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Malta Chamber of Commerce, Enterprise and Industry Survey on Financing Conditions

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BOX 7: MALTA CHAMBER OF COMMERCE, ENTERPRISE AND INDUSTRY SURVEY ON FINANCING CONDITIONS[1]

Surveys provide important information for the analysis of economic and financial developments, but those analysing such developments in Malta are limited. In 2008 the European Commission and the ECB launched the Survey on Access to Finance (SAFE) to assess financing conditions of enterprises in the European Union (EU). A survey covering the largest euro area economies is run every six months by the ECB, while a more comprehensive exercise, covering all EU countries, is carried out every year in cooperation with the European Commission.[2] The first wave of the surveys was conducted in 2009.

To gauge developments in financing conditions on a timelier basis, in 2014 the MCCEI, in conjunction with the Central Bank of Malta, introduced questions on access to finance, based on the SAFE. The survey, carried out on a quarterly basis, covers firms in the manufacturing, service, retail and construction sectors.

This note reviews the key results of the first four sets of collected data covering 2014. When appropriate, comparisons are made with results from the SAFE and enhanced by responses from the BLS, which gauges credit demand and supply conditions from the banks' point of view.[3]

The sample

In carrying out this survey, the MCCEI generates a sample, which includes a number of large companies in each quarter and another number of randomly selected firms from the rest of the population. On average, 1,481 companies were chosen to take part in the survey and response rates fluctuated between 20% and 35%.

Including the same set of large companies each time is meant to aid representativeness within individual sectors and favours comparability of results across rounds. However, this may intensify sampling bias, since large firms are more likely to be included than others. At the same time, it may also skew results as the financing behaviour of large companies may differ from that of smaller ones. In particular, larger companies may be in a better position to tap capital markets and may obtain funding from foreign parents, which may bias downwards the incidence of loan applications. These caveats need to be kept in mind when analysing survey results.

The results of the MCCEI surveys presented hereafter are based on weighted responses, with the weights based on the number of employees.

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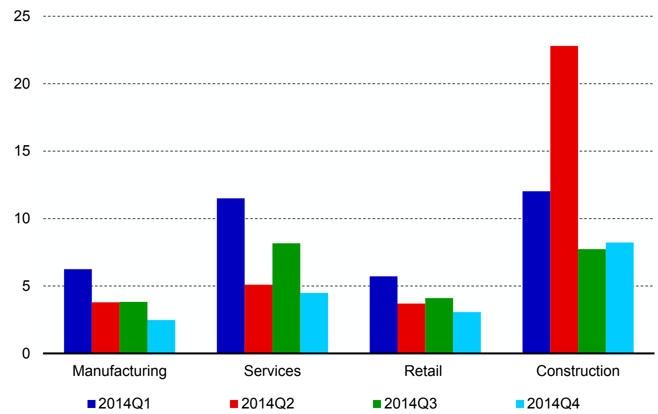
2 The bi-annual survey conducted by the ECB covers the largest euro area countries, excluding the seven smallest ones – Malta, Cyprus, Estonia, Latvia, Luxembourg, Slovakia and Slovenia.

3 The SAFE refers to the 11th wave of the survey for the reference period April to September 2014. The BLS is carried out on a quarterly basis, analysing developments in the previous three months. The relevant surveys for this Box are those conducted between April 2014 and January 2015.

Demand for funding by firms

The SAFE shows that the use of bank loans by Maltese firms was rather low during the six months to September 2014, with overdrafts and credit lines being more relevant sources of financing.

Chart 1
PROPORTION OF FIRMS THAT APPLIED FOR A LOAN IN THE PREVIOUS THREE MONTHS
(percentage)



Source: MCCEI.

Chart 1 shows the proportion of firms that applied for a bank loan in the previous three months according to the MCCEI survey. The survey shows that there was only a small percentage of such firms, with the figure never exceeding 25%. This is broadly in line with the results from the SAFE, which shows that 27% of Maltese firms applied for a bank loan during the six months to September 2014.

The MCCEI survey shows that, with the exception of construction firms, loan applications were highest in the first quarter of 2014, with applications generally falling thereafter. According to BLS data, only one bank out of the four surveyed reported an increase in demand for loans by enterprises in the second quarter of 2014. Subsequently, banks reported declines in demand in the second half of the year.

In general, the MCCEI survey shows that construction firms were the most likely to apply for bank loans. Firms in services were the next most likely to apply for a loan, followed by those in retail and manufacturing.

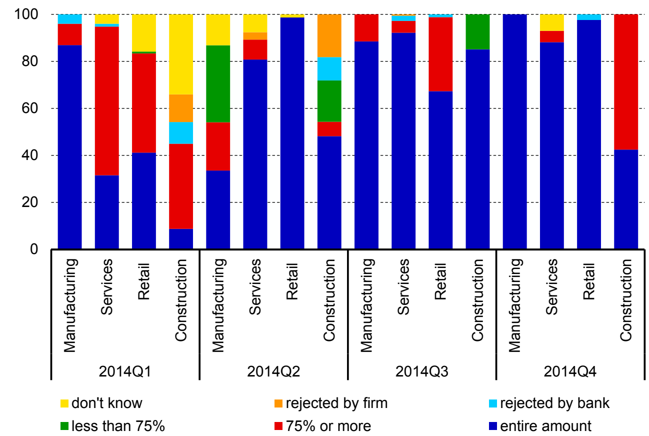
A point of interest is the increase in loan applications recorded within the services sector in the third quarter. Part of this rise came from firms operating in the accommodation sector, in which the percentage applying for a loan rose to 13.5%, up from zero in the previous quarter. This may reflect higher demand for finance by hotel operators, following the decision of the Malta Environment and Planning Authority to allow hotels to build additional floors, though the lag between this policy decision and the eventual loan applications is hard to ascertain.[4]

Availability of funding

In a separate question, the survey also asks firms that have applied for a loan whether their request had been accepted or rejected. If accepted, the firm is asked to indicate whether it had obtained the entire amount or part of it. On the other hand, if rejected, firms are

[4] See "Height Limitation Adjustment Policy for Hotels – Boosting Malta's competitiveness in the tourism market", *MEPA*, June 2014.

Chart 2
AMOUNTS OBTAINED BY FIRMS
(per cent of requested amount)



Source: MCCEI.

asked to indicate whether they refused the offer themselves because of unattractive conditions or whether it was the bank that had rejected the request. This question seeks to shed light on loan supply in Malta, that is, banks' willingness to provide credit.

Acceptance rates for loans were, in general, quite high. Around 85% of firms operating in the manufacturing, service and retail trade sectors that had applied for a loan obtained 75% or more of the requested amount (see Chart 2). This is in line with results obtained from the SAFE, in which the percentage of firms that had applied for a loan and obtained the full amount stood at 71.2% in 2014, up from 55.6% in the previous year.

On the other hand, on the basis of the MCCEI surveys, the percentage of firms in the construction sector that had applied for a loan and obtained 75% or more of the requested amount was lower than in other sectors in the first two rounds, at around 50%. Furthermore, higher shares of loan rejections by banks were also recorded in this sector. This indicates that banks may have been more cautious in increasing their exposure to this sector. In turn, this could reflect vulnerabilities stemming from the level of exposure to the property market, coupled with a relatively high level of non-performing loans in this sector as highlighted in the Central Bank of Malta's *Financial Stability Review* and by the International Monetary Fund.[5] Although the exposure of the Maltese banking sector to the property market has decreased in recent years, loans to the construction sector account for a large proportion of total loans to resident private NFCs, with this share standing above 20% as at the end of 2014.

Furthermore, amounts obtained by firms in the construction sector were also relatively low in the first half of the year because a number of firms rejected the banks' offer. This may indicate that banks offered loans, but with conditions that were assessed as too onerous by firms. However, during the second half of the year, the share of construction firms that obtained most of the loan required rose to over 85%, with this figure approaching 100% in the last quarter of 2014. It will be important to monitor this apparent improvement in access to bank loans over 2015.

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[5] See Central Bank of Malta: *Financial Stability Report Update* 2014, and "Malta: Concluding Statement of the 2014 Article IV Mission", *International Monetary Fund*, 2014.

Overall, firms reported that loans were primarily used to finance working capital and to obtain additional tangible assets, such as property, plant, equipment and motor vehicles, or replace existing ones. The use of funds to finance R&D or intellectual property was mentioned solely by firms operating in the services sector. Meanwhile, firms rarely used loans for product promotion, market development or staff training. These results are similar to those in the SAFE, in which small and medium-sized enterprises' need for external financing is predominantly to finance inventory and working capital, followed by new fixed investment.

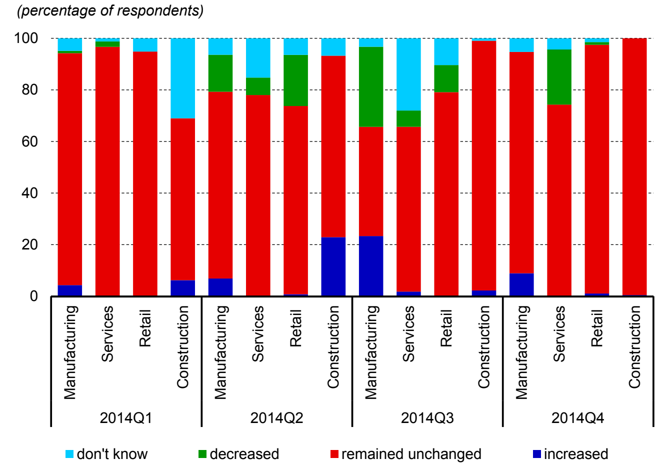
Interest rates on bank loans

When asked about interest rates on bank loans, most respondents answered that they had remained unchanged over the previous three months, in all four quarters (see Chart 3).

In the first quarter, however, increases were reported by a small share of firms in construction and manufacturing sectors. In the following two quarters all sectors, except the construction sector, reported on balance lower interest rates. This corresponds to a decline in interest rates reported by credit institutions on new business in the same period. In the last quarter of 2014, however, net decreases in interest rates were mentioned by firms in the services sector. Manufacturing firms reported an increase in interest rates, while firms in the remaining sectors replied that interest rates had remained unchanged.

Central Bank of Malta data on bank lending rates show that banks reduced their lending rates following the fall in the ECB's key refinancing rate to record lows of 0.15% in June and 0.05% in September. Nevertheless, interest rate pass-through in Malta has been incomplete.[6] Relatively high lending interest rates were still being observed in certain sectors.[7] The weighted average rate on outstanding bank loans to NFCs stood at 4.41% at the end of 2014, down from 4.70% a year earlier.

Chart 3
INTEREST RATES OVER PAST THREE MONTHS
(percentage of respondents)



Source: MCCEI.

Non-interest terms and conditions on bank loans

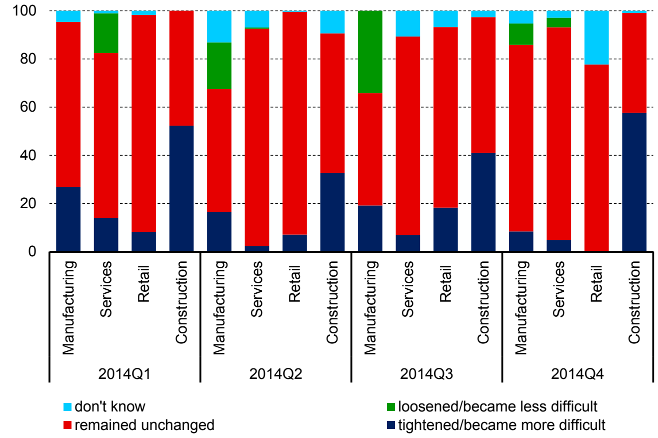
Firms were also asked about other conditions on bank loans, such as collateral requirements, non-interest rate charges and the time required for

[6] Micallef, B. and Gauci, T., "Interest Rate Pass-Through in Malta", *Quarterly Review,* Vol. 47 No. 1, Central Bank of Malta, 2014, pp. 71-82.

[7] "Malta: Concluding Statement of the 2014 Article IV Mission, 2014", *International Monetary Fund,* 2014.

loan approval. In general, most firms reported that these conditions remained unchanged over the course of 2014.

Chart 4
OTHER CONDITIONS ON BANK LOANS
(percentage of respondents)



Source: MCCEI.

A look into particular sectors reveals varying developments. In the manufacturing sector, around 27% of firms saw conditions on bank loans tightening during the first quarter. However, in the remaining quarters, manufacturers reported easing conditions on balance (see Chart 4). This is in line with the increased proportion of loan demands that were met.

On the other hand, in the construction sector firms reported a tightening of non-price lending conditions in each of the survey rounds. The share of firms reporting a tightening in non-interest conditions fell from around 50% in the first quarter to just above 30% and 40%, respectively, in the second and third quarters. However, it rose again in the last quarter of 2014.

Firms in the retail sector also reported tightening conditions, on balance, across the year while the services sector reported easing conditions, on balance, in the first quarter, and a tightening thereafter.

In summary, all firms except those in the manufacturing sector saw conditions tightening as the year progressed. The SAFE shows similar results: in 2014 a bigger percentage of responding firms reported an increase in the cost of financing other than interest rates when compared with the previous year.

Conclusion

The MCCEI survey aims to provide information on access to finance by Maltese firms as perceived by firms themselves. It also helps in explaining demand and supply factors influencing the provision of loans to the private sector. While the SAFE has an important role in this regard, the MCCEI survey provides more timely information, given its quarterly frequency. Furthermore, it enhances the information gathered by differentiating between firms in four different sectors.

The survey results show that only a small percentage of responding firms applied for a bank loan in the previous three months, suggesting that other sources of finance, which include bank overdrafts, loans from parent companies and financing from capital markets, are more popular. It also suggests that the majority of firms that had applied for a loan obtained most of the funds. In general, firms within the manufacturing, service and retail sectors obtained 75% or more of the amount requested. Loan success rates in the construction sector were lower in the first half of the year, indicating that banks were cautious in increasing their exposure to the sector. However, success rates for these firms rose in the second half of the year.

With regard to interest rates, the majority of respondents saw no change over the course of 2014. However, a greater percentage of firms mentioned a fall in interest rates in the middle of the year as banks reduced lending rates, following further cuts in the ECB's main refinancing rate. Nevertheless, it appears that these declines were not passed on fully to firms in the construction sector, given the significant percentage that reported a rise in interest rates in the second quarter. Firms in this sector were also more likely to report a tightening in other conditions on bank loans. Conversely, credit conditions eased for manufacturing firms.

One drawback of the survey is its short history, which does not allow one to compare results over a longer time period. Furthermore, results must be treated with caution because of the manner in which the sample is drawn up.