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DIRECTIONS FOR IMPROVING FINANCING OF SMALL BUSINESS

INVESTMENT ACTIVITIES

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Small business plays a crucial role in modern economic systems as a key driver of employment generation, innovation, competition, and inclusive economic growth. In both developed and developing economies, small business entities contribute significantly to GDP formation, diversification of production, and enhancement of social welfare. In recent years, the importance of small business investment activities has further increased due to globalization, technological transformation, and the transition toward sustainable and green economic development. However, despite its growing importance, financing small business investment activities remains one of the most challenging areas of economic policy and financial system development.

The financing of investment activities in small businesses refers to the process of providing financial resources for the expansion, modernization, innovation, and sustainability of small enterprises. These financial resources may come from internal sources such as retained earnings, or external sources such as bank loans, leasing, venture capital, government subsidies, international financial institutions, and capital markets. The effectiveness of financing mechanisms directly determines the ability of small businesses to grow, compete, and contribute to long-term economic development.



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In many economies, including transitional and developing countries, small businesses face structural constraints in accessing finance. These constraints include high interest rates, strict collateral requirements, limited credit history, underdeveloped financial infrastructure, and information asymmetry between lenders and borrowers. As a result, investment activities in small businesses are often underfunded, which limits productivity growth and innovation potential. This situation creates the need for more efficient, inclusive, and innovative financing mechanisms that can support sustainable business development.

One of the key issues in small business financing is the mismatch between the risk profile of small enterprises and the risk appetite of financial institutions. Banks often perceive small businesses as high-risk borrowers due to their limited capital base, unstable cash flows, and lack of formal financial reporting. Consequently, credit is either not provided or offered at relatively high interest rates, which reduces investment feasibility. Therefore, improving risk assessment methodologies and developing alternative financing instruments becomes essential.

Another important dimension is the role of government in supporting small business investment financing. Governments implement various policy tools such as subsidized loans, credit guarantees, tax incentives, and development programs to reduce financial constraints. In recent years, many countries have also introduced innovative mechanisms such as green financing, ESG-based lending, fintech platforms, and public-private partnerships to enhance access to finance for small businesses.

Digital transformation has significantly changed the landscape of financial services. Fintech solutions, including online lending platforms, crowdfunding systems, and digital banking services, have improved the speed, accessibility, and efficiency of financing processes. These innovations reduce transaction costs and



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expand financial inclusion, particularly for micro and small enterprises that previously had limited access to formal financial institutions.

Sustainable development goals (SDGs) and environmental concerns have also influenced the financing of small business investment activities. The emergence of green finance, social bonds, and ESG-compliant investment frameworks encourages businesses to adopt environmentally friendly and socially responsible practices. This shift not only improves environmental outcomes but also increases the long-term competitiveness of small enterprises in global markets.

Despite these positive developments, significant challenges remain. These include insufficient financial literacy among entrepreneurs, weak institutional coordination, limited venture capital markets, and regulatory barriers. Additionally, macroeconomic instability, inflation, and currency fluctuations may further complicate access to stable financing sources. Therefore, a comprehensive approach is required to improve the financing system for small business investment activities.

The main objective of this study is to analyze the directions for improving financing mechanisms for small business investment activities and to propose practical and theoretical recommendations for enhancing their efficiency. The study focuses on identifying key challenges, evaluating existing financing instruments, and exploring innovative solutions that can support sustainable growth of small businesses.

The analysis of financing mechanisms for small business investment activities demonstrates that access to financial resources remains a fundamental determinant of business development, competitiveness, and innovation capacity. Small businesses, despite their significant contribution to economic growth and employment, continue to face structural financial constraints that limit their investment potential. These constraints are mainly associated with limited access



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to credit, high borrowing costs, insufficient collateral, and underdeveloped financial markets.

The study highlights that traditional financing sources such as bank loans remain the dominant instrument for small business investment financing. However, reliance solely on banking sector financing is insufficient to meet the diverse and growing needs of small enterprises. Therefore, diversification of financing sources is essential. This includes the development of leasing services, venture capital markets, microfinance institutions, and capital market instruments such as bonds and equity financing.

One of the key findings is that government intervention plays a critical role in improving access to finance. Policy tools such as interest rate subsidies, credit guarantee schemes, and tax incentives significantly reduce financial barriers for small businesses. Moreover, strategic programs aimed at supporting priority sectors, including manufacturing, services, and green economy initiatives, contribute to more balanced and sustainable economic development.

The introduction of ESG-based financing instruments represents a modern and forward-looking direction in small business investment financing. Green loans and social bonds encourage environmentally responsible and socially inclusive business practices, while also attracting international investors who prioritize sustainability. This approach aligns small business development with global sustainability standards and enhances their long-term resilience.

Another important conclusion is the growing significance of digital financial technologies. Fintech platforms, online lending systems, and digital payment infrastructures improve financial accessibility and efficiency. These technologies reduce administrative costs, shorten loan approval times, and increase transparency in financial transactions.