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SURVEY ON ACCESS TO FINANCE (SAFE) IN 2015

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BOX 6: SURVEY ON ACCESS TO FINANCE (SAFE) IN 2015[1]

In Malta the reliance of the non-financial business economy on small and medium-sized enterprises (SME) is higher than that of any other European Union Member State. Estimates for 2014 indicate that SMEs produced 77% of value added and accounted for 82% of jobs in the non-financial business economy.[2] Malta's SME sector is also one of the very few in the European Union to have expanded throughout the crisis. Between 2008 and 2014, the performance of Maltese SMEs has been extraordinarily robust, with employment levels rising by 14% or 13,000 across most sectors of economic activity, but most significantly in tourism and IT-related services.[3]

On a European level, economic performance is also largely dependent on the growth of SMEs, which represent 99% of all businesses in the European Union. In 2014, SMEs across the European Union achieved a full recovery since the crisis, with value added being 2.4% higher than in 2008. Corroborating evidence of a jobless recovery, employment levels in 2014, however were still 1.3% below the 2008 level.[4] Being considered the backbone of Europe's economy,[5] one of the key priorities set out in the European Union's growth strategy – Europe 2020, is the need to facilitate access to finance for SMEs whilst providing a healthy financial system that supports growth.

The financing needs of SMEs differ greatly from those of large scale enterprises, which have a more direct access to capital markets. SMEs rely heavily on bank financing and consider it the most relevant source of external finance. Developments in the conditions facing SMEs throughout the European Union can be monitored through the bi-annual survey on the Access to Finance of Enterprises (SAFE)[6] which was established by the ECB and the European Commission in 2008. On the basis of reporting by participating SMEs, policymakers are able to deduce significant information about the behaviour and expectations of firms in terms of the accessibility and cost of finance, and consequently valuable information about the monetary policy transmission mechanism in the euro area.

This article provides an overview of the main developments reported in the SAFE survey by domestic SMEs in terms of their need for, access to and cost of finance. When deemed

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[2] Estimates for 2014 are based on 2008-12 figures from Eurostat's Structural Business Statistics Database. The term 'non-financial' business economy includes the industry, construction, trade and services sectors but excludes enterprises in agriculture, forestry, fisheries and non-market services sectors such as education and health.

[3] Source: "2015 Small Business Act Fact Sheet" published by the European Commission to report on the national progress in the implementation of the Small Business Act (the framework for the EU policy on SMEs). Data provided in this report show that between 2014 and 2016, the number of employees in SMEs is expected to rise by 6% or 5,000 persons, while value added is expected to grow by 13%.

[4] Source: "Annual Report on European SMEs 2014/2015", published by the European Commission. According to this report, in 2014, SMEs accounted for 67% of total employment and generated 58% of the value added in the non-financial business sector in the EU 28.

[5] European Commission: Entrepreneurship and Small and medium-sized enterprises. http://ec.europa.eu/growth/smes.

[6] This note is based on the results of the SAFE which was conducted between 21 September and 26 October 2015 across the EU Member States and several additional countries. The EU sample considered in this survey round consisted of 15,579 enterprises, of which 44% employed less than 10 employees. In the sample for Maltese SMEs, 41% of enterprises were micro-firms employing up to 9 employees, whilst 29% and 30% of firms were medium-sized enterprises, employing between 10 to 49 employees, and between 50 to 249 employees respectively.

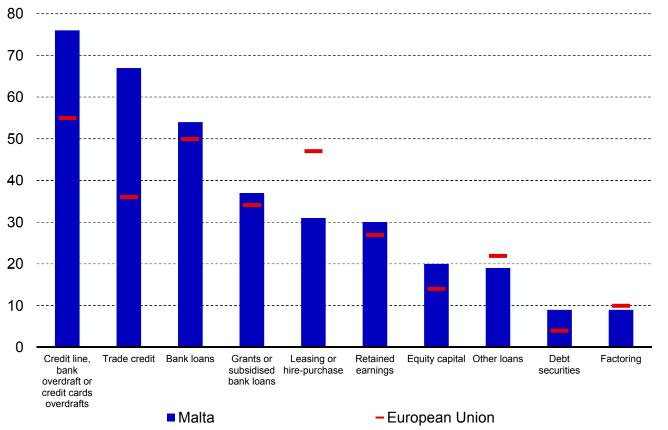
necessary, comparisons with the results of other European economies in this round and preceding waves are also carried out.

Financing sources used by SMEs

Results from this survey round are the first ones since 2009 in which the proportion of SMEs having positive perceptions about the development of the general economic outlook slightly exceed the proportion of those who reported a deterioration. SMEs were also generally more positive about changes in the availability of different types of funding, with the exception of equity financing. However, when Maltese SMEs are compared with European counterparts in respect of the relevance that various funding sources have for their specific needs, significant differences prevail.

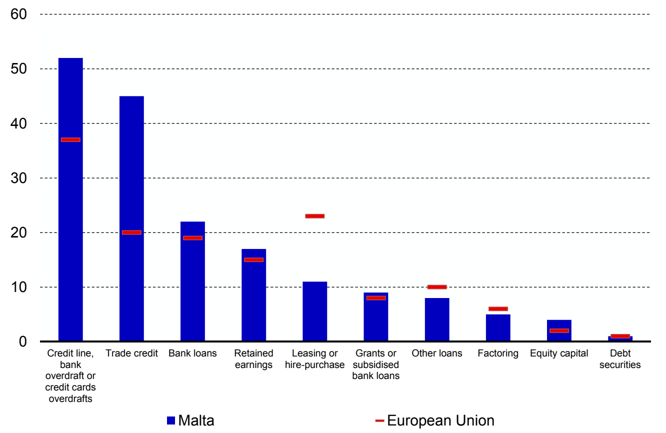
Chart 1 illustrates the sources of finance that local SMEs have used in the past and expect to use in the future while Chart 2 shows the sources that they have actually used in 2015. In line with earlier trends, Maltese and other European SMEs consider bank-related products such as bank loans, overdrafts and credit lines as the most relevant sources of finance when compared with market-based products and other sources of finance. Domestic SMEs attach heavier reliance on bank financing when compared with their European counterparts. In line with developments a year earlier, around 75% of Maltese enterprises in 2015 considered this type of financing as being the most relevant in comparison with around 55% of firms across the European Union. However, around three-fourths of

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



Source: SAFE (2015).

Chart 2
SOURCES OF FINANCE USED BY SMEs IN 2015
(over the preceding 6 months; percentage of respondents)



Source: SAFE (2015).

local SMEs and those in the EU that consider bank loans as being irrelevant for their enterprise, also believed that they did not require such financing. Only around 10% considered interest rates to be too high, whilst a considerably smaller percentage of firms believed that they had insufficient collateral or guarantees. Whilst the demand for bank loans remained unchanged for around 65% and 56% of SMEs in Malta and the European Union respectively, 20% of enterprises reported increased demand for credit lines, bank overdrafts or credit cards, despite the fact that interest charged by domestic banks to non-financial corporations, is higher and thus, sub-optimal when compared with interest rates charged on total bank loans.[7]

Dependence on trade credit as opposed to bank loans has increased during 2015. Chart 2 shows that domestic SMEs have resorted to trade credit much more than their European counterparts. Whereas half of all SMEs obtained trade credit in Ireland, Malta and the United Kingdom, only 6% and 4% of all SMEs obtained this type of financing in Slovenia and Hungary. Trade credit is generally considered an important source of finance for firms which find it difficult to obtain external funding via credit institutions and tends to serve as a buffer to pre-finance production and assist constrained customers.[8] Survey data show that 45% of Maltese SMEs have used trade credit in 2015 as opposed to 15% in 2014, mirroring to a limited extent declines in the use of bank loans and credit facilities.

The survey also suggests that trade credit tends to be most prevalent among micro and large enterprises and is mostly used by innovative SMEs that trade. While large similarities between countries prevail, at 62%, a larger proportion of domestic SMEs were considered innovative in terms of having over the past year introduced into the market significantly improved or totally new products, service, production processes, organisation of management or way of selling goods or services, as opposed to an average of 57% SMEs in the European Union.

In terms of internal financing, retained earnings have been the most widely used source of funding following bank financing and trade credit. At 17%, domestic SMEs which financed their operations and investment from retained earnings were at par with their European counterparts. Nonetheless, the percentage of enterprises that used retained earnings in 2015 dropped when compared with a year earlier across all European Union member states. Survey results also indicate that innovative, exporting SMEs which operate in the industry sector are more likely to retain earnings or use proceeds from the sale of assets than those in services. Meanwhile, substantial divergences prevailed in terms of leasing or hire purchase, with domestic SMEs being much less reliant on this type of financing than the average European SME. Debt securities and factoring remained the less sought-after types of financing.

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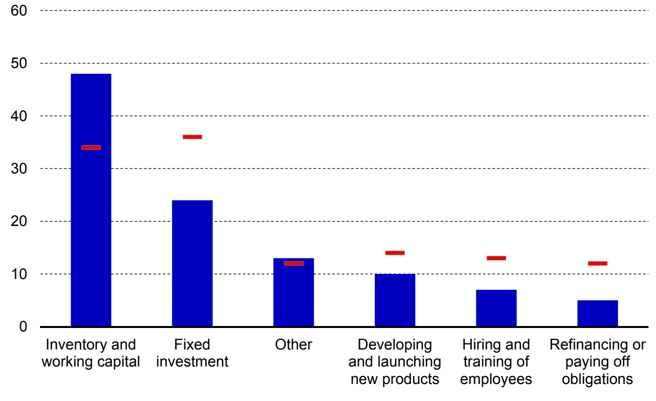
7 MFI interest rate statistics show that interest rates charged by domestic bank to non-financial corporations (NFCs) on revolving loans averaged 5.0% between April and September 2015, when compared with 4.2% on total bank loans to NFCs.

8 Ferrando, A. & Mulier, K., “Do firms use the trade credit channel to manage growth?”, ECB Working Paper Series, No. 1502, December 2012. In this paper the authors find that trade credit of euro area non-financial firms has been procyclical and moved broadly in line with the business cycle, compensating and acting as a buffer when short-term bank loans started to decline since the mid-2009.

Chart 3 shows the purpose for which external financing was used by SMEs in Malta and the European Union as a whole between April and September 2015. Inventory, working capital and fixed investment were the most important factors affecting the demand for external financing, though domestic enterprises were more reliant on external financing to fund inventory and working capital. Conversely, their European Union counterparts resorted to a greater extent to external financing to fund fixed investment. Unlike a year earlier, Maltese SMEs were less likely than the average European Union SME to use external finance to develop or launch new products, refinance or pay off debts or utilise it for hiring and training of employees.

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



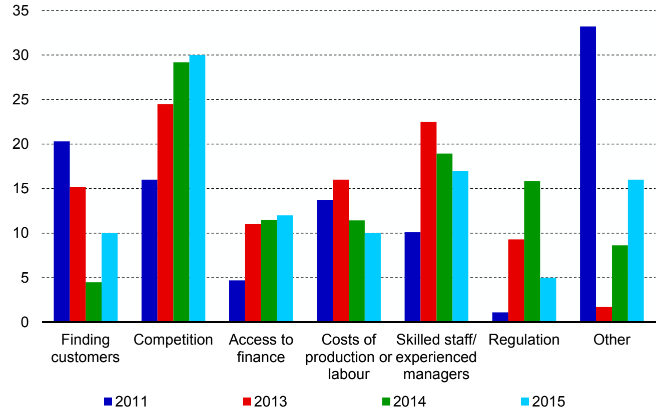
Source: SAFE (2015).

Most pressing problems facing SMEs

On an EU-wide level an improvement in financing conditions has been registered during 2015 with a smaller proportion of SMEs considering access to finance as the main impediment to their business. Chart 4 shows that an increasing proportion of domestic firms considered competitive pressures as their most pressing problem. Conversely, a larger percentage of enterprises considered the need to find new customers as a major concern, while a smaller share of SMEs considered the availability of finding skilled staff and costs of production as their most critical problems.

There has been a gradual increase in the percentage of domestic SMEs that consider competition as their primary concern, though at 30%, enterprises locally remain more concerned with competitive pressures than 14% of enterprises across the European Union, an almost constant share since 2009. An equivalent share of SMEs in Lithuania perceived competition as a significant

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



Source: SAFE (2015).

problem in their current situation, compared with just 8% of SMEs in Greece. Interestingly enough, concerns over competition persisted despite reported improvements in turnover and profits. According to the SAFE Report, heightened internal competitive pressures felt by enterprises across the European Union most probably stem from increasing costs of labour and other inputs to the production process during the same period. In Malta however, the percentage of those considering competition as a major problem increased, even though a smaller proportion of SMEs viewed costs of production as a priority concern.

The challenge of finding customers has been retained as the dominant concern for 25% of SMEs in the European Union in 2015, as opposed to 20% a year earlier. Locally, it has become a most pressing problem for 10% of SMEs from 4% in 2014. The percentage of those who viewed the availability of skilled staff or experienced managers as a major concern fell from the preceding year, possibly reflecting the emergence of a skilled labour deficit that prevails in periods of economic stabilisation and growth.

Access to finance is considered as the most pressing problem for only around a tenth of enterprises in Malta and across the European Union. Though it had risen to 11.5% in 2014 from 4.7% in 2011, it remained almost stable at 12% in 2015, slightly above 10% of SMEs in the European Union. EU-wide divergences prevail. Though on average a smaller share of SMEs consider access to finance as a pressing concern, 30% of SMEs in Greece but only 7% of SMEs in Austria, Finland and Germany perceive it as their major problem.

Terms and conditions of bank loan financing

Survey results show that around 83% of domestic SMEs believe that the availability of bank loan financing remained unchanged during 2015, as opposed to around 60% of enterprises across the EU. Looking forward, a larger number of domestic SMEs perceived an improvement in the availability of such financing during the six months from the date of survey.

With regard to developments in the level of interest rates or the cost of financing other than interest rates during the period April to September 2015, Table 1 shows that 21% of

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	2015	2011	2013	2014	2015
Level of interest rates								
increased	6	9	23	21	52	34	23	14
unchanged	73	85	62	63	33	41	40	47
decreased	21	0	14	16	8	20	32	33
Level of cost of financing other than interest rates (e.g. charges, fees, commissions)								
increased	16	35	44	22	48	43	39	30
unchanged	84	60	47	74	43	46	48	53
decreased	0	0	7	0	4	5	9	11

Source: SAFE.

domestic SMEs reported an increase in the interest rate, 16% reported a decrease, while for the remaining 63% interest rates remained unchanged. These developments contrast with those reported across the European Union. Almost half of participating firms in the European Union claimed that interest rates remained unchanged while 14% reported an increase. The percentage of firms that reported a decrease in interest rates increased slightly to 33% when compared with the preceding year.

In the context of interest rate developments, this survey round is the first one in which the percentage of domestic SMEs reporting an increase in interest rates declined, whereas those reporting a decrease increased slightly. This reflects stepped up efforts by the European Central Bank to stimulate the euro area economy through quantitative easing incentives and negative interest rates, aimed at easing the impact on banks with cheaper short-term loans and longer-term liquidity. Survey results indicate that the effects of these measures seem to have impacted SMEs across the European Union much more significantly than domestic firms, supporting evidence of incomplete pass-through in Malta. A Central Bank of Malta study shows that the pass-through was further reduced in the aftermath of the financial crisis for deposit rates as well as for lending rates charged to non-financial corporations (NFCs).[9]

There have been more significant developments in the percentage of firms which reported differences in the cost of financing other than interest rates, such as charges, fees and commissions. In 2015, 22% of domestic firms reported an increase in such costs as opposed to 44% a year earlier, while 74% reported unchanged costs. No domestic firms reported fallen costs, contrasting 11% of firms in the European Union which reported such declines.

Credit demand and supply

Survey results also provide information on the supply (availability of financing) and demand (need for financing) between April and September 2015. For the second time, SMEs reported an increase in the availability of bank financing (loans and bank overdrafts), though their demand for bank loans and overdrafts had increased, but at a slower pace than in the previous round. These developments were also supported by the October 2015 euro area bank lending survey[10] which suggested that changes in credit standards and loan demand are continuing to support a recovery in loan growth.

Table 2 shows the number of firms that applied for bank loans, trade credit, overdrafts and credit lines since 2011. In 2015, the percentage of respondents which applied for trade credit remained unchanged, fell in the case of bank loans and rose only marginally in respect of bank overdraft and credit lines. This contrasts with a gradual pick-up in the demand for financing instruments used by domestic SMEs over the 2011 to 2014 period.

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9 See Micallef, Rapa & Gauci (2016), "Interest-rate pass-through in Malta" in *Understanding the Maltese Economy* publication by the Central Bank of Malta. The authors found evidence of an incomplete pass-through in Malta, even in the long-run. Cross-country comparison also suggests that the pass-through to NFCs in Malta is one of the lowest in the euro area, though that to households is broadly in line with the median for euro area countries.

10 According to the October 2015 bank lending survey, banks are using the additional liquidity from the Asset Purchase Programme (APP) to grant loans. This implies that the APP had a net easing impact on credit standards and particularly on credit terms and conditions. The survey also reports a low general level of interest rates that is supporting a pick-up in demand for loans in all categories.

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	2015	2011	2013	2014	2015	2011	2013	2014	2015
Applied over the past 6 months	15	19	25	26	6	24	27	23	6	22	33	33
Did not apply because of possible rejection	6	1	1	0	6	0	5	0	1	0	3	0
Did not apply because of sufficient internal funds	32	48	45	51	32	40	38	49	37	35	39	45
Did not apply for other reasons	47	30	23	17	55	37	20	23	54	43	20	16

Source: SAFE.

Trade credit persisted as the financing instrument demanded by the largest proportion of domestic SMEs over the years.

During this survey round, there were no domestic firms which chose not to apply for these types of financing instruments because they feared a possible rejection. A larger proportion of SMEs chose not to apply because of sufficient internal funds. Survey results also provide an indication of credit supply factors over time. Developments in the credit standards applied by banks to their customers are observed by asking participating firms that had applied for the various financing instruments whether their application had been accepted or rejected. In the case where an application was accepted, firms were asked to specify whether the full amount or a part of it was given, or else whether the offer was refused because the cost was too high.

Table 3 shows that following considerable tightening in credit conditions between 2011 and 2013, substantial improvement in credit conditions registered in 2014 has slowed down considerably during 2015. In 2015 the percentage of firms that applied for overdraft and credit lines and got everything was smaller than that observed in 2014, while the proportion of those applying for bank loans and trade credit and receiving the full amount, increased

Table 3
OUTCOME OF APPLICATION FOR FINANCING OVER THE PAST SIX MONTHS
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	2015	2011	2013	2014	2015	2011	2013	2014	2015
Applied and got everything	81	53	74	69	51	56	71	72	96	43	54	56
Applied and got most of it[(1)]	7	19	17	6	15	11	10	15	2	20	12	14
Applied but only got a limited part of it[(2)]	7	16	9	7	19	28	9	0	0	20	34	20
Applied but refused because cost too high	0	0	0	0	0	0	10	0	0	7	0	0
Applied but was rejected	0	12	0	7	0	0	0	8	2	0	0	0

[(1)] between 75% and 99%.

[(2)] between 1% and 74%.

Source: SAFE.

only slightly. Meanwhile, around 8% of firms that applied for bank financing had their application rejected. However, there were no firms who refused to take any of these financing items because the cost was too high.

Conclusion

SMEs across the countries of the European Union and especially in a small economy like Malta play a major role in terms of employment creation and value added generation. Access to finance however, is a main obstruction to the growth and efficiency of SMEs. In fact, they were the most adversely affected by the recent financial and sovereign debt crises, as the transmission of changes in the monetary policy stance to the real economy was limited and credit was restrained.

The purpose of the SAFE is to provide policy makers with access to timely information on the financing conditions facing SMEs. Amongst others, respondents are asked to provide their expectations for the demand and supply of credit in the six months following the survey. For instance, the SAFE which was carried out between April and September 2015 shed light on the effects of the ECB's asset purchase programme and a low interest rate environment on credit dynamics. Lending conditions have improved and for the first time since 2009 more respondents have positive perceptions on the general economic outlook.

Survey results are particularly interesting for Malta given the economy's heavy reliance on SMEs. The performance of local SMEs has been remarkable throughout the recent economic crisis, causing an increasing proportion of firms to reduce their demand for bank financing due to sufficient internal funds. Access to favourable financing condition however, still remains a conditional pre-requisite for firms to be able to venture beyond the limited domestic market and enhance their long-term competitiveness.