

The role and transparency of subsidies in SME financing: The Dutch situation described.

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Assignment: Master Thesis
Version: Final
Graduation date: 7 June 2012

UNIVERSITEIT TWENTE.



Acknowledgement

With the completion of this master thesis my days as a student have come to an end. The process of performing research and writing this thesis has been a valuable experience to me. As with any process, there were ups and downs.

Hereby I would like to thank Finan for giving me the opportunity to do an internship at their office, and especially Ronald van Alderen for his guidance. I am also grateful to my supervisors from the university, Ger Vergeer and Reinoud Joosten, for their comments and feedback. Every meeting we had was always a pleasure.

To my family and friends, thank you for supporting me unconditionally. It has been very helpful to talk to you about the issues I encountered. And the good times we had were very important for maintaining a clear view.

Last but not least, I want to dedicate this thesis to both my grandmothers who sadly passed away during the performance of the research presented in this thesis.

Management summary

The research presented in this thesis examines the role and transparency of subsidies in SME financing in the Netherlands. This is done through examining three key topics: SME financing, subsidies and accountability by reviewing literature and conducting interviews with professionals in the work field.

After a short introduction the second chapter presents the research framework, followed by the literature review. The topics discussed during the interviews are based on the literature review. The fourth chapter describes the situation in the Netherlands. In Chapter V the interview structure and sample of respondents will be addressed. The sixth chapter presents the research outcomes, these outcomes will subsequently be discussed in Chapter VII. Followed by the conclusions and recommendations of the research performed at the end of the thesis.

SME financing has caught the attention of scholars, economists and policy makers because SME firms are important for economic development. As a result of the ongoing consequences of the 2007 credit crunch it is difficult for SME firms to obtain external financing. It is vital for firms to overcome information asymmetries when attempting to obtain external financing. The leading information based theory on SME financing is the pecking order theory, which will be applied during the research.

Firms can use subsidies as a source of external financing. Subsidies are granted by governments to correct for market imperfections or to stimulate politically desired developments. The most relevant subsidy types related to SME financing are: cash, credit and tax subsidies. As most subsidies are aimed at stimulating certain activities firms are often required to account for the specific content in addition to the financial accountability that has to be provided towards government.

Accountability is about the justification towards internal and/or external stakeholders by sharing information with them and thereby reducing information asymmetries. When firms are transparent they voluntarily provide full and understandable information towards stakeholders to gain their confidence. In order to compare information more easily and to increase the consistency of information, financial accounting information is becoming more harmonized.

Regarding the role of subsidies in Dutch SME financing it can be stated that in general this role is rather limited. Relatively few firms receive subsidies and they stand low in the pecking order of financing sources due to the connected terms and conditions. Firms that do receive subsidies can experience financing benefits from them, to what extent differs per type of subsidy and the specific circumstances. The influence of cash and tax subsidies on the overall financing of a firm is limited whereas credit subsidies have a relative large impact. However, this type of subsidy is least preferred by entrepreneurs and is placed at the bottom of the subsidy pecking order: cash, tax and credit subsidies. Although the role of subsidies in Dutch SME financing is rather limited, subsidies seem to fit well into widely used theories on SME financing like the pecking order and life cycle theory.

The accountability for subsidies is quite strict compared to other sources of finance, mainly because of the amount of accountability required: financial and content specific. Subsidies are typically not explicitly displayed in the annual accounts of SME firms. Through deducting subsidies from the corresponding expenses or balance sheet items the annual accounts still present a true and fair view. However, because subsidies are not explicitly mentioned the role of subsidies in SME financing is not very transparent.

As subsidies fit well into theories on SME financing it is recommended to perform further research on the role of subsidies in SME financing. To get more tangible outcomes it is advised to examine the influence of one subsidy in more detail instead of examining the whole range of subsidies. To perform a quantitative study would also be a valuable addition to the qualitative research presented in this thesis. In order to enhance the transparency of subsidies in SME accounting financing it is suggested to incorporate subsidies in the upcoming SBR framework in an explicit manner. This could increase the awareness among entrepreneurs and thereby the use of subsidies. This use could also be stimulated if government focuses on offering fewer and longer existing subsidies.

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Chapter I: Introduction

This chapter gives the background of the research presented in this thesis and shortly introduces the key topics examined during the research. The scientific and practical relevance, the objectives and structure of this thesis will also be addressed in this chapter.

1.1: Background

The motivation behind the research presented in this thesis is twofold. First, the firm where the author of this thesis did an internship was looking to become more knowledgeable about subsidies and subsidy accountability in particular. Second, this thesis serves as the final step for the author in completing the study Business Administration with a specialisation in Financial Management. Due to this specialisation the research should also be about financing.

As most subsidies are focused on SME firms it is a logical step to examine the role of subsidies in SME financing. To gain insight in this role, the transparency of subsidies in SME accounting information will be examined. In this manner the accountability of subsidies is also investigated because transparency and accountability are tightly connected.

All in all, there was no crystal clear trajectory at the start of the research. By combining the necessary topics in one research, the author of this thesis can be considered as the instigator and problem owner of the research.

1.2: Topics

The topics that are discussed in this thesis are based on the desire to gain insight into the role of subsidies in the financing of SME firms and the transparency of this role.

This results in the following three key topics of this thesis:

- SME-financing.
- Subsidies.
- Accountability.

In the following sections a short description of each topic will be given to introduce the key topics. An elaborate description of these key topics will be given in Chapter III, from basic concepts to more practical applications.

1.2.1: SME-financing

SME financing focuses on firms that have up to 250 employees, a maximum turnover of €50 million or total assets with a maximum value of €43 million (Roth [2011]). The financing of SME firms has become an important topic for scholars, economists and policymakers the last couple of years (De la Torre et al. [2010]). This is because SME firms are considered to be an important driver behind economic activity and innovation (OECD, Policy brief; Financing SME's and entrepreneurs [2006]).

The financing of SME firms is rather complicated because of the large variety in activities performed by this type of firms. Furthermore, the ongoing consequences of the 2007 credit crunch hamper the availability of credit to SME firms because banks are more reluctant to lend money (Dell'Ariccia et al. [2008]). SME firms are even more vulnerable in such cases because of relative large information asymmetries between them and the suppliers of finance (Berger & Udell [2006]).

1.2.2: Subsidies

According to Lerner [1999] subsidies are financial instruments that are used by governments to correct for market imperfections and achieve political goals. There are different types of subsidies, these will be addressed in Chapter III.

The Netherlands is considered to be a subsidy paradise, a statement which is supported by the presence of more than 3000 subsidies in total (Fondswervingonline [2011]).

An often mentioned drawback of subsidies is the amount of regulations and conditions that are connected to them. Firms and entrepreneurs can therefore be hesitant towards using them, because they do not want to account for everything they do.

The subsidies taken into account during the research are those available to SME firms in the Netherlands.

1.2.3: Accountability

Accountability is the process of justifying for actions towards internal and/or external stakeholders by providing them with information (Burchell et al. [1980]). The recipients of subsidies have to account for their actions towards government and society because subsidies are publicly funded.

Subsidy recipients' accountability will be investigated in this thesis, with a focus on the transparency of this accountability. Transparency is a principle that is based on performing actions in a visible, predictable and understandable manner (Oliver [2004]).

Transparency originates from accountability and the two topics are tightly connected (Hood [2010]). Because accountability lies at the root of transparency, a good understanding of accountability is required before examining transparency. Therefore accountability is one of the key topics of this thesis. Transparency will be discussed as a part of accountability.

1.3: Relevance

The impact of this thesis depends on the relevance of the research performed in the context of this thesis. The upcoming part describes the relevance of the research from a scientific and practical viewpoint.

1.3.1: Scientific relevance

The three key topics of this thesis have been addressed separately in scientific literature. By combining these topics in one research this thesis aims to add to the existing body of literature.

Previous research on SME financing has focussed upon the characteristics of SME financing and the difficulties SME firms experience in obtaining financing (Berger & Udell [2006]).

Academic work on subsidies is mainly concerned with the motives, types and effects of subsidies (Schwartz & Clements [1999]). The effects of subsidies on SME financing have not received much attention from scholars so far. Subsidies seem to be only identified and mentioned as a source of finance for SME firms. Therefore, this thesis aims to contribute to literature by examining the role of subsidies in SME financing in more detail. This examination will lead to a better understanding of SME financing as a whole, and could produce interesting subjects for future research. The examination of the role of subsidies in SME financing will build further upon literature on both subjects. The literature used in this thesis will be discussed in Chapter III.

One of the expected reasons why little research is performed on the role of subsidies in SME financing is the lack of available information. The lack of information about SME firms is often a challenge for scholars involved in SME financing research (OECD, The SME financing gap (Vol. 1): Theory and evidence [2006]). The level of information about SME firms available for scholars depends on how detailed SME firms have to account for their actions, and the availability of this accounting information. Therefore; this thesis examines accountability of SME firms and the transparency of this accounting information.

The combination of the three key topics makes this thesis somewhat different from research already performed on the key topics. But subsidies do influence SME financing and without accountability there would not be any information available to examine this influence. By connecting these topics; new insights could come forward and add to the understanding about SME financing, subsidies and accountability. Thereby adding to the existing body of literature and exploring possibilities for further research.

1.3.2 Practical significance

Besides the scientific relevance of this thesis there should also be a practical significance to society that is what social science is all about.

The author of this thesis did an internship at a firm with a particular interest for subsidy accountability, they intended to develop an accountability software tool. The knowledge obtained

during the research was passed on to the firm, making the firm more knowledgeable about subsidy accountability and SME financing.

The key topics of this thesis have also been in the media during the course of the research (www.nu.nl, Banklening pijnpunt Nederlandse MKBer [2011]), (www.nuzakelijk.nl [2011]) and (www.nu.nl, Rekenkamer kraakt subsidiebeleid [2011]). These items show that the topics addressed are relevant to society, and could have practical implications.

For instance, a possible practical implication for an entrepreneur could be that he experiences fewer difficulties in financing his firm after reading this thesis. If an entrepreneur is better informed about the role subsidies can play in the financing of his firm, he could use this information for his own benefit.

The accountability aspects discussed in this thesis are also topical at the moment. Because of upcoming budget cuts there is an increased interest for how government funds are spent. What is accomplished with public funding should be clear and visible so that the expenditures can be justified towards society. This also applies to subsidies that are granted to SME firms.

Another possible practical implication could be that the outcomes of this thesis' examination of the accountability of subsidy recipient SME firm are used by government. These outcomes can be used either to justify the current accountability requirements for subsidy recipient SME firms or to improve these requirements.

Finance professionals could also benefit from reading this thesis because of the topicality of the issues addressed. The information displayed in this thesis can be especially useful for professionals who deal with SME financing and subsidies.

The research performed by means of this thesis will probably produce several leads for further investigations, and can therefore be useful for scholars who are seeking interesting topical research topics.

1.4: Research objectives

With the topics and relevance of the research discussed above, this part addresses the purpose and the objectives of this thesis. As pointed out by Verschuren & Doorewaard [2007] these objectives are important for determining the research questions, and objectives help structure a thesis.

Combining the three key topics of the research leads to the following purpose of this thesis:

The research purpose is to investigate the role of subsidies in financing SME firms and to examine the transparency of this role in these firms in the Netherlands.

The following objectives are drawn up to support this purpose and to structure the research:

1. Identify the aspects that are related to financing SME firms.
2. Identify the aspects that are related to subsidies for SME firms.
3. Identify the aspects that are related to the accountability of SME firms.
4. Examine how and to what extent subsidies play a role in financing SME firms.
5. Examine how subsidies for SME firms are accounted for.
6. Examine how strict the required accountability for subsidies for SME firms is perceived in comparison to other sources of finance.
7. Examine the transparency of the financial accounting for subsidies for SME firms.

These objectives are divided into two categories. The first three objectives are intended to become more knowledgeable about the key topics of the research. The remaining four objectives are aimed at providing the information required to meet the purpose of this thesis.

1.5: Structure

This introduction concludes with presenting the structure of this thesis. With the key topics introduced, relevance examined and the objectives set: the following chapter will discuss the research framework. In this second chapter the research questions, design and approach will be presented.

Chapter III will review the literature written about the three key topics. These topics will be reviewed separately so that the first three objectives of this thesis will be met. The literature review provides a theoretical background and serves as a stepping stone towards the empirical part of this thesis. The literature review will be used to identify relevant aspects that structure the empirical part of the research. Basing this empirical part on literature about the three key subjects ensures that this thesis connects to the existing literature.

As most literature about the three key subjects stems from international sources, Chapter IV focuses on the situation in the Netherlands. Sound knowledge about the situation in the Netherlands is required in preparation for the empirical part of this thesis. So, Chapter IV serves as an intermediate step between the literature review and the empirical part of this thesis. This empirical part consists of conducting interviews with professionals in the work field. In the Netherlands are, unlike in Belgium, no quantitative data readily available to examine the influence of subsidies on SME financing statistically. As no quantitative data are readily available and performing a quantitative study goes beyond the resources available for executing the research presented in this thesis, interviews are used to qualitatively assess the role of subsidies in SME financing in the Netherlands.

Chapter V addresses the interviews that are conducted in more detail. The interview structure, the respondents and the interview process will be discussed.

The results of the interviews will be presented in Chapter VI. In this chapter, the empirical outcomes will be confronted with theory to place them in a theoretical perspective.

Chapter VII critically discusses the results from Chapter VI, and addresses the limitations of this thesis.

Finally, Chapter VIII presents the conclusions and recommendations.

Chapter II: Research framework

This second chapter addresses the framework used in conducting the research. This part of the thesis presents the problem statement and research questions, and discusses the research design, research approach and research process.

2.1: Research questions

This part of the thesis presents the questions used during the research. As described by Verschuren & Doorewaard [2007] is the development of research questions an important step in conducting research, because they provide guidance throughout the research process.

The research questions of this thesis relate directly to the research purpose and objectives mentioned in Chapter I. A strong connection between the objectives and questions ensures that the outcomes of the research are in line with the research purpose. This method is described and promoted by Verschuren & Doorewaard [2007] and therefore applied in this thesis.

This method of constructing research questions results in the following problem statement:

What is the role of subsidies in financing SME firms in the Netherlands and what is the transparency of this role?

The following research questions are developed in support of this problem statement.

1. *What are the aspects that are related to the financing of SME firms?*
2. *What are the aspects that are related to subsidies for SME firms?*
3. *What are the aspects that are related to the accountability of SME firms?*
4. *How and to what extent do subsidies play a role in financing SME firms?*
5. *How are subsidies for SME firms accounted for?*
6. *How strict is the required accountability for subsidies for SME firms perceived in comparison to other sources of finance?*
7. *How transparent is the financial accounting for subsidies for SME firms?*

Above questions are based on the research objectives. Answering these research questions contributes in resolving the problem statement.

Two types of research questions can be identified within this thesis; 'what' questions and 'how' questions. Answers to 'what' questions result in a better understanding of the characteristics of research topics. 'How' questions are aimed at understanding the relation between research topics (Cooper & Schindler [2011]).

The answers to the three 'what' questions provide theoretical background and reveal relevant aspects of the three key topics of this thesis. These aspects will be taken into account during the interviews. A sound understanding of the three key research topics is achieved by answering the 'what' questions, therefore this is an important step in preparation for the interviews and answering the four remaining 'how' questions.

The answers to these 'how' questions focus on the relation between the key topics of this thesis, and will be based on the interview outcomes. The answers to these questions are crucial for resolving the problem statement and reaching the research objectives.

2.2: Research design

A useful method in structuring research is to make a research design. Such a design clearly presents the different parts of the research, and gives an overview of the most important topics and actors. Presented in a graphical form, it is also more easily to understand where the research is about and how it is performed.

The method used in this thesis to construct the research design is that of Verschuren & Doorewaard [2007]. Applying their model results in the following research design:

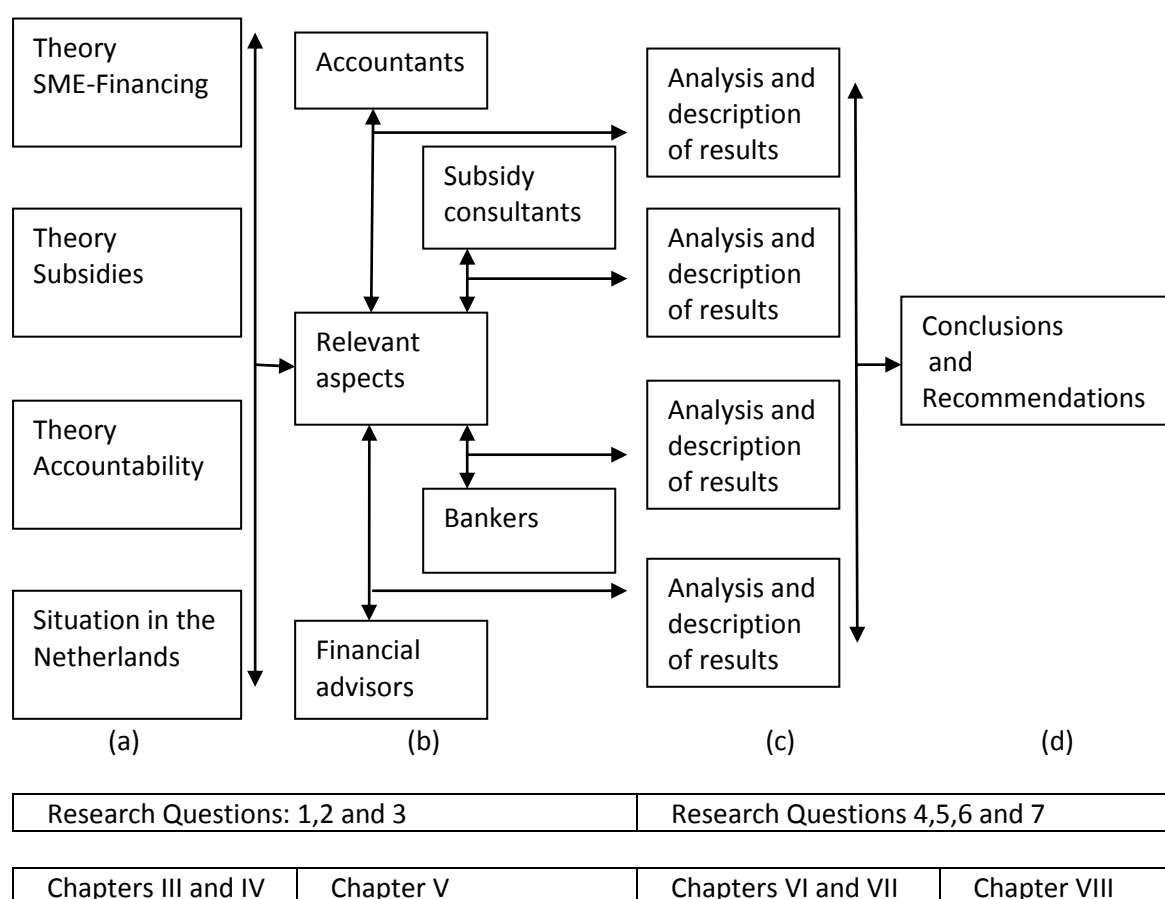


Figure 1: Research design, adapted from Verschuren & Doorewaard [2007].

The research design consists of four columns, representing the major parts of the research: a theoretical part (a), an empirical part (b), analytical part (c) and concluding part (d).

The first part of the research, represented by Column (a), answers Research Questions 1, 2 and 3, and will be addressed in Chapters III and IV. This theoretical part focuses on becoming more knowledgeable about the three key topics of this thesis. This is done by reviewing scientific literature about the three key research topics, and by examining the situation in the Netherlands regarding these topics. Reviewing scientific literature provides a theoretical base and identifies the aspects that should be considered during the empirical part of the research. The reviewed literature stems from international sources, therefore the situation in the Netherlands is examined separately. This examination serves as an intermediate step towards the empirical part of the research which takes place in the Netherlands.

The empirical research part, represented by Column (b), will be addressed in Chapter V. This second part of the research is performed by conducting interviews with professionals in the work field. During these interviews, relevant aspects that emerged from the literature review will be discussed.

As shown in Figure 1, four professions will be interviewed in light of the empirical part of this thesis. Details about the interviews and respondents will be presented in Chapter V.

The third part of the research design, represented by Column (c), aims to answer Research Questions 4, 5, 6 and 7 and will be addressed in Chapters VI and VII. In these chapters, the interview outcomes will be described, analysed and interpreted. Analysing the outcomes will be done by comparing the outcomes with each other and with theory. Placing the interview outcomes in a theoretical perspective is an important step in interpreting the results.

The last part of the research is represented by Column (d) and will be presented in Chapter VIII of this thesis. This chapter concludes and recommends on the role and transparency of subsidies in SME financing. These conclusions and recommendations will be based on the answers to Research Questions 4, 5, 6 and 7.

2.3: Research approach

With the research questions and the research design addressed, this section focuses on the research approach. This is done by discussing the type of research, data and methods of analysis and description.

2.3.1: Type of research

In general there are two types of research: quantitative and qualitative research. Quantitative research attempts to give precise measurements in a numerical way, qualitative research intends to develop understanding through detailed description (Cooper & Schindler [2011]).

As the key topics of this thesis have not yet been studied together in one research, a qualitative research approach is best suited for describing the research topics and the relation between these topics (Cooper & Schindler [2011]). Furthermore, the data required to perform quantitative research on the role of subsidies in SME financing in the Netherlands are not readily available. Collection of these data exceeds the resources available for the research in terms of: time, money and cooperative respondents. Therefore, this thesis is bound to a qualitative investigation into the role of subsidies in SME financing in the Netherlands.

As quantitative data are not readily available, the transparency of subsidies in SME financing in the Netherlands is also examined. By examining the role and transparency of subsidies in SME financing qualitatively, this thesis adds to the understanding of the three key research topics: SME financing, subsidies and accountability.

Next to a distinction between quantitative and qualitative research, there are also different research purposes. Three purposes are distinguished by Babbie [2004]: exploration, description and explanation. Explorative research aims at developing a rough understanding of the research topics. Descriptive research intends to report in detail about the characteristics of the research topics. Research with an explanatory purpose is set out to empirically prove relations between research topics. This thesis' research purpose is description, this is the best suited purpose in relation to the objectives as presented in Chapter I. 'What' and 'how' research questions, as addressed in this thesis, are also characteristic for research with a descriptive purpose (Cooper & Schindler [2011]).

Regarding the time dimension of research, this thesis classifies as a cross-sectional study (Babbie [2004]). This means that the research is based on observations taken in a single point in time.

All in all, the type of research performed in light of this thesis can be defined as: qualitative cross-sectional descriptive research.

2.3.2: Data

Information is required to answer the problem statement and research questions. This information is called data. There are different types and sources of data. Quantitative and qualitative data are the two main types of data (Cooper & Schindler [2011]). Quantitative data are a numerical expression; anything else is characterized as qualitative data.

In accordance with the qualitative nature of the research, this thesis uses qualitative data to answer the research questions and problem statement.

A description of the data sources will be divided in a part about secondary data and a part on empirical data (Babbie [2004]).

2.3.2.1: Secondary data

As displayed in the research design by Column (a), the first step of the research is becoming more knowledgeable about the three key research topics. This is done by reviewing scientific literature and examining the situation in the Netherlands. This review and examination is entirely based on secondary data sources.

Secondary data sources are all kinds of written information such as: scientific articles, books, reports, newspaper articles and information obtained from websites. In fact, all information that can be referred to classifies as secondary data (Cooper & Schindler [2011]). The advantage of using secondary data is that it saves effort, time and money.

Information obtained through secondary sources must be referred to. This allows readers to verify whether the information is used properly, and gives credit to the original authors. This thesis follows the APA guidelines in referring to secondary data. A full list of references is attached at the end of this thesis.

2.3.2.2: Empirical data

Next to secondary data, the research outcomes also rely on primary data. This type of data is also referred to as empirical data because of the way it is obtained, through performing empirical research (Cooper & Schindler [2011]).

The empirical research performed in light of this thesis is represented by Column (b) in the research design. This part of the research is performed through conducting interviews with professionals in the work field. And can be defined as qualitative field research using in-depth interviews. These in-depth interviews are a common method of empirical investigation in qualitative descriptive research (Cooper & Schindler [2011]). The interviews will be semi-structured and face to face. More detailed information about the interview approach, structure, respondents and interview process will be presented in Chapter V.

2.3.3: Analysis and description

The third column (c) of the research design focuses on answering Research Questions 4, 5, 6 and 7 by analyzing and describing the results of the empirical investigations.

The method used in this thesis for analyzing the interview outcomes is the Constant Comparative Method. This method originates from the Grounded Theory Method (Glaser & Strauss [1967]) which is often used in constructing theories based on empirical outcomes.

Even though this thesis' objectives are to identify and examine the role and transparency of subsidies in SME financing instead of developing theory, the Constant Comparative Method is an appropriate method for analyzing the outcomes of the interviews. As discussed by Boeije [2002], the Constant Comparative Method can also be used separately from the Grounded Theory Method and is suitable for analyzing the outcomes of qualitative interviews. Therefore, this method is selected for analyzing the empirical research outcomes.

The Constant Comparative Method is aimed at comparing outcomes on research topics with each other or to external factors (Boeije [2002]). In this thesis the outcomes of the interviews will be compared to each other and with theory on the research topics. The comparison with theory is made because the aspects discussed during the interviews are also based on theory. Linking back to theory is therefore an important step in interpreting the outcomes of the interviews.

As the Constant Comparative Method depends on the interplay between data and researcher when gathering and analysing data (Strauss & Corbin [1998]), the comparisons that will be made in the context of this thesis cannot yet be determined. These comparisons are dependent on the outcomes of the literature review and the interviews, and will be presented and discussed in Chapters VI and VII.

Interview outcomes not suitable for comparison with other outcomes or theory will be described instead of analysed. These descriptive outcomes will be structured according to the aspects discussed during the interviews, and will contribute to answering the research questions.

2.4: Research process

This last part of Chapter II presents the research process. This process is displayed by enlisting the steps involved in conducting the research presented in this thesis.

1. Reviewing literature on:
 - a. SME financing.
 - b. Subsidies.
 - c. Accountability.
2. Examining the situation in the Netherlands.
3. Deriving relevant aspects.
4. Designing interview structure based on these aspects.
5. Selecting and approaching respondents.
6. Conducting the interviews.
7. Typing interview notes.
8. Getting the interview notes confirmed.
9. Analyzing the interview outcomes by comparing:
 - a. The outcomes with each other.
 - b. The outcomes with theory.
10. Describing the remaining outcomes.
11. Discussing the outcomes.
12. Concluding and recommending.

Taken together, these consecutive steps make up the research process. This process clearly sums up the activities performed in conducting the research presented in this thesis. These steps will be addressed in the following chapters. The next chapter focuses on step 1, reviewing the literature.

Chapter III: Literature review

This chapter addresses the characteristics of the three key research topics: SME financing, subsidies and accountability by examining literature on these topics.

The objectives of this literature review are: to present a clear overview of the key topics, provide theoretical background and to disclose the aspects that should be discussed during the interviews. By doing so, this chapter answers Research Questions 1, 2 and 3.

This chapter is divided into three parts, each discussing one of the key topics of the research.

3.1: SME financing

SME financing is about the financing of firms that have up to 250 employees, a maximum turnover of €50 million or total assets with a maximum value of €43 million (Roth [2011]). The majority, over 95%, of the firms are SMEs: they provide an important share of total employment (60% to 70%) and are vital in bringing innovative products to the market (OECD, Policy brief; Financing SME's and entrepreneurs [2006]).

SME financing received much attention in recent years from researchers, economists and policy makers (De la Torre et al. [2010]). Basically, the level of required financing depends on a firm's financial performance and its assets (Hillier et al. [2010]).

In order for a firm to survive financially it is important that a sufficient positive cash flow is generated. The cash flow statement of a firm, an example can be found in Appendix 1, shows whether cash is generated or burnt. When cash is burnt, firms have to fill this gap by drawing into their financial reserves or obtain additional financing.

Firms are financially viable in the long run when their income statement, see Appendix 1 for an example, has a positive result. The income statement also takes non-cash expenses into account and is therefore a good representative for a firm's overall performance. Poor performance can lead to a need for additional financing.

A firm's balance sheet displays its financial position at a certain point in time, an example is given in Appendix 1. The debit side of a balance sheet displays the assets of a firm and the credit side shows how these possessions are financed. The more assets a firm has, the more financing is required.

So, a firm's financial performance and assets influence the amount of financing required. The credit side of the balance sheet displays by what means a firm is financed. There are different sources of finance, the most important distinction is between internal and external sources of finance (Modigliani & Miller [1958]). The proportion of internal and external sources used to finance a firm determines the capital structure of a firm and will be discussed in the following section.

3.1.1: Capital structure

Capital structure is concerned with the ratio between internal and external capital used in financing a firm's activities and assets. This ratio can be displayed as a pie chart as shown in Figure 2.

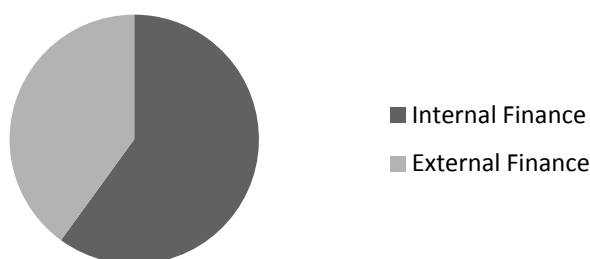


Figure 2: Capital structure.

Internal capital is obtained from surplus income earned with operations or from the owner of the firm. External capital is typically obtained through employing debt or raising new equity from investors (López-Gracia & Sogorb-Mira [2008]).

The capital structure of firms has been researched ever since Modigliani & Miller [1958] presented their proposition that under perfect conditions (no taxes, no transaction costs and full information) the value of a firm is independent from its financial structure.

From this initial proposition several theories have been developed which do not assume perfect conditions. These more developed theories intend to be a better reflection of everyday practice. The theories used in SME financing are based on those applied in corporate finance research (Norton [1990]) and (Cassar & Holmes [2003]).

Next, the three most profound theories on capital structure (Rasiah & Kim [2011]) will be discussed with a focus on SME firms.

3.1.1.1: Trade-off theory

The trade-off theory assumes that there is optimal ratio between internal and external finance used by a firm. This optimum is reached when the benefits and shortcomings of using external finance are in equilibrium (Baxter [1967]).

In this theory, the main source of external finance is debt and the theory is tax based. The interest payments on debt are tax deductible, therefore firms have a tax advantage when using debt as an external source of finance. However, firms are also faced with higher financial distress and bankruptcy costs due to the increased leverage when employing debt (Scott [1976]).

By balancing the tax advantage with the leverage related costs, the desired amount of external financing is determined and the optimal capital structure of a firm is traded-off. Although the trade-off theory is useful in gaining an understanding in the concept of capital structure, the empirical testing of interesting implications has been disappointing because of their low explanatory power (Watson & Wilson [2002]) and (Myers [2001]).

In literature it is furthermore argued that the trade-off theory of capital structure cannot be fully applied in the context of SME firms. The leverage related costs are relatively high compared to the tax advantage, therefore SME firms do not abundantly benefit from employing debt (Sogorb-Mira [2005]).

Due to its rather low explanatory power and limited applicability on SME financing, the trade-off theory will not be used explicitly in this thesis.

3.1.1.2: Pecking order theory

The pecking order theory is information based, and assumes that there is a hierarchical order of financial sources used by a firm (Myers & Majluf [1984]) and (Myers [1984]).

Information asymmetries are important factors in the pecking order theory. These asymmetries exist because insiders of a firm possess more information about the firm than outsiders. This difference in access to information gives insiders an advantage and more control over the firm.

As a result of information asymmetries it is difficult for outside investors to determine the value of a firm, this can lead to an undervaluation of the firm from an insiders' perspective (Myers & Majluf [1984]). It is possible to reduce the information asymmetries between insiders and outsiders of the firm, but this leads to information costs and loss of control for the insiders.

The issues of undervaluation, information costs and loss of control lead to a pecking order of financial sources: internal sources are preferred about external sources. When internal sources are insufficient, employing debt is preferred before issuing new equity (Myers [1984]). Following the pecking order theory, the capital structure of a firm is determined by the availability of internal funds and a firm's need for financing.

The typical owner of a SME firm also manages the firm, therefore SME firms are very reluctant in sharing information and giving control towards external investors (López-Gracia & Sogorb-Mira [2008]). This leads to the following pecking order from most to least preferred: retained earnings, funds from existing shareholders, debt and finally issuing new external equity (Brounen et al. [2006]).

As SME firms are faced with relative large information asymmetries (OECD, The SME financing gap (Vol. 1): Theory and evidence [2006]), the information based pecking order theory is suitable to apply in this thesis. How subsidies fit into the pecking order and influence SME financing will be examined.

3.1.1.3: Agency theory

The capital structure of firms can also be approached by using the agency theory (Jensen & Meckling [1976]). In this case, the optimal capital structure is determined by minimizing the conflicts costs of parties involved.

Agency theory is based on conflicts of interest between shareholders and managers of a firm. In firms where ownership and management are separated, managers are induced to maximize their wealth at the expense of shareholders (Jensen & Meckling [1976]). This inducement is larger when managers have control over free cash. By employing debt, a firm is required to pay interest and instalments. This leads to a lower amount of free cash for the manager.

Although the conflict of interest between shareholders and managers of a firm is decreased by employing debt, another conflict of interest between shareholders and debt holders is created (Rasiah & Kim [2011]). Each conflict of interest involves costs, by minimizing these conflict costs the optimal capital structure can be found.

As SME firms often have an owner-manager, agency theory on SME firms focuses on the conflicts of interest between the owner-manager and suppliers of external finance (Sogorb-Mira [2005]). The common owner-manager structure of SME firms limits the applicability of traditional agency theory on SME financing. Therefore, agency theory will not be the leading theory used during the research. If necessary, the agency conflicts between owner-managers of firms and suppliers of external finance will be addressed.

How a firm is financed is reflected by its capital structure. As concluded by Rasiah & Kim [2011] there are numerous factors that impact a firms' choice of capital structure. These factors (taxes, costs of financial distress, information asymmetries and agency costs) are embedded in the above discussed theories. The pecking order theory seems to be most appropriate within the context of this thesis, so this will be the leading theory used throughout the research.

3.1.2: External financing

Following the pecking order theory, firms prefer financing through internal sources over using external financing sources. Only using internal financing sources often constrains a firm in its abilities to invest and grow (Carpenter & Petersen [2002]). Therefore, external finance is often required to enable investments and growth of SME firms. This part of Chapter III addresses the external financing of SME firms.

3.1.2.1: Bank loans

The most important source of external finance for SME firms is to engage in debt by taking out a bank loan (Yesseleva [2010]) and (Verhoeven & Smit [2011]). To gain a better understanding of the external financing of SME firms, the literature on bank loans and SME financing will be discussed.

Due to relative large information asymmetries, lending to SME firms is perceived as high risk from a bank's perspective (Petersen & Rajan [1994]) and (Berger & Udell [2006]). Banks can use several techniques in order to decrease the risks connected to SME lending.

The most straightforward technique for banks in controlling SME lending risks is to apply credit rationing (Stiglitz & Weiss [1981]). When using this technique, banks apply a fixed interest rate for all loans and randomly select which loan applications are granted. This approach is one-sided because the characteristics and desires of clients are not taken into account, making it rather unpleasant for clients.

A more client oriented approach is when banks use transaction lending techniques, usage of these techniques allows for individual assessments of loan applications. Transaction lending techniques require 'hard' quantifiable information about SME firms to assess loan applications (Berger & Udell [2006]). In order to obtain financing, firms have to provide banks with this 'hard' information: leading to a transaction of information and financing. The information firms have to provide concerns their assets, financial statements, ratios, etc. (Berger & Udell [2006]), and reduces the information asymmetries between firms and banks. The information provided is quantitative, enabling banks to

use computer aided methods to calculate the risks involved and determine the loan conditions. Also, information can be transferred and shared more efficiently by using information technology (Udell [2008]). Using computer aided methods and information technologies makes it easier and cheaper banks to assess loan applications, making transaction lending the most used technique in SME financing (De la Torre et al. [2010]). The drawback of transaction lending is that 'hard' information is required.

When this information is not available banks can use 'soft' non-quantitative information to reduce the risks connected to SME lending, this is done through relationship lending (Petersen & Rajan [1994]), (Berger & Udell [1995]) and (Elyasiani & Goldberg [2004]). Relationship lending focuses on reducing information asymmetries through regular contact between banks and SME firms. By building relationships with firms, banks acquire all kinds of 'soft' information about the suppliers, customers, competitors and community of these firms (Elyasiani & Goldberg [2004]). Banks use this 'soft' information to monitor their clients and assess risks and loan applications. Relationship lending can help banks in overcoming information asymmetries but is a rather time-consuming and therefore costly lending technique (Berger & Udell [1995]).

For gaining a better understanding in SME financing it is useful to be aware of the difference between 'hard' and 'soft' information and the techniques banks apply in SME lending. Although banks can choose to simply rationing credit, relationship lending and transaction lending are identified as more popular lending techniques in literature.

3.1.2.2: SME financing gap

Firms in need of external financing can experience a shortage in external financing available to them, this phenomenon is called the 'SME financing gap' (OECD, The SME financing gap (Vol. 1): Theory and evidence [2006]). The size of this financing gap depends on the supply and demand for external SME financing. In literature, the emphasis lies on the issues connected to the supply side of external SME financing (Beck et al. [2008]).

Banks, the main supplier of external SME financing (Yesseleva [2010]), are restricted in the amount of financing they can supply to SME firms because they have to meet capital requirements (Bijlsma & Zwart [2010]). Due to the effects of the 2007 credit crunch (Dell'Ariccia et al. [2008]) it is more difficult for banks to meet these requirements. This has a negative effect on the supply of external financing available for SME firms (Hodorogel [2009]).

Information asymmetries also affect the supply of external financing for SME firms (OECD, The SME financing gap (Vol. 1): Theory and evidence [2006]). When these asymmetries cannot be sufficiently overcome through transaction or relationship lending techniques, banks are less willing to supply external financing for SME firms (Berger & Udell [2006]).

Demand for external SME financing depends on firms' internal financing sources, if these are insufficient the demand for external finance increases (Carpenter & Petersen [2002]). Demand for external financing is also influenced by economic circumstances. When these circumstances are favourable, firms are more likely to invest and require external financing to make these investments (OECD, The SME financing gap (Vol. 1): Theory and evidence [2006]). Under poor economic circumstances SME firms focus on maintaining current activities, dependent on their performance and situation external financing can be required to continue with current activities (Verhoeven & Smit [2011]).

In summary, the two main aspects that determine the SME financing gap are: economic circumstances and information asymmetries.

3.1.2.3: Life cycle approach

Besides economic circumstances and information asymmetries, the age and size of SME firms also influences the availability of external financing (Berger & Udell [1998]). These aspects are important factors in life cycle theory (Ferreira et al. [2011]). Life cycle theory assumes that firms, just like living creatures, develop themselves by going through several stages.

Following the life cycle approach, Walker [1989] presented this financial development model for SME firms:

| Stage | Start-up | Development | Expansion | Maturity |
|-----------------------------------|-------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Maturity | New firm | Developing small firm | Established small firm | Mature firm |
| Form of legal organisation | Sole proprietorship | Sole proprietorship Few partners S corporation | Numerous partners of small corporation S corporation | Many partners Corporation |
| Goal | Survival | Maximize profits Moderate growth | Maximize profits Return on equity \geq target rate of return | Maximize growth |
| Equity | Owner's capital Retained earnings | Owner's capital Retained earnings Informal investment | Owner's capital Retained earnings Informal investment Venture capital | Owner's capital Retained earnings Informal investment Venture capital Traditional markets |
| Debt | Accrued expenses Trade credit Bank credit | Accrued expenses Trade credit Bank credit Mortgage credit Secured or guaranteed notes payable Mortgage payable | Accrued expenses Trade credit Bank credit Mortgage credit Secured or guaranteed notes payable Mortgage payable Line of credit | Accrued expenses Trade credit Bank credit Mortgage credit Secured or guaranteed notes payable Mortgage payable Line of credit Unsecured notes payable |

Source: Small Business Economics, Walker [1989], p. 294.

This model distinguishes four stages in the development of SME firms, and displays the available sources of finance during each stage. A small young firm has a limited amount of financing sources at its disposal, whereas a more mature larger firm has a variety of financing sources available. This difference originates from a firm's ability to provide collateral and existence of a proven track record (Berger & Udell [1998]).

The life-cycle approach towards SME financing is widely accepted and also described by other authors like Berger & Udell [1998] and Gregory et al. [2005]. Therefore, the aspects firm age and firm size are relevant to examine in the context of this thesis.

3.1.2.4: Bootstrapping

As discussed, obtaining external financing is not an easy task for SME firms. Information asymmetries, bank requirements, limited supply, collateral and financial track record are all factors that must be considered.

When firms expect that they do not qualify for a loan, are not willing to share information or want to retain full control: they can decide to minimize the required amount of external financing. This phenomenon is called 'bootstrapping' and is defined as:

"Highly creative ways of acquiring the use of resources without borrowing money or raising equity financing from traditional sources" (Bhide [1992] p. 102)

A widely used classification, by for instance Van Auken [2005] and Ebben & Johnson [2006], of these creative ways of minimizing the need for external financing is empirically developed by Winborg & Landström [2000], and contains five types of bootstrappers:

- *Delaying bootstrapper*: pays creditors as late as possible and keeps stocks at a minimum level.
- *Private owner-financed bootstrapper*: firm is entirely financed by the owner of the firm.
- *Minimizing bootstrapper*: keeps accounts receivables and stock as low as possible.
- *Relationship-oriented bootstrapper*: uses its network to keep costs as low as possible by for instance borrowing equipment from friends.
- *Subsidy-oriented bootstrapper*: focuses on obtaining subsidies.

These are strategies firms can apply to minimize their external financing needs. In the context of this thesis the subsidy-oriented strategy is the most important one. Firms who apply this technique use subsidies to lower their need for traditional sources of external finance.

So far, SME financing literature only acknowledged subsidies as an alternative source of external financing. How subsidies relate to traditional sources of external finance and SME financing theories is unclear. By examining these aspects, this thesis attempts to place subsidies in a broader SME financing perspective.

3.2: Subsidies

In the previous part on SME financing, subsidies have already been identified as an alternative source of external finance. A more in-depth examination of subsidies and its characteristics will be presented in this part of the literature review.

Due to the absence of a clear definition of the term subsidy, Schwartz & Clements [1999] developed the following definition:

"In most general terms, a subsidy can be defined as any government assistance that (i) allows consumers to purchase goods and services at prices lower than those offered by a perfectly competitive private sector, or (ii) raises producers' incomes beyond those that would be earned without this intervention" (Schwartz & Clements [1999] p. 120).

This definition distinguishes two kinds of subsidy recipients: consumers and producers, and gives a very broad description of subsidies: any government assistance. As this thesis is about the relationship between SME financing and subsidies, the focus of the research lies on subsidies intended for SME producers. The subsidies towards consumers will not be examined.

In order to clarify the description 'any government assistance' the motives, types and effects of subsidies available for SME firms will be discussed in the following sections.

3.2.1: Motives for subsidies

The existence of subsidies originates from the motives behind them. In literature the main motive given by for subsidies is that they correct market imperfections (Lerner [1999]) and (Hall & Van Reenen [2000]). Which market imperfections are corrected depends on the developments politically desired by governments (Czarnitzki [2006]).

As mentioned, only the subsidies intended for SME firms are examined in the context of this thesis.

The most profound market imperfection faced by SME firms is the SME financing gap (OECD, The SME financing gap (Vol. 1): Theory and evidence [2006]) and then especially in financing their R&D activities (Klette et al. [2000]) and (Kleer [2010]).

The majority of the firms are SME firms; therefore they are considered to be crucial for the economy (OECD, Policy brief; Financing SME's and entrepreneurs [2006]). SME firms also perform a relative large part of all R&D activities, and these are considered to be important for future economic development (Czarnitzki [2006]).

As a result of the importance of SME firms for the economy and future economic development, they are politically relevant for governments. Therefore, governments grant subsidies to support SME firms in overcoming market imperfections (Schwartz & Clements [1999]). These subsidies are aimed at supporting R&D activities and reducing the financing gap (OECD, Policy brief; Financing SME's and entrepreneurs [2006]). By doing so, governments attempt to stimulate the economy and ensure economic development. The granted subsidies are expected to have higher social returns than the funds invested by governments (Kleer [2010]), justifying the expenditures of governments on subsidies for SME firms.

So, the motives for subsidies are twofold: they are meant to correct market imperfections and are used to support politically desired developments.

3.2.2: Types of subsidies

There are different types of subsidies, Schwartz & Clements [1999] distinguished and described the following seven types:

- *Cash subsidies*: direct payments.
- *Credit subsidies*: loan guarantees and interest benefits.
- *Tax subsidies*: reduction of tax liabilities.
- *Equity subsidies*: equity participation.
- *In-kind subsidies*: provision of goods or services below market prices.
- *Procurement subsidies*: purchase of goods or services above market prices.
- *Regulatory subsidies*: actions that alter market prices or market access.

These different types of subsidies are not all equally relevant for this thesis, therefore this classification of Schwartz & Clements [1999] will not be fully applied. However, it serves as the base for the classification that will be used during the research.

In order for a subsidy type to be relevant for the research, it should directly affect SME financing and be granted directly from government to the firm. These requirements will keep the subsidy types examined during the empirical part of the research clear and comprehensible.

The subsidy types: in-kind, procurement and regulatory are expected to only have a small indirect effect on SME financing and will therefore not be included in the subsidy classification used throughout the research.

Equity subsidies do affect SME financing directly, but these are mostly granted through venture capital structures that combine public and private funds (Keuschnigg & Nielsen [2001]). These subsidies are not granted directly from government to the firm, meaning that an extra explanation is required during conduction of the interviews to show the link between government and a firm. This is undesirable and therefore this type of subsidies will not be included in the classification used in this thesis.

The three remaining types of subsidies do affect SME financing and are directly granted to firms. Therefore, the following three types of subsidies will be examined during the research:

- *Cash subsidies*: direct payments.
- *Credit subsidies*: loan guarantees and interest benefits.
- *Tax subsidies*: reduction of tax liabilities.

In literature, these three types of subsidies are also most discussed in relation to SME firms. Cash subsidies are for instance discussed by Bergström [2000]. Credit subsidies received attention of Shaffer & Collender [2009], Beck et al. [2010] and Honohan [2010] recently. Tax subsidies have been examined by for instance Hall & van Reenen [2000] and Greenbaum et al. [2010].

So, prior research findings provide support for the observation that cash, credit and tax subsidies are the most important types of subsidies and that these are appropriate for distinguishing differences between the subsidies that are available to firms.

The presented classification of cash, credit and tax subsidies will be used throughout the research in order to describe the role of subsidies in financing SME firms.

3.2.3: Effects of subsidies

Besides the motives and types of subsidies, the effects of subsidies have also been examined in literature. The effects studied can be divided into: effects on firm performance and the effects on R&D expenditures.

The effects of subsidies on firm performance have been examined by Lerner [1999], Bergström [2000] and Tzelepis & Skuras [2004]. They investigated the effects of subsidies on productivity, efficiency and the growth of firms. The authors only found significant results for the effect of subsidies on firm growth; these are positively related to each other. The effects of subsidies on firms' efficiency and productivity could not be established with certainty.

As most subsidies for SME firms are aimed at supporting R&D activities, the effects of these subsidies on R&D expenditures are investigated (Clausen [2009]). Especially the relationship between public and private R&D expenditures has caught the attention of researchers. Public expenditures are subsidies from governments, whereas private expenditures are made by firms themselves (Gonzalez & Pazó [2008]). Governments try to encourage private expenditures on R&D by making public expenditures in the form of subsidies (OECD, Policy brief; Financing SME's and entrepreneurs [2006]). The opposite effect is also possible, that public expenditures actually reduce private expenditures. If so, subsidies are used by firms as a replacement for private expenditures. This phenomenon of public expenditures replacing private expenditures is called 'crowding out' (Cumming & MacIntosh [2006]).

The empirical evidence on the effects of subsidies on private R&D expenditures is mixed. According to Lööf & Heshmati [2005], subsidies have a positive effect on private R&D expenditures made by small firms; for medium sized firms their results were ambiguous.

The amount of public expenditures also affects the level of private expenditures. Görg & Strobl [2007] found that small and medium amounts of subsidy stimulate private R&D expenditures, but that too large subsidies decrease private R&D expenditures.

By making a distinction between research subsidies and development subsidies, Clausen [2009] discovered that research subsidies are likely to increase private expenditures while development subsidies often replaces private expenditures.

Subsidies can be the cause for private investors to participate in the financing of a firm or a project. Whether a subsidy is granted or not can be perceived as a signal from government on the quality of firm or a project. This is called the 'signalling function' of subsidies (Kleer [2010]) and can influence the behaviour of private investors. To what extent this behaviour is influenced by subsidies is difficult to determine, but when governments include a quality signal along with granting a subsidy the influence is significant (Kleer [2010]).

All in all, the discovered effects of subsidies on the level of R&D expenditures are rather ambiguous and difficult to interpret clearly. Due to the variety of subsidies, firms and influencing factors only partial significant results about the influence of subsidies on R&D expenditures are found (David et al. [2000]) and (Gonzalez & Pazó [2008]).

Due to the fact that the results found cannot be clearly interpreted, only the basic concepts of 'crowding out' and 'signalling function' will be used during the research presented in this thesis.

3.2.4: Function in SME financing

The literature on the motives, types and effects of subsidies revealed some possible connections between subsidies and SME financing. For instance, the SME financing gap could serve as a motive for governments to grant subsidies (OECD, Policy brief; Financing SME's and entrepreneurs [2006]), and subsidies can affect a firm's R&D expenditures (Lööf & Heshmati [2005]) and consequently their financing needs.

Despite the connections between subsidies and SME financing; subsidies are hardly discussed, and only identified as an alternative source of external finance (Ebben & Johnson [2006]) in SME financing literature.

After reviewing the literature on SME financing and subsidies, it seems likely that subsidies fulfil a more elaborate function in SME financing than just being an alternative source of external finance. Little is known about the function of subsidies in SME financing, therefore this thesis aims to add to the understanding by describing the role and relevance of subsidies in SME financing.

3.3: Accountability

As mentioned in the introduction, accountability is the process of justifying actions towards internal and/or external stakeholders by providing information.

As SME firms often have an owner-manager (Sogorb-Mira [2005]), justification towards internal stakeholders is not particularly relevant for SME firms. As a result of relative large information asymmetries, accountability towards external stakeholders is of importance for SME firms (Berger & Udell [2006]). Therefore, the research focuses on the accountability aspects required by external stakeholders of SME firms.

In the following sections the theoretical aspects of accounting and transparency will be discussed.

3.3.1: Accounting

Accountability takes place through the process of accounting, the following definition of accounting is given in literature:

“Accounting is a process which is essentially concerned with the provision of “relevant information for decision making”, with the achievement of a “rational allocation of resources” and with the maintenance of institutional “accountability” and “stewardship”.” (Burchell et al. [1980] p. 9,10).

This definition clearly states that the objective of accounting is to provide information relevant for decision making. What information is provided depends on the type of accounting that is applied. According to Salvato & Moores [2010] and Weißenberger & Angelkort [2011] there are two major types of accounting: management accounting and financial accounting.

The information provided by management accounting is for use within the firm. Management of a firm uses this information to monitor performance and to control the firm. Financial accounting information is used for justification towards external stakeholders. This information displays a firm's financial situation and performance.

Due to the research focus on external accountability, financial accounting is the most relevant type of accounting in the context of this thesis.

3.3.1.1: Financial accounting

Financial accounting provides information to external stakeholders that can be used for making rational decisions. In modern society, the economy has an increasingly dominant position (Habermas [1981]). The economy is a system based on rational behaviour, because financial accounting provides information suitable for making rational decisions it is an important communication tool in modern society (Burchell et al. [1980]). Financial accounting information is displayed in for example: annual reports and the earlier mentioned cash flow statement, income statement and balance sheet.

Although it is acknowledged that financial accounting holds an important position in the economy and society, little is known about the broader context of financial accounting in society (Hopwood [2000]). It is argued that the financial accounting community wants to come across as objective and has developed an own language to support this (Hamilton & Ó hÓgartaigh [2009]). The financial accounting community states that it gives a true and fair view of a firm's financial situation and performance. The credibility of this statement and objectivity of financial accounting has been discredited by the role financial accounting performed in the 2007 credit crunch (Arnold [2009]). As a result, there is a renewed interest for the critical view towards financial accounting as presented by Laughlin [1987]. This approach tends to focus on the negative sides of accounting, according to Lehman [2010] it is better to discuss how financial accounting can fit into and contribute to the

current society. It is useful to be aware of the position of financial accounting in society because SME firms are an important part of this society (EIB [2003]). In the context of this thesis it is relevant to examine the position and development of financial accounting for SME firms in more detail.

As SME firms are an important factor in the economy there is an increasing interest for SME accountability (Ritchie & Richardson [2000]). SME accounting information is important for obtaining external financing (Berger & Udell [2006]) and justifying towards external stakeholders. Especially the quality and verifiability of the accounting information is important (Kano et al. [2011]).

The accounting regulations for SME firms are not as strict as for large corporations (IASB [2004]), therefore the quality and verifiability of SME accounting information varies considerably among different firms (Alp & Ustundag [2009]).

In most countries, large corporations are bound to the International Financial Reporting Standards (IFRS) (Soderstrom & Sun [2007]). This has led to a harmonization of accounting information, enhancing quality and verifiability. When accounting quality is high and information is consistent, it is easier for corporations to overcome information asymmetries and obtain financing (Biddle et al. [2009]).

SME financial accounting is not as harmonized and high-quality as corporate financial accounting, most countries apply their own Generally Accepted Accounting Procedures for SME firms (Pascu & Vasiliu [2011]). In Europe, these national GAAP's have to comply with the EU Accounting Directives (EFRAG [2010]).

Assuming that SME firms would benefit from further harmonization of accounting rules, the International Accountants Standards Board presented a discussion paper on an IFRS for SME firms (IASB [2004]). This paper was discussed in literature, the main criticism was that the needs of SME accounting information users were not sufficiently taken into account (Schiebel [2008]).

In the mean time the IASB continued with developing an IFRS for SME firms (IASB [2009]), which has been presented in 2009. This IFRS for SME firms has been compared to existing European directives (EFRAG [2010]) and to national regulations (Albu et al. [2010]) and (Ernst & Young Accountants LLP [2009]). These comparisons showed several differences between the frameworks.

Although the IFRS for SME firms is an important step towards further harmonization of SME financial accounting, the national GAAP's are still leading (Pascu & Vasiliu [2011]). The IFRS for SME firms is currently only used on a voluntary basis. For this thesis it is relevant to be aware of the development towards further harmonization of SME accounting.

So, initiatives are undertaken to improve the quality and verifiability of SME financial accounting through harmonization. This is a positive development for external stakeholders because it enables them to make better informed rational decisions. Another aspect that positively affects information available to external stakeholders is transparency, this will be discussed in the next section.

3.3.2: Transparency

Accountability is concerned with justification of firms' actions towards stakeholders, this is done through sharing information. Transparency is tightly connected with accountability according to Hood [2010], and will therefore be examined.

Transparency is defined by Oliver [2004] as acting in a visible, predictable and understandable manner. Conducting business in a fashion that makes decisions, rules and other information visible for outsiders is how Hood [2010] described transparency.

As not all aspects mentioned in those descriptions are relevant for this thesis, transparency in the context of this thesis is best described as: full, available, and understandable information for external stakeholders. Especially relevant to examine is the completeness, availability and understandability of the information shared with suppliers of subsidies and external financing.

In financial accounting, transparency is becoming increasingly important (Bushman & Smith [2001]) and (Berger [2011]). Due to accounting scandals, corruption (Kolstad & Wiig [2009]) and the role of accounting in the 2007 credit crunch (Ackermann [2008]), higher levels of transparency are encouraged and demanded.

When firms are transparent and voluntarily disclose information, they can gain the confidence of external stakeholders (Angluin & Scapens [2000]) and (Behn et al. [2010]). So, transparency could be valuable for SME firms in overcoming information asymmetries and gaining the confidence of external stakeholders.

Computer aided methods, information technologies and their continuous improvement make it easier for external stakeholders to process information. Therefore more information and higher levels of transparency are required (Berger [2011]).

Although transparency has potentially many benefits, it also has negative aspects when not applied correctly (Roberts [2009]). For instance, when the disclosed information is difficult to comprehend it can lead to confusion instead of clarification (Epps & Cleaveland [2009]). This stresses that just making information available to external stakeholders does not classify as transparency, the information should be understandable also.

With respect to this thesis it is interesting to examine whether subsidies are transparently displayed in SME accounting information.

Chapter IV: Situation in the Netherlands

This chapter describes the situation in the Netherlands regarding the three key topics of the research: SME financing, subsidies and accountability.

The literature review is mainly based on international sources, while the empirical part of the research takes place in the Netherlands. A good understanding about the Dutch situation is required to obtain useful information from the interviews.

So, this chapter serves as intermediate step between the literature review and the empirical part of the research.

4.1: SME financing

As mentioned in the literature review, SME firms can be financed through internal and external sources of finance (López-Gracia & Sogorb-Mira [2008]). When firms cannot obtain a sufficient amount of external financing they are faced with a 'SME financing gap' (OECD, The SME financing gap (Vol. 1): Theory and evidence [2006]).

Whether SME firms in the Netherlands experience such a financing gap was examined by the Expertgroep KMO financiering [2007]. They found that in the Netherlands: SME firms with a low or moderate growth rate (85% of the firms) are hardly confronted with a financing gap. Firms with a high growth rate (15% of the firms), mainly young firms and firms involved in R&D activities, are more likely to experience a financing gap. The extent to which firms are faced with a financing gap is also dependent on economic circumstances (Expertgroep KMO financiering [2007]).

After these findings were disclosed, economic circumstances deteriorated as a result of the 2007 credit crunch and its ongoing effects.

To gain insight into the influence of poor economic circumstances on SME financing, the Dutch government decided to monitor SME financing: starting December 2008. The results from the 2008-2010 financing monitor (Verhoeven & Smit [2011]) showed that: in December 2009 about 29% of the SME firms needed additional financing, and that in July 2010 only 33% of the firms in need of financing successfully obtained the necessary financing. These percentages deviate substantially from the pre credit crunch percentages according to Verhoeven & Smit [2011], indicating that current economic circumstances affect SME financing in the Netherlands.

As mentioned in the literature review, a bank loan appears to be the preferred source of external financing for SME firms. The results of the 2008-2010 Dutch SME financing monitor support this statement. From the firms in need of additional financing during that period 88% of these firms turned to the bank to obtain that financing. The significance of bank loans for Dutch SME firms is supported by the ratio between outstanding SME debt and GDP, which is approximately 50% in the Netherlands (Roth, 2011). This is one of the highest ratios in the world, indicating a relative high importance of bank loans in SME financing in the Netherlands.

The outcomes of the Dutch SME financing monitor also show that the terms and conditions of bank loans changed as a result of poor economic circumstances (Verhoeven & Smit [2011]). Up to 57% of the firms faced negative changes of their loan terms and conditions. These changes are related to: the applied interest rate, loan related costs, loan duration and collateral requirements.

Not only SME firms are faced with stricter terms and conditions. In order to prevent another credit crunch, banks face stricter capital requirements (Bijlsma & Zwart [2010]). On the short term these stricter requirements could decrease the supply of bank financing and negatively affect SME financing. Because bank loans hold an important position in Dutch SME financing, these developments should be closely monitored according to the Dutch Bureau for Economic Policy Analysis (Bijlsma & Zwart [2010]).

In conclusion, the SME financing situation in the Netherlands corresponds well with the theory discussed in the literature review: especially young firms and firms involved in R&D experience a financing gap (Expertgroep KMO financiering [2007]), and economic circumstances substantially affect SME financing (Verhoeven & Smit [2011]). Characteristic for the Netherlands is the large role of bank loans in SME financing (Roth [2011]).

4.2: Subsidies

As mentioned in Chapter I, there are up to 3000 subsidies in the Netherlands (Fondswervingonline [2011]). This section focuses on the subsidies available for SME firms in the Netherlands, because only those are relevant in the context of this thesis.

The available subsidies for SME firms in the Netherlands intend to correct market imperfections and support economic development (Van Kuijck [2010]), just as in other countries (OECD, Policy brief; Financing SME's and entrepreneurs [2006]).

Subsidies for SME firms are the responsibility of a separate government agency in the Netherlands, this agency is known as 'agentschapnl' and serves as an executive body of the Dutch government. All information about subsidies for Dutch SME firms can be found on their website: www.agentschapnl.nl [2011].

Subsidy recipients have to comply with subsidy regulations and conditions (Van Kuijck [2010]). These regulations and conditions are considered to be excessive by SME firms, and are important reasons for entrepreneurs to discard subsidies deliberately when making financing decisions (Verhoeven & Smit [2011]). Although regulations and conditions are necessary to ensure that subsidies are granted and used correctly, the Dutch government acknowledges that the regulatory burden should be reduced. Therefore, a uniform subsidy framework (Rijksoverheid [2011]) has been constructed which unifies and simplifies the regulations for numerous subsidies. Despite the efforts made by government to reduce the regulatory burden of subsidies; the general perception among SME firms is still that subsidies are accompanied by complicated regulations and conditions (Verhoeven & Smit [2011]).

In the Netherlands are specialized subsidy consultants that advise and assist firms during the entire subsidy process with for instance: subsidy applications, project reports and finalisation documents. In this manner, entrepreneurs can benefit from subsidies without being preoccupied with the detailed regulations and conditions.

In the literature review three relevant types of subsidy were distinguished: cash, credit and tax subsidies. The situation in the Netherlands regarding each type will be discussed in the following part of this chapter.

4.2.1: Cash subsidies

Cash subsidies for SME firms in the Netherlands are mainly aimed at supporting innovative and sustainable developments (www.agentschapnl.nl [2011]). By contributing to a particular project or investment, government wants to support these developments.

Subsidised projects are for instance: research and development projects, cooperation projects of firms to jointly develop new products or projects encouraging firms to perform international activities.

Investments that use innovative techniques or sustainable resources are also supported through cash subsidies by Dutch government. By subsidizing these types of investments, government encourages firms to perform sustainable activities.

In general, a cash subsidy is restricted to a maximum amount or to a certain percentage of total costs of the project of investment (www.agentschapnl.nl [2011]).

4.2.2: Credit subsidies

This type of subsidies received a lot of attention recently due to the financial crisis and its consequences on SME financing (www.nuzakelijk.nl [2011]). In the Netherlands, credit subsidies are mostly in the form of a guarantee.

With a government guaranteed credit default risk is diverted from banks to government, allowing banks to hold larger loan portfolios before exceeding capital requirements.

When firms cannot obtain a regular bank loan due to lack of proven track record or insufficient collateral, a government guaranteed credit can be an adequate alternative method to obtain external financing.

To counter the effects of the financial crisis on SME financing (Verhoeven & Smit [2011]) and to stimulate SME lending, the Dutch government expanded several credit guarantee funds (Ministerie van Economie Landbouw & Innovatie [2011]). The most widely known credit subsidy in the Netherlands is the BBMKB subsidy.

4.2.3: Tax subsidies

The two leading tax subsidies for SME firms in the Netherlands are: the WBSO and the Innovation Box (www.agentschapnl.nl [2011]).

The WBSO is a tax subsidy that encourages firms to spend time on research and development activities. This is done by allowing tax deductions on wage tax charges, lowering a firm's effective tax rate.

The other leading tax subsidy, the Innovation Box, allows firms to pay less income tax on the profit they made with innovative products.

There are also some other tax subsidies which can be applied when innovative or sustainable investments are made, but these are not as widely used as the WBSO and Innovation Box and will therefore not be included in the research.

This part of the chapter about subsidies in the Netherlands showed that the classification of cash, credit and tax subsidies, as distinguished in the literature review, can be applied in this thesis also. As these subsidies are all present in the Netherlands.

Furthermore, subsidy regulations and conditions came forward as relevant aspects, because they influence firms' attitudes and choices regarding subsidies.

4.3: Accountability

As mentioned in the literature review, accountability towards external stakeholders is most important for SME firms.

In the context of the examination of the role and transparency of subsidies in SME financing in the Netherlands the most relevant external stakeholders are:

- Government (represented by [agentschapnl](http://agentschapnl.nl)): because they grant subsidies.
- Banks: because they supply loans, the most important source of external SME financing.

In the Netherlands, the accountability for subsidies is prescribed by legislation (Bok [2002]). Subsidy recipients are required to provide two types of information to government: financial information and information about the content of the subsidised items. The content where subsidies are spent on must be accounted for, therefore subsidies have detailed regulations and conditions (Bok [2002]). This additional accountability aspect distinguishes subsidies from the most regular source of external financing, bank loans.

The accountability required by banks focuses mainly on financial information (Verhoeven & Smit [2011]). Because both government and banks require financial information, financial accounting of SME firms in the Netherlands will be discussed in the following section.

4.3.1: Financial accounting

As discussed in Chapter III, financial accounting is an important instrument for SME firms in overcoming information asymmetries and holds an important place in society. Especially the quality and verifiability of accounting information is important for external stakeholders (Kano et al. [2011]).

In the Netherlands, the Dutch Accounting Standard Board (DASB) is concerned with ensuring and improving the quality of financial accounting information of Dutch firms (www.rjnet.nl [2011]). Therefore the DASB imposes accounting standards on firms, which standards should be applied depends on the size of the firm.

SME firms in the Netherlands have to choose between the following standards (www.rjnet.nl [2011]):

- Book 2 of the Dutch Civil Code combined with fiscal valuations.
- Dutch Accounting Standards for small legal entities.

- Dutch Accounting Standards for medium sized and large legal entities.
- EU-IFRS combined with a part of the Dutch Accounting Standards for medium sized and large legal entities.

Which standard is appropriate to apply depends on the size and circumstances of a firm. In general, small firms have to meet at least the requirements described in Dutch law (Burgerlijk Wetboek 2; Titel 9 [2011]), medium sized firms are required to follow at least Dutch GAAP.

In the literature review, further harmonization of SME accounting through an IFRS for SME firms was discussed as a way to improve accounting quality. The IFRS for SME firms as presented by the (IASB, 2009) has been compared with the Dutch accounting regulations by among others: Ter Hoeven & Manschot [2009] and Ernst & Young Accountants LLP [2009]. These comparisons showed that the two standards are quite similar, but that there are some challenges that must be overcome when implementing IFRS for SME firms.

To examine the support for the IFRS for SME firms in the Netherlands, a panel discussion was held (Strating [2010]). This discussion revealed that further harmonization of SME financial accounting is desired, but it is questioned whether the IFRS for SME firms is the best way to achieve this. The transition costs for firms, the interpretability and the comparability of IFRS for SME accounting information in relation to Dutch GAAP are points of concern (Strating [2010]). Voluntary use of the IFRS for SME accounting standards was supported by the panel. However, because Dutch GAAP functions to full satisfaction of most stakeholders it is unlikely that the IFRS for SME firms will be used voluntarily on large scale in the Netherlands (Strating [2010]).

A more successful initiative towards further harmonization of Dutch SME accounting information is the implementation of Standard Business Reporting (SBR) (www.sbr-nl.nl [2011]). SBR is an accounting technique that enables stakeholders to transfer financial accounting information in a cheaper, faster and easier way by using information and communication technology (Boxmeer [2010]). These advantages are acknowledged by government and banks, the latter are even aiming at receiving 80% of firms' annual figures through SBR by 2012 (Knoop & Van IJendoorn [2011]).

SBR uses a digital information format called XBRL and a taxonomy to structure information (www.sbr-nl.nl [2011]). The taxonomy used in the Netherlands is based on the legal requirements described in the Dutch Civil Code (Burgerlijk Wetboek 2; Titel 9 [2011]) and compatible with Dutch GAAP. SBR is based on a prescribed format, therefore information generated with SBR can be easily compared and is highly consistent.

To make useful recommendations at the end of the research, it is good to be aware of the development towards uniform and easily transferable SME financial accounting information in the Netherlands by the means of SBR.

During the interviews the focus will be on aspects directly related to the research questions: the differences between the required accountability of SME firms towards government and banks, and how subsidies are incorporated in the financial accounts of SME firms will be examined in more detail.

4.3.2: Transparency

As mentioned in the literature review: transparency is concerned with full, available and understandable information, and is useful in overcoming information asymmetries and gaining the trust of external stakeholders.

Dutch SME firms are required to share financial accounting information with the Chambers of Commerce, tax authorities and banks (www.pleinplus.nl [2011]). The compacted annual figures of Dutch SME firms are generally available at the Chambers of Commerce after paying a small fee. Large corporations are required to make their annual figures publicly available free of charge. This difference leads to the observation that the transparency of SME firms is perceived as relatively low (Hessels & Hooge [2006]).

As a result of changing demands from external stakeholders and the increasing significance of information, transparency is becoming a prerequisite and SME firms in the Netherlands are more interested in transparency (Hessels & Hooge [2006]).

Current economic circumstances also influence the required level of accountability in the Netherlands, for instance: banks are demanding more information from SME firms (Verhoeven & Smit [2011]), and government is advised to justify their expenditures on subsidies more carefully (Algemene Rekenkamer [2011]). The demand for more accountability also increases the relevance of transparency because these are tightly connected. This acknowledges the relevance of examining the transparency of subsidies in SME financial accounting in the Netherlands.

Chapter V: Interviews and sample

As mentioned in Chapter II, the empirical research part is performed by conducting in-depth interviews with professionals in the work field. In-depth interviews are a common method of empirical investigation in qualitative descriptive research (Cooper & Schindler [2011]), and is therefore applied. The interviews will be based on the research questions and the relevant aspects that came forward during the previous two chapters. In this part of the thesis: the interview structure, respondents and interview process will be addressed.

5.1: Interview structure

Before the interviews can be conducted, the structure and the topics discussed should be clear.

Interviews can be conducted in an unstructured, semi-structured or structured way (Cooper & Schindler [2011]).

With unstructured interviews there are no questions prepared by the interviewer, the conversation and contents discussed are mainly determined by the respondent.

Semi-structured interviews are based on a list of topics or questions on which the researcher wants to know more about, these are structured in a basic interview protocol. Dependent on the answers and knowledge of the respondent; certain topics are discussed in more detail than other topics. It is the responsibility of the interviewer to steer the conversation in such a way that all relevant topics are discussed.

Structured interviews use a detailed interview protocol which determines the specific questions that will be asked and in which order this will be done. There is little room for improvisation and the role of the interviewer is rather limited.

As the interviews are supposed to provide information to answer the research questions, unstructured interviews are not suitable to apply in the context of this thesis. The purpose of the interviews is too specific for applying the unstructured interview method.

The sample used for the empirical research consists of respondents with four different professions: accountants, subsidy consultants, bankers and financial advisors. This variation among the respondents makes it difficult to design a detailed interview protocol that can be used to conduct all interviews to full satisfaction, making the structured interview method unsuitable to apply.

This leaves the semi-structured interview method as the most appropriate method, the combination of a basic interview protocol and the possibility to discuss certain topics in more detail makes the semi-structured interview method very suitable to apply. The basic interview protocol ensures that the research questions and relevant aspects are discussed. As there is the possibility to discuss topics that emerge during the interview in more detail, the profession specific knowledge of the respondents can also be obtained.

The semi-structured interviews will be conducted by asking open-ended questions and will be held face to face, this way of conducting interviews is appropriate for qualitative research (Babbie [2004]) and therefore applied.

The basic interview protocol that will be used to conduct the semi-structured interviews is based on the research questions and relevant aspects derived from literature.

The included aspects are:

- Pecking order, based on pecking order theory.
- Firm age, based on life cycle theory.
- Firm size, based on life cycle theory.
- Sectors, based on literature on subsidies.
- Subsidy types, based on literature on subsidies.
- Signalling function, based on literature on subsidies.
- Additional costs of subsidies, based on literature on subsidies.
- Significance of subsidies for banks, based on literature on SME financing.

Together with the research questions, as presented in Chapter II, these aspects form the basic interview protocol and structure the interviews. The interview protocol used during the interviews can be found in Appendix 2.

5.2: Respondents

With the interview structure and protocol discussed, this part of the thesis focuses on the respondents of the empirical research.

As mentioned in Chapter II: the respondents are professionals in the work field of SME financing, subsidies and accounting. At first sight it might seem logical to interview entrepreneurs of SME firms, but since the research presented in this thesis combines three key topics; interviewing professionals is preferred over interviewing individual entrepreneurs of SME firms. This preference is based on the following two assumptions:

- Professionals are more knowledgeable about the three key topics of the research and the relations between these topics than entrepreneurs.
- Professionals are more capable in placing the key research topics in a broader perspective than entrepreneurs.

Professionals perform activities for multiple clients, therefore interviewing professionals instead of individual entrepreneurs is also a rather efficient method to enlarge the scope of the interviews. Due to time constraints connected to the research, this was also a factor in selecting professionals over entrepreneurs as respondents.

Although semi-structured face-to face interviews are an appropriate method for performing qualitative research (Babbie [2004]), they are also very time-consuming. Due to the limited time that is available to perform the research, the number of interviews that will be conducted is set on the amount of ten interviews.

This also limits the amount of respondents to ten, the sample of respondents is selected through applying a non-probability sampling method called purposive sampling (Cooper & Schindler [2011]). The respondents are purposively selected based on their profession, the selected professions are related to at least one of the key research topics.

The final sample consists of:

- Two independent subsidy consultants.
- Two subsidy consultants affiliated with an accountancy firm.
- Two accountants.
- Two bankers.
- Two financial advisors.

Further details such as the names and functions of the respondents can be found in Appendix 3. The distribution of several professions in the sample of respondents ensures that the key topics of the research are approached from different viewpoints, leading to a better understanding of the topics and more complete answering of the research questions. At least two respondents of each profession are interviewed to increase the validity of the interview outcomes.

5.3: Process

With the interview structure and respondents addressed, this last section of this chapter presents the process followed in performing the empirical part of the research.

In order to ensure the reliability of the interview outcomes, a clear process is followed in obtaining these outcomes.

As discussed by Kvale [1996] an interview process consist of different stages, the following flowchart presents the stages of the empirical research conducted as part of this thesis.

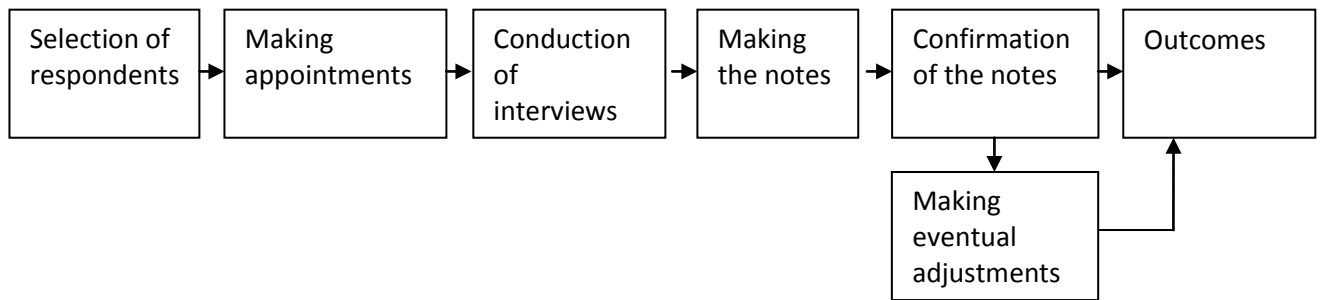


Figure 3: Interview process, adapted from Kvale [1996].

The first stage of the interview process is the selection of the respondents, as previously discussed: the respondents are purposively selected based on their profession. Stage two is making appointments to conduct the interviews, followed by stage three: the conduction of the interviews. In order to protect the objectivity of the interview outcomes, the interview protocol serves as guidance for the interviewer. Following this protocol prevents that the more professionally experienced respondent determines the topics discussed instead of the interviewer.

The interviews conducted in the context of this thesis are recorded. These recordings are used for making detailed notes of the interviews, the fourth stage of the interview process. The fifth stage of the interview process is important for ensuring the reliability of the interview outcomes and consists of sending the interview notes to the respondents for confirmation, if necessary the notes will be adjusted. Confirmation of the notes leads to stage six, the interview outcomes that will be used to answer the research questions.

To protect the privacy of the respondents the notes of the interviews are not included in this thesis. If desired, the notes and recordings of the interviews are available upon request at the author of this thesis.

Chapter VI: Results

This chapter presents the outcomes of the interviews and answers Research Questions 4, 5, 6 and 7. There is a clear division in this chapter between the role of subsidies in SME financing on the one hand and the accountability and transparency of subsidies on the other.

6.1: Role of subsidies in SME financing

This first section focuses on answering Research Question 4:

How and to what extent do subsidies play a role in financing SME firms?

This question will be answered by describing the role of the three main types of subsidies in SME financing and by analyzing this role through applying the Constant Comparative Method.

6.1.1: Cash subsidies

The role of cash subsidies in the financing of SME firms is the first one that will be examined in more detail. Cash subsidies are contributions to a project or investment, these contributions are very specific and must be used for the project or investment they are granted to. There are often strict application regulations and accountability requirements connected to cash subsidies. This entails that only a limited number of firms is able to qualify and benefit from this type of subsidies.

A cash subsidy is very tangible and recognizable for entrepreneurs because it is a cash contribution. Therefore, cash subsidies are preferred by firms who are eligible to receive this type of subsidy over other types of subsidies.

Cash subsidies also indirectly influence the financing of a SME firm. As a result of the contribution firms have to finance less of the project or investment themselves. This enhances the profitability of the subsidised items and can be decisive for the continuation.

As cash subsidies only partially contribute to a project or investment, firms have to make a considerable contribution themselves also. Therefore cash subsidised projects or investments are undertaken by firms who have the financial capability to do so. These are typically longer existing firms of a respectable size. A cash subsidy can be very important with respect to a particular project or investment but for the financing of the firm as a whole it is often not that relevant.

Cash subsidies lower the amounts of financing firms have to invest themselves. This decreases the amount of external financing required and lowers interest expenses, thereby positively affecting the discount rate and profitability of firms. To what extent cash subsidies affect these financial performance indicators of a firm depends on the amount of subsidy and the particular situation of that firm.

Dependent on the terms and conditions of a subsidy it can be necessary for firms to pre-finance the entire project or investment. By doing so firms take a considerable risk, if a project fails or a subsidy is not awarded firms are faced with the consequences.

Due to required accountability, cash subsidy recipient firms are often faced with additional administrative tasks such as applications, progress reports and final reports. These tasks lead to subsidy related costs for the firms in question. When firms decide to use the services of a subsidy consultant these additional costs increase significantly.

All in all, cash subsidies can serve as an incentive and can be very important for certain one-time projects or investments, but for the financing of a SME firm as a whole they are not decisive. They have certain benefits with respect to the discount factor and profitability of a firm but there are also risks and costs involved.

6.1.2: Credit subsidies

This type of subsidies is in the Netherlands mostly in the form of guarantees and has less regulatory constraints than the other two subsidy types. There are fewer requirements regarding the intended use of the funds. The purpose of this type of subsidy is just to facilitate and stimulate lending to SME firms. Lending to young and small firms is especially stimulated as there are extended possibilities for this type of firms to receive credit subsidies in the Netherlands.

Although firms are free in choosing how to use the funds obtained through a credit subsidy, this type of subsidy is not preferred among entrepreneurs. This stems from the fact that credit subsidies are often used after banks denied a loan application because of lack of track record or securities of a firm/entrepreneur. The only way left to obtain a loan then is with a state guaranteed loan, so the use of a credit subsidy is often a necessity and not preferred by entrepreneurs.

Due to the effects of the financial crisis and the consequently stricter conditions of banks, credit subsidies are more frequently used at the moment. When they are used the influence of these subsidies on SME financing is significant. Without the subsidy a firm probably would not get a loan, so a credit subsidy is often decisive and important for the financing of a firm. Also because the amounts involved are relatively large. Especially for young and small firms that do not have a track record or sufficient securities, a credit subsidy can be the only way to obtain a loan.

During the interviews some drawbacks that make credit subsidies unpopular by entrepreneurs came to light. A great deal of the process to obtain a credit subsidy is performed by banks, thus the same bank that denies an initial loan application is responsible for the subsidised loan. This is an efficient process for the government but somewhat confusing for entrepreneurs.

A more important detriment is the inflexibility that is often connected to credit subsidised loans. This inflexibility is caused by strict terms incorporated in the credit agreement. For instance: when using a BBMKB credit subsidy in the Netherlands it is not allowed for firms to make earlier repayments and transferring to another bank is impossible. These strict terms cannot be altered throughout the duration of the loan which requires a huge commitment from an entrepreneur if personal assets are used as collateral to secure the loan.

There can also be additional costs connected to a subsidised loan in the form of commission that has to be paid to the government as compensation. These additional costs are justified but also make credit subsidies unattractive to entrepreneurs.

A credit subsidy is also not very visible and recognizable for an entrepreneur because all arrangements are done through the bank, just as with a regular loan.

Taken together, credit subsidies are not preferred in financing SME firms but when used they are of significance. This is because credit subsidies are often a last resort and the amounts involved are of a considerable size in relation to the total financing of a firm. As a result of the financial crisis, credit subsidies have attracted more attention recently and became a more important factor in SME financing.

6.1.3: Tax subsidies

Just as cash subsidies, tax subsidies are also specifically intended to stimulate certain activities and developments. The two most profound tax subsidies in the Netherlands, the WBSO and Innovation Box, are both aimed at stimulating R&D activities. Therefore, only a limited number of firms are eligible to receive tax subsidies.

To ensure the correct deployment of government funds there are strict terms and conditions connected to tax subsidies. Firms have to meet these terms and conditions in order to receive the subsidy. For instance: the Innovation Box subsidy is granted on basis of the profit a firm made with an innovative product, so making profit is a prerequisite in this example.

In general, tax subsidies are granted afterwards so firms have to pre-finance the initial expenditures themselves. This contains risks for firms because the amount of subsidy they will receive is unknown beforehand.

The amounts involved in tax subsidies are mostly relatively small with respect to the total financing of a firm, this makes the role of tax subsidies in SME financing rather limited.

Tax subsidies influence the cash position and profitability of firms because they lower the amount of tax firms have to pay. To what extent the cash position and profitability is affected differs per situation. When firms receive tax subsidies on a regular basis, this has a structural influence on the cash flow management and profitability of firms.

Just as with cash subsidies there are additional costs connected to tax subsidies due to accountability requirements. In order to receive a WBSO subsidy firms are for instance required to keep and submit timesheets.

Tax subsidies are relatively small, granted afterwards and often deducted from other tax liabilities. Therefore they are not crucial for the financial decisions made by firms. But tax subsidies can be decisive for firms to undertake or continue certain activities. Especially the potential structural contribution they can make to R&D expenditures is appreciated and preferred by firms.

The role of the three types of subsidies in SME financing can be summarised as followed:

| | Amounts involved | For specific use only | Influence on overall financing |
|-------------------------|-------------------------|------------------------------|---------------------------------------|
| Cash subsidies | Medium | Yes | Limited |
| Credit subsidies | Large | No | Significant |
| Tax subsidies | Small | Yes | Limited |

There are substantial differences in the role each type of subsidy plays in SME financing, this makes it difficult to already answer Research Question 4. To give a more detailed answer to this research question, the following section compares and analyses the outcomes of the interviews with each other and theory.

6.1.4: Comparisons and analysis

By applying the Constant Comparative Method, this section places the outcomes of the interviews in a broader SME financing perspective and enables a better interpretation of the outcomes.

Comparing the three main types of subsidies with each other reveals that cash and tax subsidies are both primarily aimed at supporting specific activities. Whereas credit subsidies are focussed on supporting firms in general. This difference affects the role a subsidy plays in SME financing.

In line with their purpose, cash and tax subsidies only directly affect the financing of specific activities. The additional effects on the overall financing of a firm are unintended. Whilst supporting the overall financing of a firm is often the intention of credit subsidies. In addition, the amounts involved with credit subsidies are most often higher than the amounts involved with cash and tax subsidies. Taken together this leads to the observation that credit subsidies play a more significant role in the overall financing of SME firms compared to cash and tax subsidies.

In the literature review, the pecking order theory of financing was discussed as the most appropriate financing theory in the context of this thesis. During the interviews this theory was also discussed with the respondents. The following subsidy pecking order is based on these discussions:

- Cash subsidies.
- Tax subsidies.
- Credit subsidies.

Cash subsidies are preferred over tax subsidies and credit subsidies are least preferred by entrepreneurs. As cash subsidies generally involve greater amounts and are more tangible these are preferred over tax subsidies. Credit subsidies are least preferred because these often serve as a last resort when banks rejected a regular loan application, firms are rather not faced with such circumstances.

Comparing the influence of the different types of subsidy on the financing of firms with the subsidy pecking order shows an apparent contradiction. Credit subsidies, which play the most significant role in SME financing are least preferred by firms.

Next to the subsidy pecking order, the position of subsidies in the regular SME financing pecking order was also examined. The interviews revealed that in general bank loans are preferred over subsidies as a source of external financing by SME firms, this leads to the following pecking order:

- Retained earnings.
- Funds from existing shareholders.
- Debt, in the form of bank loans.

- Subsidies.
- Issuing new equity.

Bank loans are generally preferred over subsidies because there are fewer administrative tasks connected to them. As not all firms are eligible to receive subsidies, it is also possible that bank loans are the only available external financing source for firms next to issuing new equity.

In accordance with life cycle theory, subsidies are more important for young and small firms than for mature larger firms. Due to differences in scale, subsidies have relatively more influence on the financing of young and small firms. These firms experience more difficulties in obtaining regular bank loans due to relative large information asymmetries and strict bank requirements. Therefore young and small firms are also more inclined to make use of the available subsidies.

Whether subsidies perform a signalling function towards banks was also addressed during the interviews. It came forward that banks primarily apply their own methods in assessing loan applications: the ability of a firm to produce a positive free cash flow, the assets of a firm and the track record of the entrepreneur are decisive herein. Subsidies are risky for banks because in advance it is often not exactly known how much and when a firm receives a subsidy. Firms can also be confronted with having to pay back subsidies received because they failed to meet all accountability requirements. As a result of these factors of uncertainty, banks do not let their judgement depend on subsidies. They are taken into account when possible, but subsidies are not decisive. Longer existing subsidies like the WBSO are easier for banks to take into account because they are familiar with them. All in all, subsidies do not perform a clear signalling function in the Netherlands.

After comparing the most often mentioned subsidies during the interviews, the WBSO, Innovation Box and BBMKB, with other subsidies available to SME firms, it is noteworthy to mention that these two subsidies exist for several years. This aspect has the effect that firms and stakeholders are well informed about these two subsidies, which stimulates the use. Other subsidies often exist for a shorter period and are therefore less known and more difficult for firms and stakeholders to take into account.

Summarizing, it is difficult to describe briefly how and to what extent subsidies play a role in SME financing because there are so many aspects involved. The influence of these aspects has been described and compared in the preceding part of this chapter.

In general, the role subsidies play in SME financing appears to be rather limited. This is caused by the fact that most subsidies are aimed at supporting specific activities instead of the overall financing of a firm. The effects of subsidies on SME financing are therefore mostly unintended and relatively small. Furthermore, the subsidies that are aimed at supporting the overall financing of SME firms are often not preferred by entrepreneurs. Combining these factors leads to the observation that the role of subsidies in SME financing is rather limited.

This observation is supported by the estimation that from the approximately 800.000 SME firms in the Netherlands utmost 40.000 firms receive subsidy, a mere 5%.

However, when subsidies are used they can be important for firms. Due to the different types of subsidies and various aspects involved, each subsidy recipient firm is faced with different circumstances. Dependent on these circumstances, subsidies can be important for the financing of certain activities or even the entire firm.

6.2. Accountability and transparency of subsidies

The second part of this chapter focuses on answering Research Questions 5, 6 and 7. These questions are concerned with the accountability and transparency of subsidies.

First, subsidy accountability will be addressed by means of answering Research Question 5:

How are subsidies for SME firms accounted for?

As mentioned in Chapter IV, Dutch legislation prescribes that subsidy recipients have to provide financial information and content specific information. Therefore, the answering of Research Question 5 is divided into two parts: financial accountability and content specific accountability.

6.2.1: Financial accountability

Financial accountability takes place through sharing financial accounting information with external stakeholders such as banks and government. This information is displayed in the financial accounts of a firm. These accounts present the financial situation and performance of a firm and enable the external stakeholders to make rational decisions. Dutch law prescribes that the financial accounts of a firm should present a true and fair view of the financial situation and performance of a firm (Burgerlijk Wetboek 2; Titel 9 [2011]). Subsidies have to be included in the financial accounts of a firm because they influence the financial situation and performance of a firm.

As subsidies have to be included in the financial accounts, firms also use these documents for the financial accountability towards subsidy granting authorities. In order to gain a better understanding about how firms account for subsidies, and thereby answering Research Question 5, it is important to be aware how subsidies are included in the financial accounts of firm.

In literature it is not discussed how the three main types of subsidies are included in the financial accounts of SME firms. Financial accounts of subsidy recipient firms were also not available to the author of this thesis. Therefore, the inclusion of subsidies into firms' financial accounts was discussed during the interviews. This led to the following outcomes per type of subsidy.

6.2.1.1: Cash subsidies

With cash subsidies there is an additional relevant financial statement next to the in Chapter III mentioned cash flow statement, income statement and balance sheet: namely the financial budget of the subsidised items. This budget accounts for the plans of a firm by showing the expected costs throughout the duration of a project or investment, and how a firm intends to finance this. The financial budget is an important document in the application process for cash subsidies because the potentially granted subsidies will be based on this budget. The budget is also used by firms to obtain financing from other sources.

The financial accounting of cash subsidies after a firm received the subsidy is done by including them in the income statement or balance sheet of a firm. When a short term project is subsidised, it lowers the expenses made on this project and the subsidy is included in the income statement. With long term projects and investments, cash subsidies are included in the balance sheet. Cash subsidies are deducted from the corresponding assets. Lowering the total amount of assets of a firm and thereby the required amount of liabilities.

6.2.1.2: Credit subsidies

As mentioned in Chapter IV, credit subsidies in the Netherlands are mostly in the form of guarantees. These guaranteed loans are shown on the liability side of the balance sheet, just like regular loans. When a commission has to be paid as compensation for using a credit subsidy, this expense is included in the income statement just like the interest expenses.

If there are additional terms and conditions connected to a guaranteed loan, these are mentioned in the notes accompanying the balance sheet.

6.2.1.3: Tax subsidies

Tax subsidies lower the expenses of a firm and are deducted from these expenses in the financial accounts of a firm. Which expenses are affected is dependent on the exact subsidy used. For instance, the WBSO lowers the wage expenses of a firm and the Innovation Box lowers the amount of income tax that has to be paid.

Expenses are shown in the income statement of a firm, so this is where tax subsidies are also included in the financial accountants of a firm.

All in all, subsidies seem to be included into the financial accounts of firms in such a way that they are linked to the items where the subsidies were intended for. This is in accordance with the requirement to present a true and fair view in the financial accounts, as prescribed by Dutch law.

6.2.2: Content specific accountability

After the part about the financial accountability, this part focuses on the content specific accountability of subsidies. This additional type of accountability is desired by subsidy granting authorities because they want to ensure that the funds are used for the intended purpose.

Therefore there are terms and conditions connected to subsidies that prescribe what content specific accountability is required. The content specific accountability that is required for each main type of subsidy will be discussed in the upcoming part.

6.2.2.1: Cash subsidies

The content specific accountability of cash subsidies starts with the application for such a subsidy. As cash subsidies only stimulate and support certain politically desired activities and investments there is an application process that examines whether firms are eligible to receive subsidy. Firms have to show in a subsidy application that the activities and investments they want to perform are within the subsidy requirements.

In order to be informed about the progress of the subsidised project or investment, subsidy granting authorities request progress reports from subsidy recipients. Typically such reports consist of invoices, costs statements, timesheets, etc. With this information, subsidy granting authorities can verify whether the granted funds are spent properly.

When firms fail to submit progress reports in time or if the reports are incomplete, there can be consequences such as seizure of payments or having to refund already received subsidy. If there are large amounts of money involved it is likely that a delegation of the subsidy granting authority visits the subsidy receiving firm to examine what is done with the granted funds.

Aside from the progress reports firms also have to submit an end report when the subsidised project or investment is finished. This report presents a complete overview of the undertaken activities and shows how the funds are spent. When this final report is approved and the project or investment is finished firms have successfully completed the subsidy process.

6.2.2.2: Credit subsidies

With credit subsidies in the form of state guaranteed loans there are no stringent requirements about how and for which purpose the received funds must be used. Therefore firms do not have to account for the specific content towards the subsidy granting authority.

The implementation of credit subsidies lies with the banks that offer such guaranteed loans. It is the responsibility of the banks that the loans stay within the subsidy terms and conditions. Banks have to register each state guaranteed loan application by the subsidy granting authority, when this registration is successful they can provide the loan. Banks also have to keep a file for each state guaranteed loan, this file has to be submitted to the guaranteeing authority when the loan guarantee has to be used. When this file is incomplete or incorrect the banks are faced with the consequences.

In order to prevent this, banks often have more frequent contact with firms that have state guaranteed loans compared to firms that have regular loans. The information firms share with banks about their activities and performance during these contact moments are included in the files on the state guaranteed loans.

However firms do not have to account for the specific content towards the subsidy granting authority, they are bound to the agreements they made with the bank. As banks want to minimize their risk, it is likely that firms are faced with more accountability requirements when making use of a credit subsidy.

6.2.2.3: Tax subsidies

The content specific accountability requirements of tax subsidies are very similar to that of cash subsidies. The first step is a subsidy application in which firms have to show that they are eligible to receive the particular tax subsidy.

When this application is positively assessed and a tax subsidy is granted, firms are bound to the terms and conditions connected to this subsidy. In general, the most profound aspect of these terms and conditions is that firms must be able to show that the subsidised activities took place. This is

mostly done through submitting information derived from a firm's administration. Therefore it is important for tax subsidy receiving firms to keep a good up to date administration which can easily produce the desired information. This is frequently a difficult point for firms because keeping an up to date administration is often not a priority.

In case of the most used tax subsidy in the Netherlands, the WBSO, the content specific accountability consist of that firms have to submit time sheets, these time sheets are used to show that there is a certain amount of hours spent on R&D activities. The time sheets have to be submitted periodically and are randomly checked by the subsidy granting authority. When they are incomplete or incorrect firms face the risk of cessation or having to refund subsidy.

All in all, the content specific accountability of cash and tax subsidies has the most impact on firms because these require firms to complete an application process and information that shows that funds are used for the intended purposes has to be submitted.

6.2.3: Required accountability compared

As mentioned in the introduction of this thesis: firms and entrepreneurs are hesitant in using subsidies because of the additional accountability aspects involved. The accountability of subsidies has been discussed in the previous sections. This section compares the required accountability for subsidies with the accountability required by other suppliers of external financing and thereby answers Research Question 6:

How strict is the required accountability for subsidies for SME firms perceived in comparison to other sources of finance?

Banks are the main source of external financing for SME firms in the Netherlands, therefore the comparison is limited to this single other source of finance.

Comparing the required accountability by subsidy granting authorities and banks shows that they focus on different aspects. As previously discussed, subsidy granting authorities often demand financial and content specific accountability whereas banks only demand financial accountability.

This is caused by the different objectives of banks and government. Banks are mainly focussed on the financial situation and performance of firms, because they want to be sure that firms can continue to fulfil their obligations and the investment they made is secure. Subsidy granting authorities aim to support certain activities and investments through cash and tax subsidies and are therefore more interested in what is achieved with the granted funds. In case of credit subsidies, they are interested in the effects on lending to SME firms.

The accountability required by subsidy granting authorities is strict in terms of the amount of accountability and procedural demands like deadlines. As both financial and content specific accountability are required the amount of accountability is relatively high. Due to the content specific accountability requirements firms are faced with additional administrative tasks. When firms put in some effort these administrative tasks and the procedural demands are not very difficult to fulfil according to the interviewed respondents. In order to decrease the administrative burden of subsidies for firms, the Dutch government is simplifying subsidies and in fewer cases audited statements are required. The previously discussed uniform subsidy framework indicates whether a audited statement is required.

As long as their financial situation and performance are sufficient firms are not required to account much towards banks. Submission of the annual accounts and notification of substantial developments is often satisfactory. However, when the financial situation and performance of firms deteriorate, banks actively protect their interests and the required accountability becomes quite strict. If necessary, banks demand to be more frequently informed about the financial affairs and in extreme cases even interfere with operational activities.

As subsidy granting authorities and banks have such different intentions it is difficult to compare the perceived strictness of the required accountability. This aspect is largely dependent on the

individual preferences and attitudes of entrepreneurs and the financial situation and performance of the firms in question.

In general, the accountability required by subsidy granting authorities can be regarded as stricter because they require a larger amount of accountability. However, banks can be very strict also when they are trying to protect their interests.

6.2.4: Transparency and subsidies

The last part of this chapter aims to answer Research Question 7:

How transparent is the financial accounting for subsidies for SME firms?

As mentioned earlier in this thesis: transparency is concerned with presenting full, available and understandable information. Subsidies also have to be included in the financial accounts of Dutch SME firms in such a way that a true and fair view is presented. These two statements seem to be in accordance with each other, but there is a difference: in order for subsidies to be transparent they have to be explicitly displayed in the financial accounts.

As availability of information is an important aspect of transparency and the annual accounts of firms are the most widely available information source for external stakeholders, the explicit display of subsidies in the annual accounts of SME firms was discussed during the interviews.

It came forward that the transparency of subsidies in the annual accounts is dependent on the attitude that entrepreneurs and accountants of SME firms have towards transparency. If transparency is considered important, some additional effort is put in to display subsidies explicitly.

However, transparency usually is a low priority for SME firms because they are not required to make their annual accounts publicly available and in some cases subsidies are involved with competition sensitive activities. Consequently, subsidies are generally not explicitly displayed in the annual accounts. In most cases received subsidies are deducted from the corresponding expenses or balance sheet items and only the net amounts of these expenses and balance sheet items are displayed in the annual accounts. If large amounts or additional liabilities are involved subsidies are often mentioned in the notes on the accounts.

As subsidies influence the corresponding expenses and balance sheet items, experienced readers of annual accounts can notice that firms receive subsidies. However, the influence of subsidies is often not fully and intelligibly displayed.

In general, subsidies are not very transparently displayed in the annual accounts of Dutch SME firms. Although firms explicitly account for subsidies through the progress and end reports they submit to subsidy granting authorities, this cannot be classified as transparent because this information is only available to the subsidy granting authorities.

Chapter VII: Discussion and limitations

This chapter discusses the implications of the research outcomes and presents the limitations of this thesis.

7.1: Discussion

Although the purpose of the research presented in this thesis is to identify and examine the role and transparency of subsidies in Dutch SME financing and not to discuss it, the research outcomes provide two major points of discussion:

- The role of subsidies in SME financing.
- The connection between accountability, transparency, subsidies and SME financing.

Regarding the role of subsidies in SME financing there are slightly contradictory outcomes. In general, the role of subsidies in SME financing is rather limited. But since subsidies are relatively important for young and small firms and stand low in the pecking order, the outcomes are in accordance with theories on SME financing like the pecking order and life cycle theory.

The difference between the seemingly limited role of subsidies and the strong link between subsidies and SME financing theory is remarkable and therefore interesting to discuss. The contradiction is probably caused by the fact that this thesis examines the whole range of subsidies, instead of limiting to a specific subsidy. By including all subsidies it is more difficult to describe the effects on SME financing in detail because there are so many aspects involved. The lack of detailed examinations also kept the research outcomes on a rather abstract level. Although the overall research outcome on the role of subsidies and SME financing is that the role of subsidies in SME financing is rather limited, the observation that subsidies fit into the existing theories on SME financing gives rise to perform further research on the role of subsidies in SME financing. More detailed examinations could add to the found research outcomes and possibly validate the inclusion of subsidies in SME financing theories.

The previous chapter focussed on answering the research questions, therefore the key topics of the research were separately addressed. However, it can be discussed that there is a connecting element that combines these individual outcomes. This connecting element is the importance of information:

- SME firms have to overcome information asymmetries in order to obtain external financing from banks or subsidy granting authorities.
- Accountability is used to provide the required information.
- Transparency ensures that information is full, understandable and available.

During the research came forward that bank loans are the most important source of external financing for SME firms. The knowledge banks obtain regarding SME firms is required through examining accounting information, hereby banks could become more knowledgeable about the subsidies firms receive. However, due to low levels of transparency subsidies are often not explicitly mentioned in the accounting information of firms. This aspect makes it difficult for banks to take subsidies into account, especially because many subsidies only exist for a short period of time. Banks are not familiar with these subsidies and do not know how these affect SME firms. Due to these information asymmetries firms could experience difficulties in obtaining bank loans. In order to reduce the information asymmetries and increase the ability of firms to obtain external financing, high quality accounting information is required. Transparency is a method for increasing this quality, just like harmonization of accounting information as discussed in Chapters III and IV. By giving subsidies a more explicit position in the accounting information of firms, information asymmetries can be reduced.

All in all, information can be considered as the connecting element throughout this thesis. Accountability is used to share information. Transparency increases the quality of this information: reducing the information asymmetries between firms and the suppliers of external financing, and thereby increasing firms' ability to obtain financing.

Building on this reasoning, there is an interesting recent news item which now will be discussed. The chairman of the Dutch Banking Association, Mr. B. Staal, stated that Dutch SME firms are too

dependent on bank loans and should more actively attempt to obtain financing from other sources (www.fdn.nl [2012]). This statement could also have consequences for the role of SME accounting information in SME financing. This information is currently mainly used to minimize the agency conflicts between firms and banks, which are still the main supplier of external financing at the moment. This approach is based on distrust because the parties involved want to minimize either their loss of control or their risk.

When firms have to seek financing more actively, they have to gain the trust of external financiers. Under such circumstances, transparency becomes more important and SME accounting information is likely to be approached more positively than is currently the case. The statement of Mr. B. Staal could also be a cause for firms to take subsidies into consideration as a source of finance. This news item shows that the topics addressed in this thesis are topical and it is likely that changes will take place in SME financing. Recommendations about how to give subsidies a more prominent role in SME financing will be given in the next chapter.

7.2: Limitations

The first limitation is the qualitative nature of the research performed. Most research on financing is quantitative, so the research performed is somewhat different than regular finance research. Although qualitative research is useful for gaining a better understanding about the research topics, it is usually difficult to draw clear-cut conclusions because significant statistic results are missing.

Another limitation is that the research outcomes are based on semi-structured interviews. Even though this is an appropriate method in performing qualitative research it also has disadvantages. The most profound one is the important role of the interviewer, this increases the risk of researcher bias.

Due to the application of the Constant Comparative Method in analysing the research outcomes and because no literal quotations were shown to protect the privacy of the respondents, all information presented in this thesis has been processed by the author. This aspect further increases the risk of researcher bias.

Due to the fact that only ten interviews were conducted during the empirical part of the research, the external validity of the research is limited. Although the sample of respondents consists of different professions, the lack of entrepreneurs in the sample further decreases the external validity of the research.

The research performed has a rather large scope because it is based on three general topics. This means that all relevant aspects are included, but also that the research questions remain quite abstract. This last aspect led to rather general and inconclusive outcomes, limiting the applicability of the research.

Chapter VIII: Conclusions and recommendations

The last chapter of this thesis concludes and recommends. The conclusions are drawn through summarizing the most important outcomes and linking back to the problem statement.

What is the role of subsidies in financing SME firms in the Netherlands and what is the transparency of this role?

When subsidies are included in a SME firm's financing situation their impact depends on the type of subsidy and the specific situation of a firm. In general cash subsidies have a large impact on the financing of a particular project or investment but not on the overall financing of a firm. Credit subsidies tend to affect the overall financing of a firm to a greater extent. Finally, tax subsidies have the least influence on overall SME-financing. All in all, the role of subsidies in SME financing is rather limited.

Although subsidies are included in the annual accounts in such a way that a true and fair view of the corresponding expenses and balance sheet items is presented, because they are often not explicitly mentioned: the transparency of subsidies in SME financing can be considered as low.

These outcomes lead to a rather negative answering of the problem statement. However, during the research other more positive outcomes also came forward. Subsidies fit well into the existing SME financing theories like the pecking order and life cycle theory. Another interesting outcome is the importance of information, which combines the separate research topics with each other.

Building on these outcomes some recommendations can be made. As discussed, subsidies fit well within existing SME financing theories and, even though it is limited, do perform a role in SME financing. Therefore it is recommended to perform further research on the role of subsidies in SME financing. A logical next step is to examine the effects of one type of subsidy or a specific subsidy on SME financing in more detail. This will probably lead to more practical and tangible outcomes than presented in this thesis and is therefore recommended.

As discussed, information is the connecting element between the key topics of this thesis. Through sharing information asymmetries between firms and stakeholders are reduced and the ability to obtain external financing increases. Therefore it is recommended to give subsidies an explicit position within the upcoming SBR accounting method. By transparently including subsidies in this accounting framework, information about subsidies can be more easily shared and becomes more unified. In this way, banks will be better able to take subsidies into account when assessing loan applications from SME firms. This could enlarge the role subsidies play in SME financing, although this is not the primary goal of subsidy granting authorities it can be a positive side effect. Especially under current poor economic conditions.

Another recommendation towards subsidy granting authorities is to limit the amount of subsidies available and to offer subsidies that exist for a long period of time. This recommendation is based on the success of the WBSO and BBMKB subsidies which are both long existing subsidies. Therefore they are well known among entrepreneurs and stakeholders, this increases the use of subsidies. By limiting the amount of subsidies it becomes easier for firms and external stakeholders to comprehend the possibilities to receive subsidy and to take them into account.

These last couple of recommendations have a rather long term focus. For the short term it is recommended to perform a survey research among entrepreneurs further study the effects of a single subsidy type or specific subsidy on SME financing. Such a survey would produce quantitative data that would be a valuable addition to the qualitative information presented in this thesis.

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Appendix

1: Cash flow statement, income statement and balance sheet examples

ABC Company Inc. Cash Flow Statement

For the Year Ending: 31/12/201X
Cash at Beginning of Year: **14,300**

Operating Activities

| | |
|-----------------------------------------------|----------------|
| Cash receipts from customers | 741,000 |
| Cash paid for | |
| Inventory purchases | (310,500) |
| General operating and administrative expenses | (100,000) |
| Wage expenses | (135,000) |
| Interest | (15,000) |
| Income taxes | (38,500) |
| Net Cash Flow from Operations | 142,000 |

Investing Activities

| | |
|------------------------------------------------|-----------------|
| Cash receipts from | |
| Sale of property and equipment | 40,100 |
| Collection of principal on loans | |
| Sale of investment securities | |
| Cash paid for | |
| Purchase of property and equipment | (81,000) |
| Making loans to other entities | |
| Purchase of investment securities | |
| Net Cash Flow from Investing Activities | (40,900) |

Financing Activities

| | |
|------------------------------------------------|-----------------|
| Cash receipts from | |
| Issuance of stock | |
| Borrowing | |
| Cash paid for | |
| Repurchase of stock (treasury stock) | |
| Repayment of loans | (38,000) |
| Dividends | (45,000) |
| Net Cash Flow from Financing Activities | (83,000) |

| | |
|-----------------------------|---------------|
| Net Increase in Cash | 18,100 |
|-----------------------------|---------------|

Cash at End of Year: **32,400**

Obtained from: <http://helpsme.com/articles/accounting/cash-flow-statement>

Income Statement

ABC Company Inc.

For the Year Ending:
Dec 31, 201X

| Revenue | | 201X |
|-------------------------------------|--|----------------|
| Sales revenue | | 130,000 |
| (Less sales returns and allowances) | | |
| Service revenue | | 50,000 |
| Interest revenue | | |
| Other revenue | | |
| Total Revenue | | 180,000 |
| Expenses | | |
| Cost of goods sold | | 65,000 |
| Advertising | | 1,000 |
| Bad debt | | |
| Depreciation | | |
| Furniture and equipment | | |
| Insurance | | |
| Interest expense | | 4,200 |
| Maintenance and repairs | | |
| Office supplies | | |
| Payroll taxes | | |
| Rent | | |
| Research and development | | |
| Salaries and wages | | 55,000 |
| Commissions | | |
| Employee benefits | | |
| Travel | | |
| Utilities | | |
| Software | | |
| Web hosting and domains | | |
| Other | | 17,460 |
| Total Expenses | | 142,660 |
| Net Income Before Taxes | | 37,340 |
| Income tax expense | | 14,936 |
| Net Income | | 22,404 |

Obtained from: <http://helpsme.com/articles/accounting/income-statement>

Balance Sheet

ABC Company Inc.

Dec. 31, 201X

| Assets | |
|---------------------------------------------|---------------|
| Current Assets | |
| Cash | 7,314 |
| Accounts receivable | |
| Inventory | 5,560 |
| Prepaid expenses | |
| Short-term investments | |
| <i>Total current assets</i> | 12,874 |
| Fixed (Long-Term) Assets | |
| Long-term investments | 2,310 |
| Property, plant, and equipment | 14,442 |
| (Less accumulated depreciation) | (2,200) |
| Intangible assets | |
| <i>Total fixed assets</i> | 14,552 |
| Other Assets | |
| Deferred income tax | |
| Other | |
| <i>Total Other Assets</i> | - |
| Total Assets | 27,426 |
| Liabilities and Owner's Equity | |
| Current Liabilities | |
| Accounts payable | 9,060 |
| Short-term loans | |
| Income taxes payable | 3,349 |
| Accrued salaries and wages | |
| Unearned revenue | |
| Current portion of long-term debt | |
| <i>Total current liabilities</i> | 12,409 |
| Long-Term Liabilities | |
| Long-term debt | 3,450 |
| Deferred income tax | |
| Other | |
| <i>Total long-term liabilities</i> | 3,450 |
| Owner's Equity | |
| Owner's investment | 6,000 |
| Retained earnings | 5,567 |
| Other | |
| <i>Total owner's equity</i> | 11,567 |
| Total Liabilities and Owner's Equity | 27,426 |

Obtained from: <http://helpsme.com/articles/accounting/balance-sheet>

2: Interview protocol

Voorstellen en korte uitleg over de bedoeling van het onderzoek: Inzicht verschaffen in de rol die subsidies vervullen binnen de financiering van MKB bedrijven, en hoe transparant deze rol is.

Door middel van het samenbrengen van drie onderwerpen:

| | |
|---|---------------------------------|
| 1 | Financiering van MKB bedrijven |
| 2 | Beschikbare subsidies |
| 3 | Verantwoording en transparantie |

Verduidelijken van het begrip subsidies aan de hand van de 3 hoofdsoorten die in de literatuur worden genoemd.

| | |
|---|-------------------------------------|
| 1 | Cash subsidies (kapitaalsubsidies) |
| 2 | Credit subsidies (kredietsubsidies) |
| 3 | Tax subsidies (belastingssubsidies) |

Uitleggen het een semi gestructureerd interview is en dat de vragenlijst dus dient als opzet voor het gesprek maar dat er ruimte en mogelijkheden zijn om er van af te wijken. Dit hangt af van hoe het gesprek loopt.

Vragen of respondent bezwaar heeft tegen opname van het gesprek.

Start interview:

| | |
|-----------------|------------------------------------------------------------------------------------------------------------------------|
| Vraag 1 | Met welke subsidies komt in aanraking tijdens uw werkzaamheden? |
| | <i>Aandachtspunten</i> Frequentie, type subsidie, doelgroepen |
| Vraag 2 | Hoeveel bedrijven ontvangen subsidies? |
| | <i>Aandachtspunten</i> Inschattingsvraag, van het totaal aan MKB bedrijven |
| Vraag 3 | Welke plek hebben subsidies in de voorkeursvolgorde voor financiering van bedrijven? |
| | <i>Aandachtspunten</i> Onderscheid per type subsidie |
| Vraag 4 | Hoe belangrijk zijn subsidies voor bedrijven? |
| | <i>Aandachtspunten</i> Onderscheid per: type subsidie, leeftijd bedrijf, bedrijfsgrootte, sectoren, doorslaggevendheid |
| Vraag 5 | Vervullen subsidies een signaalfunctie richting andere investeerders? |
| | <i>Aandachtspunten</i> Onderscheid per type subsidie |
| Vraag 6 | Verlichten subsidies de benodigde financiering? |
| | <i>Aandachtspunten</i> Onderscheid per type subsidie |
| Vraag 7 | Hoe moet er voor subsidies verantwoord worden? |
| | <i>Aandachtspunten</i> Onderscheid per type subsidie, frequentie, accountantscontrole, communicatie |
| Vraag 8 | Hoe verhoudt die verantwoording zich met andere bronnen van financiering? |
| | <i>Aandachtspunten</i> Inhoud, frequentie, striktheid |
| Vraag 9 | Hoe worden subsidies in de boekhouding verwerkt? |
| | <i>Aandachtspunten</i> Onderscheid per type subsidie, rol van de accountant |
| Vraag 10 | Hoe zichtbaar zijn subsidies in financiële stukken en verslagen? |
| | <i>Aandachtspunten</i> Onderscheid per type subsidie, rol van de accountant |
| Vraag 11 | Wat zijn de kosten van subsidies voor bedrijven? |
| | <i>Aandachtspunten</i> Onderscheid per type subsidie |
| Vraag 12 | Worden deze kosten ook herkend door ondernemers? |
| | <i>Aandachtspunten</i> Invloed van deze kosten op beslissingen |
| Vraag 13 | Hoeveel bedrijven maken gebruik van een tussenpersoon? |
| | <i>Aandachtspunten</i> Onderscheid per type subsidie, redenen voor gebruik, drempel |
| Vraag 14 | Zijn subsidies van belang voor banken? |
| | <i>Aandachtspunten</i> Onderscheid per type subsidie, invloed van subsidies op risico's |
| Vraag 15 | Hebt u verder nog vragen of opmerkingen? |

Einde interview.

Bedanken voor de medewerking en vertellen dat de notulen toegestuurd zullen worden ter goedkeuring. Als het onderzoek is afgerond ontvangt de respondent ook een kopie van het verslag.

3: List of respondents

| Name | Function | Organization | Date and place of interview |
|----------------------------------|-----------------------------------|-------------------------------------------------------|-----------------------------|
| Mr. J.H.J. van Aken QT | Regiodirecteur Business Banking | Van Lanschot Bankiers | 24-06-2011 Enschede |
| Mr. B.M.T.M. Brus | Senior Subsidieadviseur | Alfa Accountants en Adviseurs | 08-06-2011 Wageningen |
| J.A. van Diemen Arbeider BAC | Product Manager Financieringen | Friesland Bank | 13-07-2011 Leeuwarden |
| Bc. R.G. Grouve MBA RI | Directeur | Currency Connect | 06-06-2011 Goor |
| A. de Haan MSc | Directeur | PNO Consultants | 14-06-2011 Arnhem |
| Drs. E. Haandrikman-Willemsen RA | Accountant | De Jong & Laan | 06-06-2011 Enschede |
| Ing. F. Kapitein AA RV | Financial Consultant and Valuator | Meeuwssen ten Hoopen | 23-06-2011 Meppel |
| A.G.J. Lammerink RA | Supervisor Audit | KPMG Accountants N.V. | 09-06-2011 Enschede |
| Drs. B. De Vries | Subsidieadviseur | Kroese Wevers | 09-06-2011 Enschede |
| J. Wietsma AA | Financial Consultant and author | MKB Kredietcoach Full Finance Accountancynieuws | 28-06-2011 Zwolle |