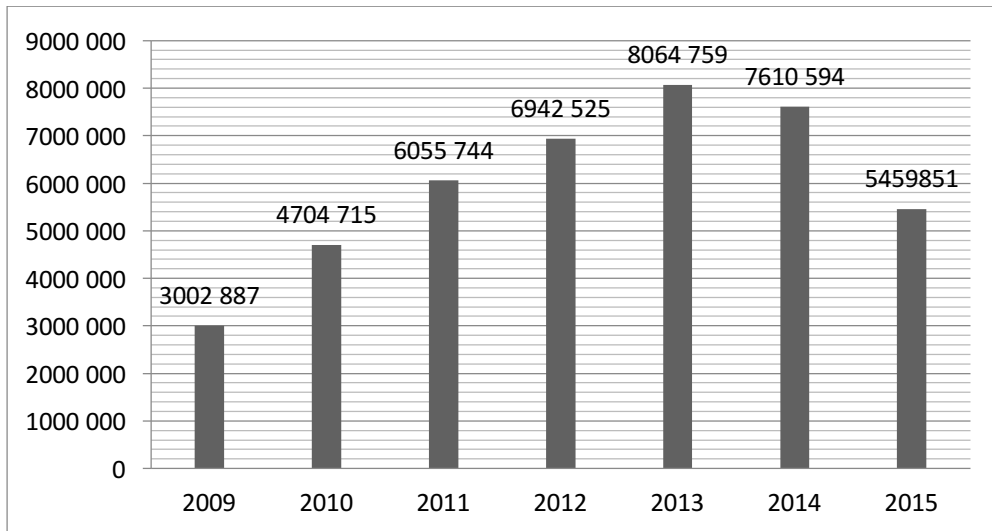


Figure 4. The total volume of loans granted to small and medium-sized businesses in 2009 - 2015, million rubles

Source: Central Bank of the Russian Federation (2016b)

In 2011, the volume of loans to SMEs grew by 29% to 1,351,029 million rubles, for 2012 – by 15% for 2013 – by 16%. Every year the volume of issued loans had increase, but it is now decreasing. In 2014, the volume of loans fell by 6% (454,165 million rubles) as a result of an increase in interest rates on loans associated with the instability of the economic situation. The downward trend in the volume of loans granted is also observed in 2015 due to the tension in the economy and a high risk of non-payment. The total volume of loans granted amounted to 5,459,851 million rubles, which is 2,150,743 million rubles less. Thus, the decline was 28.3% (The Central Bank of the Russian Federation, 2016).

The weighted average rate on loans increased steadily during the period from 2012 to 2016 (fig. 5). During this period, its value ranged from 12.31 to 13.32%, indicating the control and maintenance of the credit rates. The sharp increase in the weighted average interest rate observed since the beginning of 2015, due to the high risk of default.

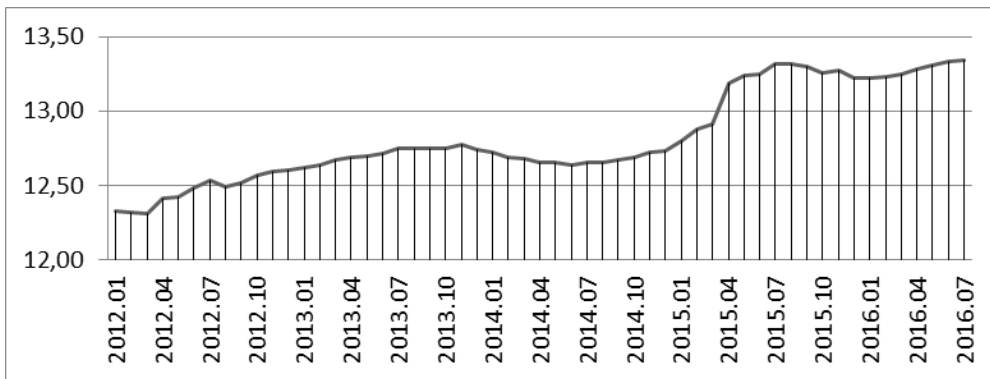


Figure 5. The weighted average rate on loans to small and medium-sized businesses in the 2012 - 2016

Source: Russian Bank for Small and Medium Enterprises Support (2016)

Against the backdrop of the increasing volume of lending to SMEs and the weighted average interest rate, increases the total amount of debt, including arrears (fig. 6). At the end of 2009 the debt amounted to 2,647,973 million rubles, 208,476 million rubles of which – arrears (8% of total debt). During the 2009 – 2014, the share of overdue loans amounted to 8 – 9 %, indicating the stability and sustainability of SMEs. In 2010, there was an increase in the share of overdue debt by 22% (to 579,597 million rubles), in 2011 – by 19%, in 2012 – by 17%, in 2013 – by 15%. In 2014, total debt decreased by 1% (43,816 million rubles), however, arrears, on the contrary, increased by 11% (to 41,811 million rubles). In 2015, the total amount of debt reached 5,459,851 million rubles, a decline of 289,542 million rubles, i.e. by 6%, and arrears, on the contrary, increased by 236,323 million rubles – 54% (The Central Bank of the Russian Federation, 2016).

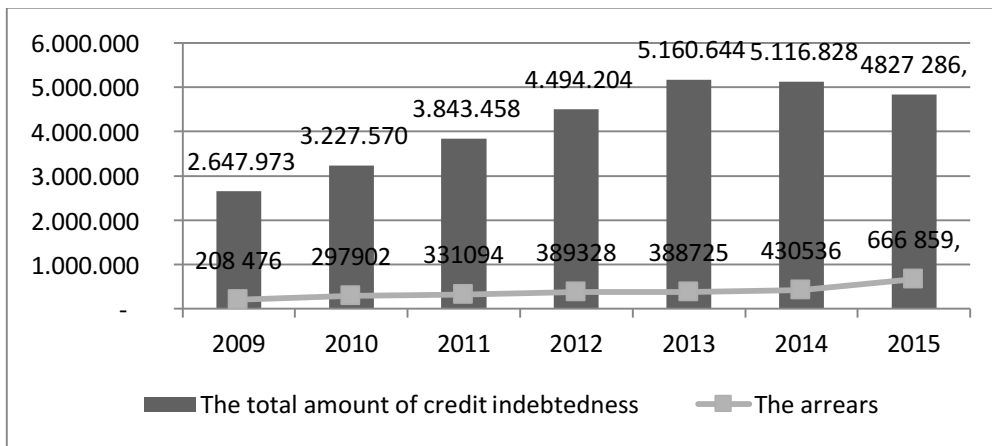


Figure 6. The total amount of outstanding loans (including arrears) of SMEs in 2009 - 2015, mln.rub.

Source: Central Bank of the Russian Federation (2016a)



Problems hampering SME lending

The economic climate of the country has a directly proportional effect on the state of small and medium-sized businesses. SMEs first and most strongly react to problems in the business climate of the country. Limitation of credit products, imposed sanctions, abrupt behavior of exchange rates, the tightening of the tax burden and foreign tensions stimulate the SME sector “to go into the shade” (Agostino & Trivieri, 2014).

The main problem for SMEs is the lack of access to financial and material resources. Lending problem of SMEs in Russia remains unresolved for a long period of time. Now due to the difficult economic and geopolitical situation occurs the exacerbation of existing and new global challenges. SME credit problems have always been an obstacle to its successful development. A successful development of the business has always hampered by lack of funds. These problems are interrelated. And this relationship is expressed in a pattern: the less money has the entrepreneur, the less credit the entrepreneur can take. That is, for SMEs only the microcredit is available (Bruton et al., 2015).

According to the Ministry of Economic Development and Trade of Russia, small and medium businesses need loans worth 30 billion annually, but they receive only 10-15% of this amount. Of the total volume of all loans issued, only 6% are SMEs. Access of SMEs to credit resources in 2016 has become more complicated, and it is practically unavailable for a number of companies. During the current year the tightening of banks' claims on borrowers is identified. While earlier the loan processing took about a month, this year it takes 2.5 – 3 months (Vilenskii, 2014). The volume of loans to SMEs has a slow annual growth. The reason for this was the decline in demand for credit resources on the part of SMEs as a result of growth in the value of loans: increasing impact of the key rate of the Bank of Russia and the restricted access of banks to international capital markets. In response, lenders have started to set higher requirements for customers and reduce unsecured lending – one of the main drivers of growth of the market over the past few years (Sinyavskij, 2014).

Major negative trends in the market of crediting of SMEs at the moment can be explained by the desire of banks to reduce their risks and reduce the growth of overdue debt. In this regard, large credit institutions apply mechanisms of ‘credit factory’ and, therefore, the overdue debt that is more susceptible to growth, reduced their activity in the market. This also contributed to the willingness of banks to concentrate on attracting customers from a number of large businesses that have lost the ability to be funded abroad.

To date, it has developed a number of serious problems of SME lending. First of all is the insufficiently developed demand – often SMEs overseeing the feasibility of lending. The banks themselves are not provided with all the necessary resources to work with SMEs. There is also the problem with the legal framework, often due to complicated bureaucratic documentation. Another weighty problem in lending to SMEs is lack of a clear business support mechanism at the federal level. (European Investment Bank, 2015). For example, legislation acknowledges the need to support SMEs, but it is limited to specific measures in its implementation.

Many banks claim that they are open to work with SMEs, but entrepreneurs still claim that they are not, as it is still difficult to get a loan, or

harder than to take a loan at the black market. Obstacles in obtaining credit by SME are presented in Table 1.

Table 1. Obstacles obtaining credit by SMEs
Source: E.V. Pashchenko (2016)

Reason	Percentage ratio
Problems with the pledge or guarantee	43
High interest rates	32
Problems with registration of documents	26
Short term lending	15
No need	12
No confidence in banks	5

According to a survey of SMEs on crediting issues revealed that the main problems hindering the production credits include: the problem with the pledge and high interest rates. Among the reasons there were also such responses as problems with registration of documents, short term lending, confidence in banks.

Prospects for the development of bank lending to small and medium-sized businesses in Russia in the next 1-2 years

Currently, the loans of commercial banks, providing the economic activities of enterprises, promote their development, support liquidity, as well as increase the volume of production, works and services rendered. Role of commercial banks loans as an additional source of financing of business activity is fully manifested in the stage of creating an organization that uses the borrowed credit funds in the implementation of long-term investments aimed at creating a new property (with the capital investment) (Berger, Goulding & Rice, 2014). At this stage the long-term loans of commercial banks are very important. Short term loans can help the organization to maintain the current level of working capital, contribute to accelerate the turnover of liquid assets, as well as help to maintain the financial stability of the organization at the appropriate level.

To assess the prospects for the development of SMEs lending a forecast of main indicators will be given – volume of loans granted to SMEs and the volume of overdue loans in the next 2 years. The data is analyzed using method of equalization analytics on the basis of data on the volume of loans and arrears in 2009 – 2015 (tables 2, 3).

Table 2. Initial and calculated data used for tend identification (million rubles)
Source: Central Bank of the Russian Federation (2016b)

Period	Y, mln rub	t	t ²	y*t	Y _t =a ₀ +a ₁ *t
1	3002887	-3	9	-9008661	4349618
2	4704715	-2	4	-9409430	4892178
3	6055744	-1	1	-6055744	5434737
4	6942525	0	0	0	5977296
5	8064759	1	1	8064759	6519856
6	7610594	2	4	15221188	7062415
7	5459851	3	9	16379553	7604975



Total	41841075	0	28	15191665	-
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Based on reported indicators the calculated parameters a_0 and a_1 via least squares method from the following equation system is:

$$\begin{cases} na_0 + a_1 \sum t = \sum y; \\ a_0 \sum t + a_1 \sum t^2 = \sum yt; \end{cases}$$

$$\begin{cases} 7a_0 = 141841075; \\ 28a_1 = 15191665. \end{cases}$$

From the first equation we express a_0 and use it in the second equation. We derive $a_0 = 5977296,43$; $a_1 = 542559,46$. Trend equation: $y_t = 5977296,43 + 542559,46 \cdot t$.

We calculate the theoretical values of Y_t over the period 2009-2015:

$$y_{t1} = 5977296,43 + 542559,46 \cdot (-3) = 4349618;$$

$$y_{t2} = 5977296,43 + 542559,46 \cdot (-2) = 4892178;$$

$$y_{t3} = 5977296,43 + 542559,46 \cdot (-1) = 5434737 \text{ etc.}$$

Using trend equation can determine the values Y_t over each period, by substituting time value with the trend function t (Table 9). With this method, it is possible to do the forecast, thus we express the volume of loans granted to SMEs in the 2016-2017. In 2016, the volume of loans granted to SMEs, according to the calculations of the authors, will be: $Y_{2016} = 5977296,43 + 542559,46 \cdot 4 = 8147534$ mln.rub. By 2017 the volume of loans granted to SMEs is forecasted in the following amounts:

$$Y_{2017} = 5977296,43 + 542559,46 \cdot 5 = 8690094 \text{ mln.rub.}$$

According to calculations the following conclusions can be drawn: the volume of loans granted to SMEs will tend to increase, in 2016 it will increase by 2.687683 trillion rub., by 2017 will amount to 8.690094 trillion rubles. Next, we estimate the prospects of overdue debts of SMEs based on data for the period from 2009 to 2015 (table 3).

Table 3. Initial and calculated data used for trend identification (million rubles)
Source: Central Bank of the Russian Federation (2016a)

Period	Y, million rubles	t	t ²	y*t	Y _t =a ₀ +a ₁ *t
1	208 476	-3	9	- 625 428	205 626,29
2	297 902	-2	4	- 595 804	266270,8571
3	331 094	-1	1	- 331 094	326915,4286
4	389 328	0	0	0	387560
5	388 725	1	1	388 725	448204,5714
6	430 536	2	4	861 072	508849,1429
7	666 859	3	9	2 000 577	569493,7143
Total	2 712 920	0	28	1 698 048	-

Based on reported indicators the calculated parameters a_0 and a_1 via least squares method from the following equation system is:

$$\begin{cases} na_0 + a_1 \sum t = \sum y; \\ a_0 \sum t + a_1 \sum t^2 = \sum yt; \end{cases}$$

$$\begin{cases} 7a_0 = 2\,712\,920; \\ 28a_1 = 1\,698\,048. \end{cases}$$

From the first equation we express a_0 and use it in the second equation. We derive $a_0 = 387\,560$; $a_1 = 60644,57$. Trend equation: $y_t = 387\,560 + 60644,57 \cdot t$.

We calculate the theoretical values of Y_t over the period 2009-2015:

$$y_{t1} = 387\,560 + 60644,57 \cdot (-3) = 205\,626,29;$$

$$y_{t2} = 387\,560 + 60644,57 \cdot (-2) = 266270,8571;$$

$$y_{t3} = 387\,560 + 60644,57 \cdot (-1) = 326915,4286 \text{ etc.}$$

Using trend equation can determine the values Y_t over each period, by substituting time value with the trend function t (Table 3). With this method, it is possible to do the forecast, thus we express the volume of arrears of SMEs in the 2016-2017. In 2016 the volume of overdue debts of SMEs, according to the calculations of the authors, will amount to:

$$Y_{2016} = 387\,560 + 60644,57 \cdot 4 = 630\,138,29 \text{ mln.rub.}$$

In 2017 the volume of overdue debts of SMEs is forecasted in the following amounts:

$$Y_{2017} = 387\,560 + 60644,57 \cdot 5 = 690\,782,86 \text{ mln.rub.}$$

According to calculations the following conclusions are drawn: the amount of arrears of SMEs will tend to increase. By 2017 it will increase by 23 923,86 mln.rub.

According to experts, in the near future the credit growth of SMEs is expected, despite the downward trend in the beginning of 2016. Thus by the end of 2016 the expected increase in the size of the loan portfolio of SMEs will be approx. 8-10% compared to 2014. Experts believe that, despite the negative dynamics of volumes of lending to SMEs, the sector has the need for long-term money at reasonable rates of interest. As for the size of arrears of SMEs, the analysts believe that in 2016 its share will reach its peak – around 14% (in 2014 its value was 8%). By year-end arrears will increase and amount to about 700 billion rubles, which is 60% more than in 2014. Thus, according to the research results, the volume of loans to SMEs is expected to increase on the basis of the positive dynamics over the 2009 – 2015 periods. Thus, assessing the economic situation in general, the sanctions imposed in 2014, and a high risk of granting unsecured loans, by the end of 2016 this figure is likely to fall. As for the size of arrears, according to the calculations, in the next two years it will increase. This trend is also confirmed by the expectations of the expert community.

Conclusion

The study shows that in the SMEs lending market there has a tendency of reducing the values of all basic indicators, a decrease of interest in credit products. JSC “SME Bank”, created to support small and medium-sized businesses annually demonstrates the ineffectiveness of its activity, which is manifested in the reduction of the number of partner banks, of SMEs participating in the program, and the number of contracts settled between partner banks and SMEs.

The volume of loans also tend to decrease in 2014 – 2016. The main reason is the increase of interest rates on credit products, which, in turn, increase due to the crisis and the risk of non-repayment. Limitation of credit products,

imposed sanctions, unstable exchange rate of the national currency, the tightening of the tax burden and foreign policy tensions stimulate the sector of SMEs “go into the shadow”. Thus, we can conclude that despite the fact that the priority objective of the Government of the Russian Federation is the development of small and medium businesses, SMEs lending as one of the factors to achieve this goal, is insufficiently implemented.

Disclosure statement

No potential conflict of interest was reported by the authors.

Notes on contributors

Oksana V. Savchina – PhD, Associate Professor, Peoples’ Friendship University of Russia, Moscow, Russia.

Olga V. Savchina - PhD, Associate Professor, Peoples’ Friendship University of Russia, Moscow, Russia.

Alexander L. Bobkov - PhD, Associate Professor, Plekhanov Russian University of Economics, Moscow, Russia.

Kristina U. Ezenkina - PhD, Associate Professor, Chuvash State University named after I. Ulyanov, Cheboksary, Russia.

Iraida A. Kalashnikova - PhD, Associate Professor, Plekhanov Russian University of Economics, Moscow, Russia.

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