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SURVEY ON ACCESS TO FINANCE (SAFE) IN 2017

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BOX 2: SURVEY ON ACCESS TO FINANCE (SAFE) IN 2017[1]

Europe's economic success depends largely on the growth of Small and Medium sized Enterprises (SME) achieving their potential.[2] Estimates for 2016 indicate that in the European Union, SMEs accounted for more than half of the total value added in the non-financial economy and around two-thirds of employed persons.[3] In Malta, the reliance of the non-financial business economy on SMEs is even greater. These accounted for 82% of total value added and almost 80% of employed persons during the same year. Strong growth is expected to persist between 2016 and 2018, partly reflecting measures implemented in recent years to improve SMEs' access to finance.[4]

In this regard, the European Commission noted that in 2016 Malta outperformed the European Union across a number of dimensions that are used to gauge access to finance conditions. As difficulties in obtaining finance hinders the ability of SMEs to grow and innovate, it remains important to analyse developments in their financing needs, which to a large extent are highly dependent on bank financing.

For this purpose, the ECB and the European Commission have developed the Survey on Access to Finance of Enterprises (SAFE) with the aim of providing evidence of changes in the financial situation, financing needs and access to external financing of SMEs. Hence, this Box provides an overview of the main developments reported in the latest SAFE, which covers the period April to September 2017.

In the case of Malta this Survey provides valuable information on the behaviour and expectations of firms at a time when a lower level of bank credit to NFCs has prevailed despite the strong economic performance of the Maltese economy.[5] When deemed necessary, domestic SMEs are compared with SMEs across other European economies, both in this round and in preceding waves.

Financing sources used by SMEs

In line with buoyant growth in the Maltese economy, an increasing proportion of SMEs have reported positive perceptions about the general economic outlook as opposed to those who reported a deterioration.

The financial situation of firms improved further. Domestically, the share of SMEs reporting higher turnover increased significantly, with the net percentage of firms expressing

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[2] European Commission Communication – An action plan to improve access to finance for SMEs /*COM/2011/0870 final*/.

[3] 2017 SBA (Small Business Act for Europe) Fact Sheet – Malta. The 'non-financial business economy' includes industry, construction, trade, and services (NACE Rev. 2 sections B to J, L, M and N), but not enterprises in agriculture, forestry and fisheries and the largely non-market service sectors such as education and health. The following size-class definitions are applied: micro firms (0-9 persons employed), small firms (10-49 persons employed) and medium-sized firms (50-249 persons employed). Firms employing more than 250 persons are considered as large firms.

[4] Value added in Malta was estimated to grow by 15.4%, while employment was expected to increase by 6.3%, or around 6,700 new jobs.

[5] For more information see Zerafa, S. (2017), Access to finance for firms in Malta: Estimating the impact of reduced credit; Policy Note July 2017, Central Bank of Malta. This study notes that the relationship between credit to NFCs and GDP growth appears to have weakened since the crisis. This may reflect structural changes in the Maltese economy that have taken place over the last decade, whereby the growth of the services sector, which is highly labour intensive, generally requires lower capital investment.

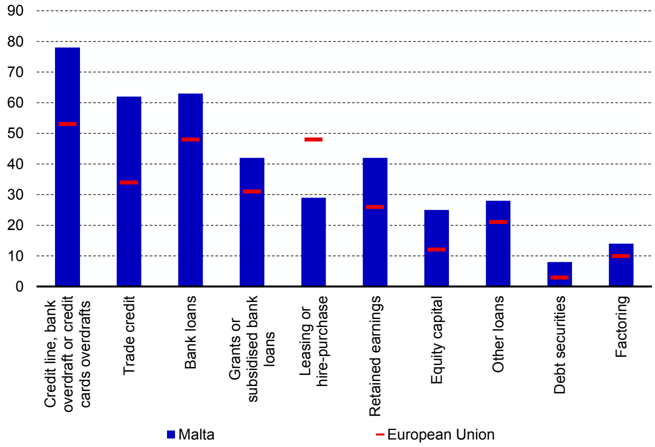
this view rising to 33% in 2017 from 22% in the preceding year. Nonetheless, a larger proportion of respondents stated that the availability of obtaining bank loans, credit lines and bank overdraft had deteriorated, while on balance, a large share of respondents reported increased availability of trade credit. This suggests that favourable economic conditions did not necessary result in improved access to bank financing, potentially because of new regulatory challenges affecting the banking sector and the banks' increased focus on credit risk.

Chart 1 illustrates the financing items 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 2017. A strong preference for bank-related products such as bank loans, overdrafts and credit lines as opposed to other market-based products and other sources of finance, persisted.

In line with trends observed in the preceding years, domestic firms continued to attach heavier reliance on bank financing when compared with their EU counterparts. Around 78% and 63% of SMEs in Malta considered overdrafts and bank loans respectively, as being highly relevant in the past or in the future, in comparison with around 53% and 48% of firms, respectively, across the European Union. In contrast with SMEs across the European Union, SMEs in Malta were less likely to consider retained earnings, grants, leasing and capital markets.

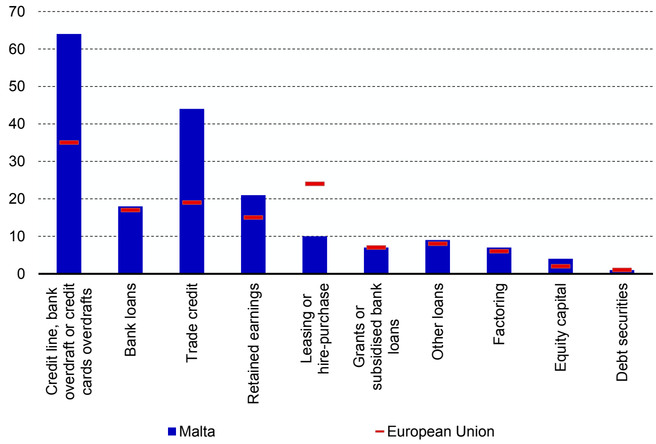
The share of firms that obtained funding through overdrafts, credit lines and credit cards in 2017 was significantly higher than in the European Union (see Chart 2). At the same time, the share of firms that obtained

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



Source: SAFE (2017).

Chart 2
SOURCES OF FINANCE USED BY SMEs IN 2017
(over the preceding six months; percentage of respondents)



Source: SAFE (2017).

bank loans over the previous six months (18%) was only marginally higher than in the European Union (17%) and broadly in line with the share of firms that made use of retained earnings. This suggests that in 2017 firms in Malta seem to have found it more opportune to rely on credit lines and trade credit, than bank loans, even if in general they would have assessed bank loans to be highly relevant.[6]

During 2017 trade credit represented the third most important source of finance for SMEs following bank debt. Chart 2 also shows that domestic firms have resorted to trade credit much more than their European counterparts, though the share of Maltese SMEs that used trade credit during 2017 fell to 44% from 50% in 2016. Ireland, Malta and the United Kingdom remained the countries with the highest prevalence of trade credit usage, with 50%, 44% and 41% of SMEs in these countries, respectively, using trade credit during 2017, while only 5% of firms in Slovenia and Hungary used this type of financing.

Retained earnings were the fourth most widely used source of funding in Malta after bank financing and trade credit. The ranking of this source of financing was higher compared with 2016. In 2017, 21% of domestic SMEs made use of this source of internal financing, as opposed to 18% in 2016 and 15% across the European Union. Retained earnings were much more prevalent in Malta than in the European Union, with Malta registering the third highest share of firms that used this source of funding in 2017. Shares of 20% or higher were recorded in the Czech Republic, Ireland, Italy, Lithuania and the United Kingdom. In contrast, less than a tenth of firms in Belgium, Denmark, Greece, Hungary, Portugal and Slovakia reported that they had used retained earnings or sold assets.

Survey results also indicate that substantial divergences continued to prevail in the use of leasing or hire purchase between Malta and other countries. On average, around a quarter of SMEs across the European Union relied on this type of financing, but only a tenth of domestic SMEs used it during 2017, compared with 15% a year earlier. Debt securities, factoring and equity capital remained the three sources of finance that were least used in Malta and across the European Union.

The Survey also carries an analysis on the use of bank credit by enterprise characteristics. In general within the European Union, SMEs in industry were most likely to use bank loans, bank overdrafts and trade credit, than those in construction and retail, while SMEs in services were the least likely to use this type of financing. Moreover, these forms of financing tend to be more prevalent among large enterprises, and among innovative and exporting firms.

A number of divergences persisted in the purpose for which external financing was used in Malta and across the European Union between April and September 2017. Domestically, the demand for external financing was largely driven by the need to finance inventory and working capital, and to a lesser extent for the hiring and training of employees and fixed investment (see Chart 3). Conversely, European counterparts were more likely to use external financing to fund fixed investment, and used it relatively less for the funding of inventory and working

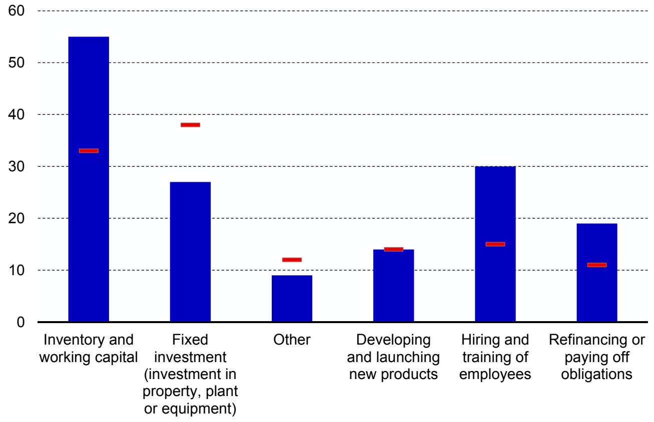
[6] The share of SMEs that resorted to bank loans across the European Union countries was largely stable over the years, standing at 17% in 2017 from 18% a year earlier, and 19% in 2015. Meanwhile in Malta, the proportion of SMEs that used bank loans rose from 22% in 2015 to 28% in 2016, but fell to 18% in 2017.

capital and the hiring and training of their of employees. Domestic and European Union SMEs however, were equally likely to use external finance to develop or launch new products.

Most pressing problems facing SMEs

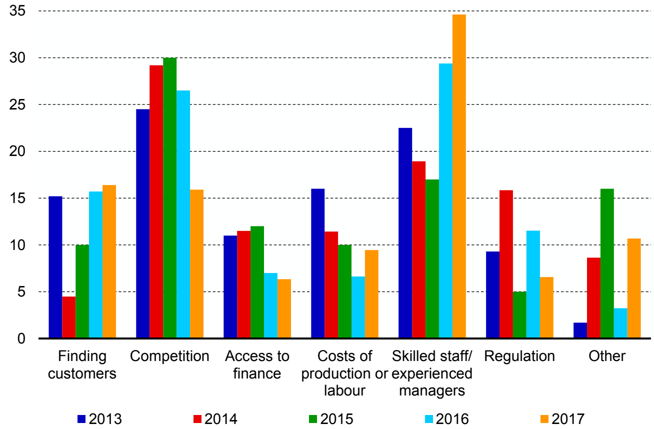
Between April and September 2017, 35% of all domestic SMEs considered the ability of finding skilled staff or experienced managers as their most challenging problem, compared with 29% a year earlier (see Chart 4). This rise reflects the historically low unemployment rate and rising employment against the current backdrop of a buoyant economy. This figure stood above that of 23% recorded on average across the European Union, though this rate is also slightly higher than that of 20% registered in the preceding year. On balance, this information suggests that labour shortages remained more of a pressing problem in Malta than elsewhere, and the shortages seems to have increased more significantly locally than abroad in 2017.

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



Source: SAFE (2017).

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



Source: SAFE.

Meanwhile, finding customers, which has been the most pressing problem for SMEs across the European Union in recent years, remained the most urgent problem during 2017. This issue was mentioned by 24% of SMEs in the European Union and 16% of domestic firms.

Competition was the third most pressing problem. In 2017, 16% of domestic SMEs and 13% of firms in the European Union mentioned this issue. The share of domestic firms highlighting this issue was lower compared with 2016, when 27% of Maltese firms had signalled competition issues. In the European Union, this proportion has been rather stable over time, irrespective of improvements in turnover and profits. This suggests a possible relation to the constantly increasing costs of labour and inputs to the production process, which raise the competitive pressure internally.

Access to finance for SMEs has fallen in importance as a major problem for both domestic SMEs and their European Union counterparts. According to the SAFE Report 2017, it had become the least important problem by 2015, though it still remains a major issue in Greece, where almost a quarter of surveyed firms flagged this as a most pressing problem. Domestically, the share of domestic firms that considered access to finance as a major pressing problem fell marginally to 6% in 2017, from 7% in 2016. This compares with 7% of firms across the European Union.

Terms and conditions of bank loan financing

According to the SAFE, around 75% of domestic SMEs believed that the availability of bank loan financing remained unchanged during 2017 compared with 62% of firms across the European Union. Meanwhile, at the time of Survey, 73% of domestic respondents anticipated unchanged availability of such financing in the six months ahead, as opposed to 61% of participants in the European Union.

Table 1 shows developments in the level of interest rates or the cost of financing other than interest rates between April and September 2017, from the perspective of surveyed firms. The proportion of domestic SMEs which reported an increase in interest rates rose to 24%, while for the remaining 76% interest rates remained unchanged. No firm reported a decrease in interest rates in Malta. In this round, 56% of participating firms in the European Union claimed that interest rates remained unchanged, while 17% reported an increase.

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

	Malta			European Union		
	2015	2016	2017	2015	2016	2017
Level of interest rates						
increased	21	2	24	14	12	17
unchanged	63	78	76	47	47	56
decreased	16	21	0	33	36	22
net balance[2]	5	-19	24	-19	-24	-5
Level of cost of financing other than interest rates (e.g. charges, fees, commissions)						
increased	22	13	50	30	33	33
unchanged	74	78	50	53	52	55
decreased	0	4	0	11	10	7
net balance[2]	22	9	50	19	23	26

[1] The percentage of respondents who reported an increase, decrease or an unchanged level of interest rates or cost of financing other than interest rates, do not add up to 100 as they exclude the proportion of 'don't know' answers.

[2] The net balance is the difference between those respondents reporting an increase and those reporting a decrease.

Source: SAFE.

Meanwhile, the percentage of firms that reported a decrease in interest rates fell to 22% from 36% a year earlier.

With regard to developments in the cost of financing other than interest rates, half of the domestic SMEs reported an increase, whereas the remaining half experienced unchanged financing costs. This proportion is well above that recorded in recent rounds, but still slightly below that of their European counterparts. Indeed, at 55%, the share of firms across the European Union which reported unchanged costs rose only slightly, whereas the share of those which experienced an increase remained stable compared with a year earlier. No domestic firms reported falling costs, as opposed to 7% of firms in the European Union which reported such declines.

On balance, banks across the European Union seem to have offset lower interest rates with higher non-interest charges. Hence, whereas a positive net percentage of firms in EU countries reported a decline in interest rates, a slightly higher net share of firms reported increases in other costs of financing, such as charges, fees and commissions. This contrasts with developments in Malta, as no SMEs reported a fall in interest rates or in other costs of financing in 2017.

On average, interest rates across the European Union fell to 2.0% in 2017 from 2.2% a year earlier and 4.4% in 2015. This partly reflects stepped up efforts by the ECB to stimulate the euro area economy through quantitative easing incentives. However, divergences continued to prevail. Interest rates stood highest in Greece (6.1%), and lowest in Luxembourg (0.8%). At 3.7%, the rate in Malta rose marginally from 3.5% a year earlier, but remained unchanged from 2015. The SAFE indicates that the effects of the ECB's non-standard monetary measures seem to have impacted SMEs across the European Union much more significantly than domestic firms, supporting evidence of incomplete pass-through in Malta.[7] Furthermore, weak competition among domestic banks may partially explain these developments.

On balance, a larger net percentage of firms in Malta reported an increase in collateral requirements during the observed period. In contrast, the net balance of firms reporting tighter collateral requirements decreased in the European Union.

Credit demand and supply

A salient feature of SAFE is the information it provides on the supply (availability of financing) and demand (need for financing).

On balance, the need for bank loans by domestic SMEs fell marginally between April and September 2017 as a slightly higher percentage of respondents reported a declining need for this type of financing as opposed to those reporting an increase. Meanwhile, the percentage of firms across the European Union that reported an increase in the demand for loans was equally met by those which did not require this type of financing. In Malta as

[7] See Micallef, Rapa & Gauci (2016), "Interest rate pass-through in Malta", in *Understanding the Maltese Economy,* edited by Grech A.G., Central Bank of Malta. The authors found 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 NFCs.

well as in the European Union, the net percentage of SMEs that reported an increase in the need of credit lines and overdrafts was positive. On balance, 7% of firms in Malta and 5% of firms in the European Union respectively, stated that their need for the latter type of finance increased over the observed period. On balance, more domestic firms reported an increase in the demand for overdrafts compared with a decline a year earlier. In contrast, the need for bank loans fell marginally compared with an increase in demand in 2016.

With regard to the demand for trade credit, a positive net percentage of domestic firms and those across the European Union stated that their need for trade credit increased during the Survey period. On balance, 23% of domestic SMEs and 10% of SMEs in the European Union claimed that their need for trade credit increased. In Malta, this net balance rose from 11% a year earlier but was unchanged in the case of the European Union.

Table 2 shows the percentage of firms that applied for bank loans, trade credit, overdrafts and credit lines since 2015. In 2017, the proportion of respondents that applied for bank loans, overdrafts and other banking facilities fell when compared with earlier years. Meanwhile, the percentage of respondents which applied for trade credit rose marginally, but remained below that in 2015.

As in recent years, during the latest Survey round, only a very small proportion of firms chose not to apply for these types of financing instruments because they feared a possible rejection. A significant percentage of firms that chose not to apply attributed this to sufficient internal funds, though the share of firms citing this consideration dropped significantly across the various financing instruments listed in the Table. In contrast, a substantial increase was reported in the percentage of domestic SMEs which chose not to apply “for other reasons”.

The Survey also provides information on developments in the credit standards applied by banks to their customers 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 are 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 information of loan applications between 2015 and 2017. In 2017, the percentage of firms that applied for bank overdrafts, credit lines and cards, and got everything

Table 2
FINANCING APPLICATIONS BY TYPE OF INSTRUMENT[1]
Over the preceding six months; per cent of responding firms

	Bank overdraft, credit line or credit card overdrafts			Bank loans			Trade credit		
	2015	2016	2017	2015	2016	2017	2015	2016	2017
Applied over the past 6 months	26	27	16	23	26	16	33	28	30
Did not apply because of possible rejection	0	2	2	0	0	3	0	0	5
Did not apply because of sufficient internal funds	51	45	31	49	50	33	45	51	18
Did not apply for other reasons	17	20	45	23	23	43	16	18	38

[1] The percentage of respondents who reported an increase, decrease or an unchanged level of interest rates or cost of financing other than interest rates, do not add up to 100 as they exclude the proportion of 'don't know' answers.

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		
	2015	2016	2017	2015	2016	2017	2015	2016	2017
Applied and got everything	69	54	60	72	68	65	56	61	62
Applied and got most of it(1)	6	10	0	15	14	0	14	10	19
Applied but only got a limited part of it(2)	7	0	5	0	0	6	20	5	8
Applied but refused because cost too high	0	5	0	0	0	0	0	0	0
Applied but was rejected	7	5	8	8	0	9	0	5	5

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

rose on the preceding year, while in the case of bank loans the proportion fell marginally. Meanwhile, the share of those that applied for trade credit and received the full amount was largely unchanged. On balance, these shares were lower compared with 2015. None of the domestic firms participating in the Survey refused to take any of the financing items listed in Table 3 because the cost was too high. Less than 10% of firms that applied for bank financing and trade credit had their application rejected, with a lower rejection rate for the latter.

Conclusion

The SAFE provides important evidence of changes in the financial situation and funding conditions of firms, consequently enabling the analysis of trends in the needs for and the availability of external financing, both from an inter-temporal perspective as well as in relation to the European Union.

Survey evidence indicates that challenges facing Maltese and European Union firms continued to prevail, with the most pressing problem facing Maltese firms being the ability of finding skilled staff, while firms across the European Union were more concerned with finding new customers. Access to finance however, was not considered as a major challenge, partly reflecting the European Commission's efforts to use regulation to make SMEs more visible to investors and markets more attractive and accessible for SMEs.

The latest Survey however, indicates that domestic reliance on bank financing remained higher than that across the European Union, although firms have been making use of alternative sources of finance.

From a monetary policy perspective, it is evident that the ECB's accommodative stance has contributed to some further reduction in interest rates across the European Union. In contrast, domestic firms did not benefit from lower interest rates in 2017. The SAFE also reveals that further tightening in costs other than interest rates was more pronounced in Malta. The share of domestic firms reporting tighter collateral requirements increased towards the EU average.

In general, whereas a higher net share of respondents reported that they received the full amount or most of the amount of trade credit requested, the corresponding percentages for bank loans and overdrafts decreased compared with 2016.