BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

SURVEY ON ACCESS TO FINANCE

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BOX 1: SURVEY ON ACCESS TO FINANCE (SAFE)[1]

Small and medium-sized enterprises (SME) form the backbone of the European economy. SMEs are typically defined as firms with less than 250 employees.[2] In the case of Malta there were approximately 30,500 SMEs actively operating in the country in 2013, representing around 99.8% of all enterprises and employing around 98,000 people, or 78% of the total workforce.[3]

The structure and characteristics of SMEs are given serious consideration by central banks when formulating monetary policy since the transmission mechanism may differ for SMEs and large firms, given the higher dependency of small firms on bank financing. In fact, the monetary transmission mechanism in the euro area has been adversely affected by the recent financial and sovereign debt crisis, and this has had a large negative impact on SMEs. This can be inferred, for instance, from heterogeneous developments in retail interest rates and from the supply of credit to the non-financial private sector in euro area countries. Studies show that SMEs usually have a harder time obtaining credit from banks than larger firms, mainly owing to their inability to provide high quality collateral and to the lack of relevant information on their creditworthiness.[4] The latter is evidenced by the relatively low survival rate of SME start-ups, which hinders their ability to develop lasting banking relationships or a credit related track record. This exacerbates the asymmetric information problem, which could lead to credit rationing and sub-optimal lending to viable SMEs. This negative state of affairs could have been reinforced by the recent financial crisis in the euro area. Thus, in periods of tight credit conditions, there is strong demand from policy makers for more detailed information about the financing conditions of SMEs.

Despite the importance of this category of firms, however, harmonised and timely statistics on SMEs have been relatively scarce. To address this gap, the European Commission and the ECB have, since 2008, commissioned regular surveys on access to finance of enterprises (SAFE) in the European Union. The survey covers micro, small, medium-sized and also large firms. It thus provides evidence on the financing conditions faced by SMEs compared with those of larger firms.[5] Since 2013 the European Commission's survey has been carried out on an annual basis, instead of biennially. In contrast, the ECB carries out biannual waves of the survey for the largest euro area economies only.[6]

This article provides an overview of the key results that were obtained from Maltese firms from the SAFE that was conducted between April and September 2014.[7] When appropriate, comparisons are made with results registered in previous waves of the survey or by other European economies.

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[2] In addition, according to the European Commission, to fully qualify as an SME a firm's turnover has to be below €50 million or its total assets have to be below €43 million.

[3] Source: "Annual Report on European SMEs 2013/2014", published by the *European Commission*. This information differs from the Business Register of the National Statistics Office since it includes only NACE sectors B to J and L to N (i.e. it excludes agriculture, finance, public administration, health and education and some service activities, including arts and entertainment). This means that the number of SMEs is higher in the Business Register, amounting to 68,275 entities in 2013, when excluding public administration, education and health.

[4] Ayadi, R. and Gadi, S., "Access by MSMEs to finance in southern and eastern Mediterranean: what role for credit guarantee schemes?" *Technical Report* No 35/2013, European Commission, MEDPRO, 2013.

[5] Micro-enterprises are enterprises with one to nine employees, while small enterprises are those with ten to 49 employees, medium-sized enterprises have 50 to 249 employees and large enterprises have more than 250 employees. SMEs comprise micro-enterprises, small and medium-sized enterprises. Further information on the European Commission's SME Access to Finance Index (SMAF) is available at http://ec.europa.eu/enterprise/policies/finance/data/index_en.htm.

[6] The biannual surveys conducted by the ECB cover the euro area countries, except Cyprus, Estonia, Latvia, Luxembourg, Malta, Slovakia and Slovenia.

[7] A total of 17,075 firms have participated in the survey, which covers all 28 EU Member States, together with Iceland and Montenegro. The Maltese results are based on the replies of 100 firms from industry, construction, trade and services.

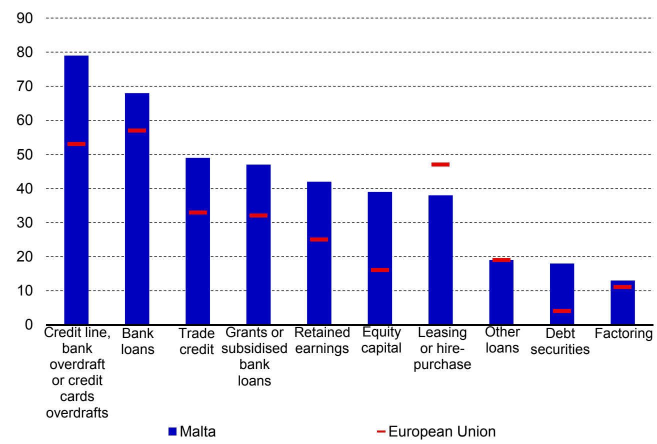
Financing sources used by SMEs

Charts 1 and 2 rank the importance of various funding sources for domestic and European SMEs. The first chart shows the sources that SMEs have used in the past or that they expect to use in future, while the second one shows the sources they have actually used in 2014.

As expected, the main similarity between Maltese and other European SMEs is their reliance on bank financing, with bank loans, overdrafts and credit lines being the most relevant sources of financing. Other sources, such as equity, factoring and debt securities, are used much less frequently by SMEs in both Maltese and European economies.

However, the survey also highlights differences between the importance attached by local and European SMEs to various sources of financing. Domestic SMEs are considerably more dependent than their European counterparts on bank overdrafts, credit lines or credit card facilities: in 2014 more than 70% of Maltese SMEs used these types of financing compared with around 37% in the European Union. This heavy reliance by domestic SMEs on overdrafts and credit cards could be suboptimal since banks typically charge higher interest rates on these forms of financing compared with bank loans.[8]

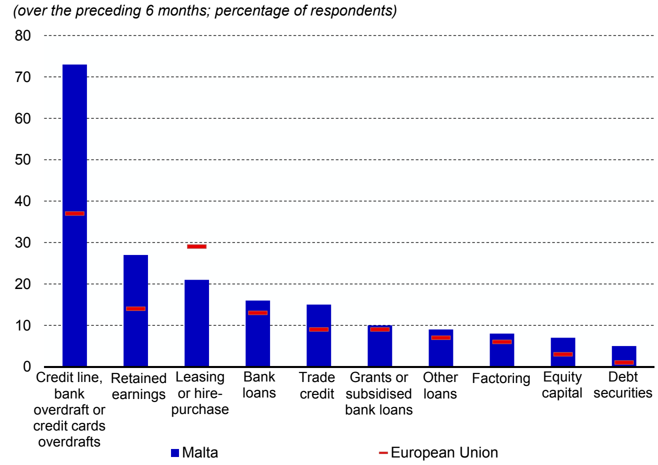
Chart 1
SOURCES OF FINANCE USED BY SMEs
(used in the past or consider using in the future; percentage of respondents)



Source: SAFE (2014).

Compared with their European counterparts, domestic SMEs also stand out as the most dependent on internal financing, more specifically, retained earnings or proceeds from the sale of assets. The survey reveals substantial differences across countries, with more than one quarter of SMEs in Malta, Ireland and Estonia financing their operations and investments in 2014 from retained earnings while, at the other end of the spectrum, less than 2% of firms in Portugal used

Chart 2
SOURCES OF FINANCE USED BY SMEs IN 2014
(over the preceding 6 months; percentage of respondents)



Source: SAFE (2014).

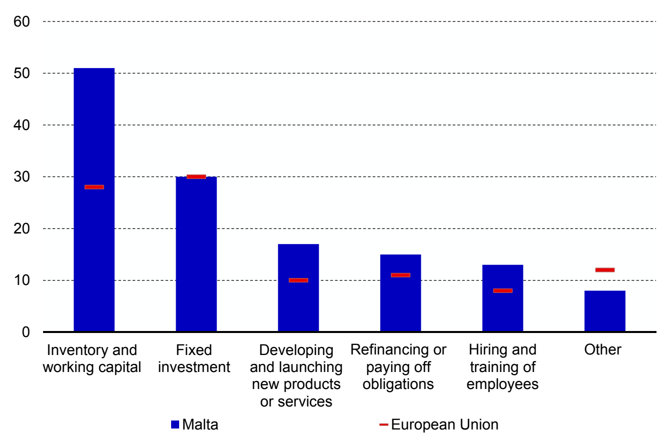
8 According to MFI interest rate statistics, the interest rates charged by domestic banks to non-financial corporations on revolving loans and overdrafts averaged 5.1% between April and September 2014, compared with 4.6% on total bank loans to NFCs.

this source of finance. On the contrary, domestic SMEs are much less reliant on leasing or hire purchase facilities than the average European SME.

The survey suggests that the use of internal financing increases steadily with firm size and is more frequently resorted to by innovative firms compared with less innovative ones. This could be linked to the risky nature of these enterprises, which makes it more difficult to obtain external finance owing to the uncertain nature of the business venture and, ultimately, the profits outcome. According to the survey, Maltese SMEs perform strongly when innovation is concerned: 45.0% of them have introduced a new or significantly improved product or service in the market during the previous year, compared with 32.0% for SMEs in the European Union as a whole. Domestic SMEs also rank more favourably than the European average SME in terms of improvements in production processes or methods and in new management organisation.

With regard to the use of external financing, the survey reveals that in Malta, as well as in the European Union as a whole, inventory, working capital and fixed investment are the most important factors affecting the demand for external financing, though the relative importance that a local or an European SME gives to these factors differs (see Chart 3). Thus, in the case of Malta SMEs are much more reliant on external financing for inventory and working capital, while in the European Union this is less so. Maltese SMEs are also more likely than the average EU SME to use such funding to develop or launch new products, refinance or pay off their debts, or utilise for hiring and training of employees.

Chart 3
USES OF EXTERNAL FINANCE
(over the preceding 6 months; per cent of respondents)

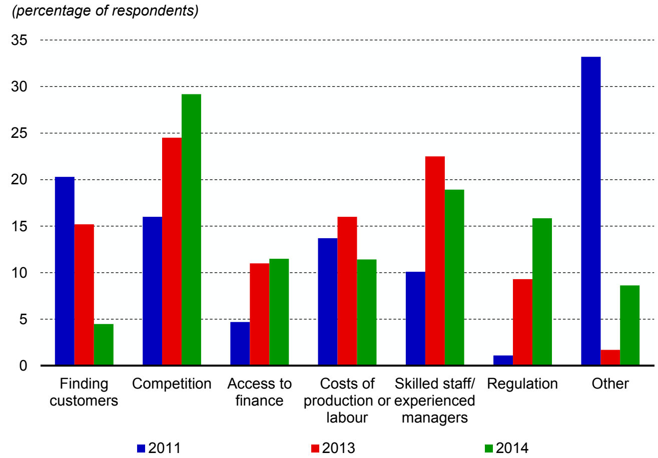


Source: SAFE (2014).

Most pressing problems facing SMEs

The survey ranks competitive pressures as the most serious problem facing domestic SMEs in 2014, followed by difficulties in attracting skilled staff and abiding by regulations (see Chart 4). The percentage of

Chart 4
MOST PRESSING PROBLEM FACING FIRMS
(percentage of respondents)



Source: SAFE.

domestic SMEs that consider competition as the priority concern has gradually increased over time, from around 16% in 2011 to slightly less than 29% in 2014. Other challenges that have attracted attention over the past three years are access to finance and costs of production or labour. For most European SMEs, finding customers ranks as the most pressing problem, whereas locally, its relative importance has been gradually declining since 2011.

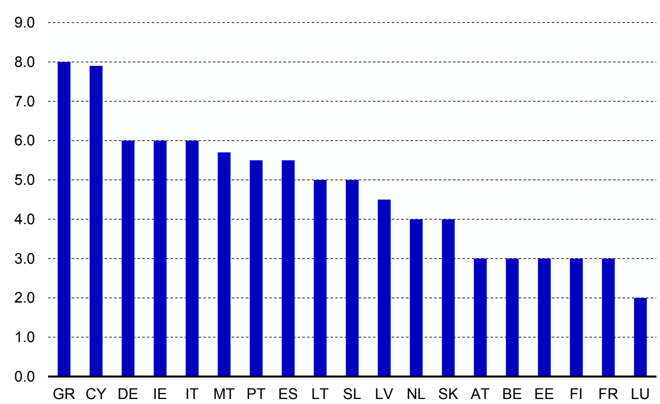
Access to finance is another important problem highlighted by domestic firms in the latest survey. Compared with previous waves, the percentage of domestic firms that mentioned access to finance as their most pressing problem has increased from 4.7% in 2011 to 11.5% in 2014. This, however, remains below the EU average of 14.0%. Across EU countries, the divergence in replies appears to be large when participants were asked to assess the significance of access to finance. A total of 45.0% of firms in Cyprus and 32.0% in Greece consider access to finance as their most pressing problem, given the financial crises these countries have experienced in recent years. At the other end of the spectrum, less than 10% of firms in Austria, Luxembourg and Germany consider it as their main problem.

Terms and conditions of bank loan financing

Chart 5 provides information on the costs of using a bank overdraft or a credit line. Thus, in the European Union as a whole, SMEs were charged a median interest rate of 5.00% between April and September 2014. On the other hand, interest rates on these facilities for local SMEs stood at 5.70% during this period, which is at the higher end of the European range. Once again, interest rate developments differed significantly between countries, with the median interest rate being the highest in Greece and Cyprus, at around 8%, and the lowest in Luxembourg, at 2.00%. SMEs in Austria, Belgium, Estonia, Finland and France also paid a relatively low interest rate, with the median level standing at 3.00%.

Survey questions also focus on changes in the terms and conditions of bank loan financing, such as the level of interest rates or costs of financing other than interest rates, and how they have evolved over the preceding six months (see Table 1). In the case of responding firms in Malta, 23.0% reported an increase in interest rates in 2014, while only 14.0% reported a decrease and, for the remaining 62.0%, interest rates remained unchanged. Developments in this regard involving firms in the European Union contrast sharply with those prevailing in Malta. Thus, the percentage of firms that reported a rise in interest rates declined notably over the three-year period, while those benefitting from lower interest rates rose substantially, reflecting the monetary easing measures by the ECB and other central banks in the European Union. This result broadly corresponds to the conclusions of a recent study that show that the interest rate pass-through in Malta is sluggish and that the transmission of changes in policy rates to the retail rates charged by banks has weakened even further after the crisis.[9]

Chart 5
MEDIAN INTEREST RATE CHARGED FOR CREDIT LINE OR BANK OVERDRAFT
(per cent)



Source: SAFE (2014).

[9] Micallef, B. and Gauci, T., "Interest rate pass-through in Malta", article published in *Quarterly Review* 2014:1, Central Bank of Malta.

Table 1
LEVEL OF INTEREST RATES AND COST OF FINANCING OTHER THAN INTEREST RATES
Over the preceding 6 months; per cent of responding firms

	Malta			EU		
	2011	2013	2014	2011	2013	2014
Level of interest rates						
increased	6	9	23	52	34	23
unchanged	73	85	62	33	41	40
decreased	21	0	14	8	20	32
Level of cost of financing other than interest rates (e.g. charges, fees, commissions)						
increased	16	35	44	48	43	39
unchanged	84	60	47	43	46	48
decreased	0	0	7	4	5	9

Source: SAFE.

Similar results emerge from replies by domestic firms on the level of the cost of financing, other than interest rates, such as charges, fees and commissions. In 2014, 44.0 % of domestic firms reported an increase in such costs, while only 7.0% reported a decline. In contrast, 39.0% of firms in the European Union reported a rise in financing costs compared with the preceding year, while 9.0% reported a decrease in costs.

Credit demand and supply

The survey also focuses on demand and supply for financing. A decline in bank credit to NFCs has been observed in the European Union, including Malta, in the aftermath of the economic and financial crisis of 2009 and, more recently, after the sovereign debt crisis of 2012. This reflects a combination of both demand and supply-side factors.

Demand for financing instruments most commonly used by Maltese SMEs has picked up over the last two years. Table 2 shows that the number of firms that have applied for bank loans, trade credit, overdrafts and credit lines has gradually increased from 2011 to 2014. In 2014 between 25.0% and 33.0% of respondent firms applied for one of these types of financing instruments, with trade credit registering the largest demand. Only a small proportion of firms did not apply for some form of credit because they feared possible rejection. The proportion of firms that did not apply for reasons other than the fear of rejection, or because of sufficient internal funds, has also gradually declined.

Table 2
FOR EACH OF THE FOLLOWING WAYS OF FINANCING, COULD YOU PLEASE INDICATE WHETHER YOU:
Over the preceding 6 months; per cent of responding firms

	Bank overdraft, credit line or credit card overdrafts			Bank loans			Trade credit		
	2011	2013	2014	2011	2013	2014	2011	2013	2014
Applied over the past 6 months	15	19	25	6	24	27	6	22	33
Did not apply because of possible rejection	6	1	1	6	0	5	1	0	3
Did not apply because of sufficient internal funds	32	48	45	32	40	38	37	35	39
Did not apply for other reasons	47	30	23	55	37	20	54	43	20

Source: SAFE.

Table 3
OUTCOME OF APPLICATION FOR FINANCING OVER THE PAST SIX MONTHS
Over the preceding six months; per cent of responding firms

	Bank overdraft, credit line or credit card overdrafts			Bank loans			Trade credit		
	2011	2013	2014	2011	2013	2014	2011	2013	2014
Applied and got everything	81	53	74	51	56	71	96	43	54
Applied and got most of it (1)	7	19	17	15	11	10	2	20	12
Applied but only got a limited part of it (2)	7	16	9	19	28	9	0	20	34
Applied but refused because cost too high	0	0	0	0	0	10	0	7	0
Applied but was rejected	0	12	0	0	0	0	2	0	0

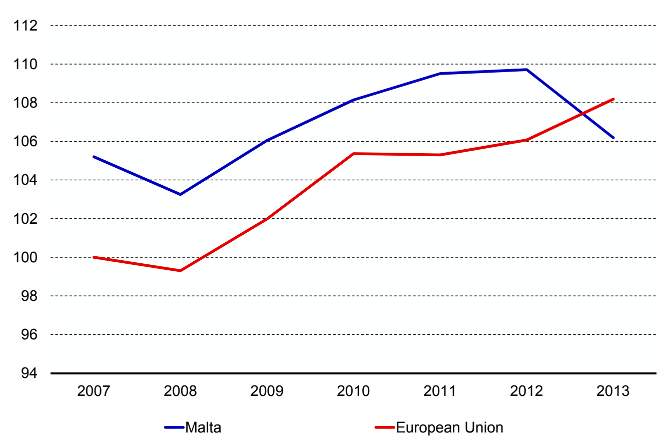
(1) between 75% and 99%.
(2) between 1% and 74%.
Source: SAFE.

With regard to credit supply factors, namely credit standards applied by banks to their customers, the survey included a separate question that requested firms that had applied for various types of financing on whether their application had been accepted or rejected. More important, the question asked whether, if accepted, the firm had got the full amount, just a part of it or whether the firm had refused the offer because the cost had been deemed too high (see Table 3).

Table 3 shows that credit standards were tightened considerably by banks in Malta in 2013 compared with 2011. Thus, there was a significant reduction in the percentage of firms that applied for credit facilities and got everything they requested, especially when these involved overdrafts, credit lines and trade credit. The percentage of firms that applied but did not get the full amount requested significantly increased for all types of financing facilities. In the case of trade credit, a number of firms applied successfully but refused to take up the credit because the cost had been deemed too high. Only a small percentage of firms had their application for bank overdraft or credit line rejected completely. The tightening stance of the banks in 2013 is also confirmed by the movement in the European Commission's index on access to finance to SMEs (see Chart 6). The latter is designed specifically to monitor developments in SMEs' access to financial resources by combining debt, equity and survey information.[10] According to the index, the access of domestic SMEs to finance declined in 2013 compared with the previous year, which is in contrast to developments in most other EU economies.

An improvement in credit supply conditions was registered in 2014, with a rise in the percentage of firms that applied and got everything in all the three types of finance categories, compared with

Chart 6
SMEs ACCESS TO FINANCE INDEX
(index EU=100 in 2007)



Source: European Commission.

[10] Further information on the European Commission's SMAF is available at http://ec.europa.eu/enterprise/policies/finance/data/enterprise-finance-index/index_en.htm

2013. Meanwhile, the percentage of firms that only had a fraction of their original loan accepted fell slightly. In some categories, however, mostly relating to trade credit and, to a lesser extent, to bank overdrafts and credit lines, the supply conditions in 2014 were still somewhat tighter than those prevailing in 2011. A small percentage of firms also refused to take up a bank loan offer because costs were deemed to be too high.

Conclusion

The use of surveys and their input in policy analysis has increased in importance in recent years. The SAFE, together with other surveys, such as the ECB's BLS and Wage Dynamics Survey, are used by the Central Bank of Malta in its analysis of local economic, monetary and financial stability developments.

The SAFE has filled an essential gap in the availability of timely information on the financial situation of SMEs in various EU Member States. This is especially important given that the financial requirements of SMEs may differ markedly from those of larger enterprises, hence necessitating a different policy response aimed at fostering a more effective functioning financial market for SMEs.

The survey enables policy makers and financial analysts to gain a better understanding of the characteristics of domestic SMEs, particularly information about their sources of finance and their most pressing problems. It also provides valuable information on the demand and supply factors that affect the provision of bank credit to the private sector. Furthermore, it facilitates cross-country comparisons across the European Union through harmonised replies to a set of incisive questions, of a qualitative and quantitative nature, that throw light on various aspects related to the financing of SMEs.

A drawback of the SAFE is that it is only conducted once a year. To address this gap, from a local perspective the Central Bank of Malta, in collaboration with the Malta Chamber of Commerce, Enterprise and Industry, decided to launch a survey on a quarterly basis, similar to the SAFE but more selective in its approach. Thus, information collected is limited to loan applications, interest rates charged on loans and overdrafts, and banks' credit conditions. Going forward, such additional information should provide more timely statistics on the demand for, and supply of, credit to domestic firms.