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EUROSISTEMA
CENTRAL BANK OF MALTA

ACCESS TO FINANCE IN 2018

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BOX 1: ACCESS TO FINANCE IN 2018[1]

The Maltese economy has historically relied on SMEs. These have been the backbone of the rapid economic expansion in recent years. In fact, official statistics show that recently growth in value added of SMEs in the business economy sector was more than double that observed in the European Union (EU) as a whole. In contrast, larger business economy firms grew at a slower pace than their counterparts in the EU.[2,3] The significant share of growth generated by domestic SMEs in recent years shows that the impression that Malta's economic growth is exclusively driven by sectors such as remote gaming is not correct.

The latest Small Business Act (SBA) Factsheet also indicates that in 2017, Maltese SMEs generated significantly higher shares of value added and employment than SMEs in the EU. In that year, only 112 firms in Malta employed more than 250 persons. In contrast, micro firms which employ less than ten persons accounted for 97.3% of all firms, while small firms which employ between ten and 49 workers made up 2.2% of all enterprises. A further 0.5% of firms were medium-sized and employed between 50 and 249 persons.[4]

In 2017 domestic SMEs generated 81.0% of value added and 80.9% of employment in the 'non-financial business economy'. The corresponding figures in the EU stood at 66.4% and 56.8%, respectively. Despite their size, the value added of small and medium-sized enterprises increased by 62.7% between 2013 and 2017, while employment rose by 24.0%. Over this period, SME value added and employment in the EU increased by 15.1% and 7.1% respectively.[5]

Several studies have shown that smaller firms are more likely to experience financial constraints such as transaction costs and information asymmetries, when compared with larger sized firms. Access to finance prevails as a critical determinant for the development of enterprises, in particular SMEs, which tend to have limited access to capital markets. As financing challenges affect the performance and growth of firms, it remains imperative to assess developments in the financial situation of enterprises including their ability to obtain finance when required. For this purpose, the ECB and the EC jointly conduct the bi-annual Survey on the Access to Finance of Enterprises (SAFE).

Results from the latest SAFE, which covered the period between April and September 2018, are presented in this Box and compared with those of previous waves with the aim of analysing the behaviour and expectations of domestic SMEs and compare them with those across other European economies.

Financial situation of SMEs

On balance, 29% of SMEs perceived an improvement in the general economic outlook, marginally higher than 27% a year earlier. In line with developments across the EU, the financial situation of domestic SMEs also improved. A larger proportion of SMEs in Malta (35% in 2018) reported net

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[2] See Grech, A. G. (2018), SME's contribution to the Maltese economy and future prospects, Policy Note October 2018, Central Bank of Malta.

[3] The 'business economy' includes sectors other than agriculture and fisheries, public administration, education, health, social work, and arts, entertainment and recreation (including remote gaming). The 'non-financial business economy' also excludes the financial sector.

[4] NSO *News Release* 068/2018 www.nso.gov.mt/en/News_Releases/View_by_Unit/Unit_B4/Business_Registers/Documents/2018/News2018_068.pdf.

[5] 2018 SBA Fact Sheet – EU: www.ec.europa.eu/docsroom/documents/32581/attachments/1/translations/en/renditions/native and 2018 SBA Fact Sheet – Malta: www.ec.europa.eu/docsroom/documents/32581/attachments/20/translations/en/renditions/native.

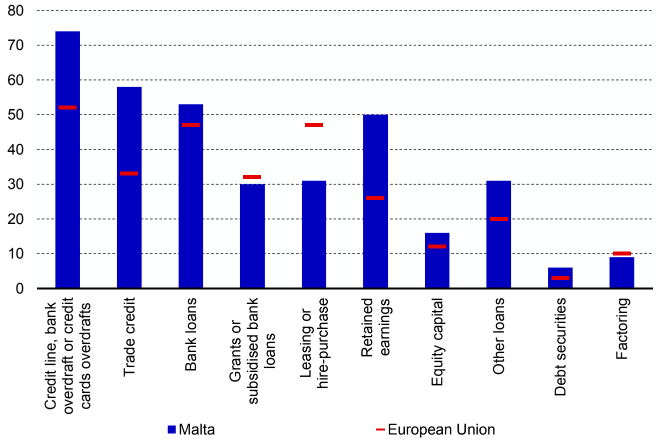
increases in turnover compared with 33% a year earlier. The net balance of SMEs reporting higher profits rose to 12%, in contrast with the net balance of -1% in 2017. On balance, the proportion of SMEs that reported higher labour costs stood at 59% in 2018, significantly lower than 77% a year earlier, though the net balance of those reporting higher costs of materials and energy, amongst others edged up to 49% in 2018 from 29% in the preceding year.

Sources of finance utilised by SMEs

The financing sources deemed relevant by SMEs in Malta and in the EU are illustrated in Chart 1. The 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, though the share of domestic SMEs which used bank loans or expected to use them in the future fell compared with 2017. Nonetheless, SMEs in Malta continued to attach greater reliance on bank financing when compared with SMEs across the EU. In 2018, 74% and 53% of domestic SMEs considered overdrafts and bank loans respectively, as being highly relevant, in comparison with around 52% and 47% of firms respectively, across the EU.

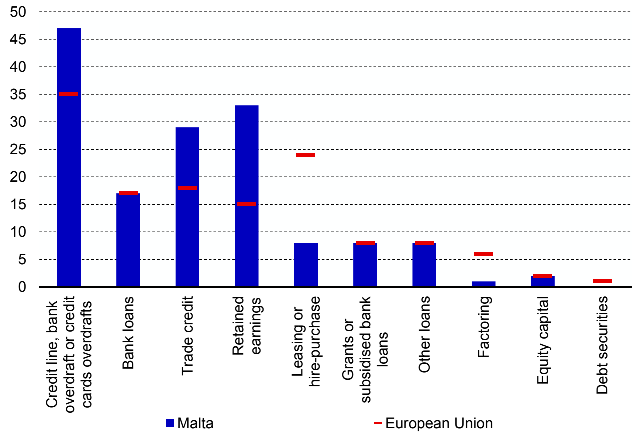
Meanwhile, the proportion of SMEs that resorted to credit lines, bank overdrafts or credit card overdrafts declined from 64% in 2017 to 47% in 2018, though this share was still relatively higher than that of 35% across the EU (see Chart 2). The share of SMEs that used bank loans in both Malta and in the EU stood largely unchanged at 17%, when compared with a year earlier. Half of the surveyed SMEs in the EU and 39% of those in Malta considered bank loans as being irrelevant. Around three quarters of those SMEs that believed that bank loans were not relevant to their enterprise stated that they did not need this type of financing. Such SMEs mostly attributed this to insufficient collateral, too high interest rates, excessive paperwork or the unavailability of bank loans. In the EU, the share of SMEs claiming that this type of financing was not required stood much higher, at 75%.

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



Source: SAFE (2018).

Chart 2
SOURCES OF FINANCE USED BY SMEs IN 2018
(over the preceding six months; percentage of respondents)



Source: SAFE (2018).

During 2018 the share of SMEs which made use of retained earnings rose to 33% from 21% a year earlier, double the rate recorded in the EU. Across the EU, the relative number of enterprises that retained earnings or sold assets increased with the size of the enterprise, with a third of large enterprises (having at least 250 employees) making use of retained earnings in 2018 as opposed to just 15% of SMEs. Survey results also indicate that innovative, exporting SMEs which operate in industry are more likely to retain earnings or use proceeds from the sale of assets than those in services.

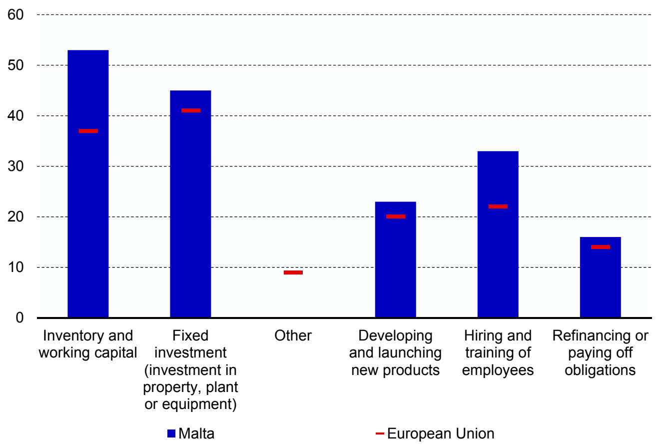
In contrast, the share of firms which resorted to trade credit fell to 29%, from 44% in 2017. Hence, trade credit, which had consistently represented the second most important source of credit for domestic SMEs after bank debt, was replaced by retained earnings. The share of SMEs in Malta that used trade credit and retained earnings was still higher than that across the EU. A significant degree of heterogeneity continued to prevail across counties as only 6% of firms in Germany and the Czech Republic obtained trade credit against 55% in Cyprus and 42% in the United Kingdom.

Malta had by far the largest proportion of SMEs that made use of this type of credit across the EU, with 28% of SMEs in Cyprus and as little as 7% of firms in Denmark resorting to this type of credit.

The latest survey tends to confirm that past patterns that have been observed with regard to the use of other sources of finance such as leasing or hire-purchase, grants or subsidised bank loans, and equity capital did not vary over time. For example, substantial divergence between SMEs in Malta and across the EU continued to prevail in 2018, with only 8% of SMEs using leasing or hire purchase compared with a quarter of SMEs across the EU. Debt securities, factoring and equity capital remained the three sources of finance that were least used in Malta and across the EU.

In 2018, more than half of the SMEs in Malta used external financing to finance inventory and working capital, while 45% of firms used it to finance fixed investment (see Chart 3). Whereas a larger proportion of SMEs in the EU (41%) resorted to external financing to fund fixed investment, EU firms were less likely than Maltese firms to use external funding for inventory and working capital (37%) and for the hiring and training of their employees (22%). Meanwhile, 45% of domestic SMEs used external finance for fixed investment in property, plant or equipment. Over time a larger proportion of SMEs has been obtaining external finance and investing it in human capital. In fact, whereas only 7% of domestic firms spent external funding on the hiring and training of employees in 2015, this share rose to 33% in 2018. This compares with 22% in the EU. Domestic and EU SMEs however, were more or less equally likely to use external finance to develop or launch new products, and refinance or pay off obligations.

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



Source: SAFE (2018).

Most pressing problems facing SMEs

In addition to the often cited financial barriers, there are also a range of non-financial barriers that affect the growth of SMEs. These include problems with finding the right human capital as limited knowledge and skills can undermine firm growth, strong market competition, a burdensome regulatory framework, as well as costs of production or labour.

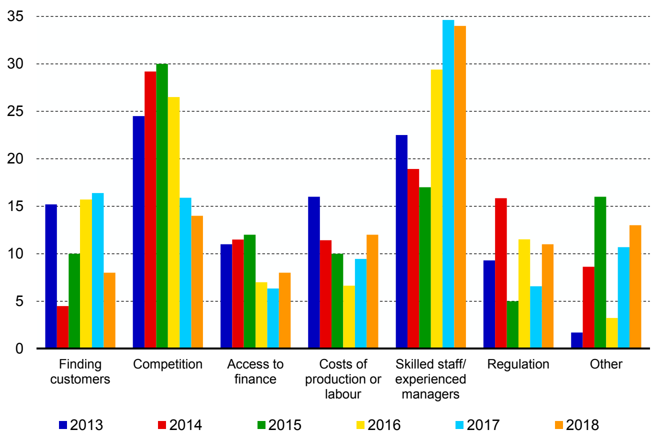
SMEs in Malta and across the EU cited the availability of skilled staff or experienced managers as the most pressing problem (see Chart 4). At 34%, the share of domestic SMEs which found it difficult to find the right staff has constantly exceeded the EU average. The latter stood at 25% in 2018. This partly reflects faster economic growth and lower unemployment in Malta. The share of firms citing labour shortages as a problem is comparable with that in Germany (35%), Austria (36%) and Finland (39%). In contrast, the proportion of SMEs that considered the shortage of skilled staff as their most concerning challenge was lower in France (28%), Italy (15%) and Greece (9%). Nonetheless, at an aggregate EU level, this challenge has become more pressing, with a quarter of SMEs considering it as their most challenging problem in 2018, up from 14% in 2013. Hence, unlike 2017, the problem with finding customers was not the most pressing one in 2018. Similar results were obtained from EIB Group Survey on Investment and Investment Finance (EIBIS) 2018, which confirmed that in Malta and across the EU, the availability of skilled staff was considered the main long-term barrier to investment, though the degree of concern of EU firms was lower than that amongst Maltese firms (77% of EU firms as opposed to 90% of domestic firms).

Meanwhile in Malta, competition stood as the second most pressing problem. This was highlighted by 14% of domestic SMEs. This compares with 11% of SMEs in the EU, though in both areas, the share of SMEs that considered this specific problem to be the most pressing has dropped over time. Domestically, the decline was more abrupt, halving from 30% in 2015 to 14% in 2018. This may reflect the fact that a growing economy tends to dampen the impact of competition as increased demand makes up for revenue lost to competitors.

Survey results show that in 2018, only 8% of domestic SMEs considered the ability of finding customers as their most challenging problem, down from 16% in 2017. This share was smaller than 12% and 11% of SMEs that viewed the costs of production and regulation as pressing issues, respectively. The share of SMEs that considered these latter issues to be most important problems increased when compared with a year ago and as at 2018 stood largely in line with shares observed across the EU.

Only 8% of domestic SMEs considered access to finance as a major problem. Hence, this issue retained its position as the least pressing problem for the third consecutive year. Similarly, across the EU, access to finance has steadily declined in importance throughout the years. Whereas in 2013 it was the second-most important problem, since 2015 it has

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



Source: SAFE (2018).

become the least urgent problem reported by SMEs. Meanwhile, 17% of SMEs in Greece continued to view access to finance as their most challenging problem, though lower than 23% a year earlier.

Terms and conditions of bank loan financing

The survey shows that 55% of domestic SMEs believe that the availability of bank loan financing remained unchanged during 2018, substantially lower than 73% a year earlier and 64% of firms across the EU. At the time of survey, 62% of domestic SMEs in Malta as well as in the EU anticipated unchanged availability of such financing in the six months ahead.

Table 1 shows firms' assessments of interest rates and other costs of financing. The proportion of domestic SMEs which reported an increase in interest rates fell to 13%, as a larger number of SMEs reported unchanged interest rates. Only 1% of firms in Malta reported a decline. The resulting effect was that of a net increase in interest rates, though lower than that observed in the preceding year.

In contrast, 57% of participating firms in the EU claimed that interest rates had remained largely stable compared with a year earlier. On balance, the net share of firms reporting higher interest rates in the EU was also positive in 2018. Around 23% of SMEs reported an increase in the level of interest rates, whereas 15% were faced with lower interest rates by banks. The resulting net effect amounts to a net increase of 7%, which contrasts with the negative net balance recorded in recent years.

With regards to developments in the cost of financing other than interest rates, just over half of domestic SMEs reported an unchanged level of costs such as charges, fees and commissions, largely unchanged from the proportion registered a year earlier, but significantly below 74% of participating SMEs in 2015. By contrast, the share that reported higher costs more than doubled from 22% to 47% over the same period. No domestic firms reported falling costs. As a result the net balance of SMEs reporting higher non-interest rate costs also doubled. In the EU the increase in this share was less pronounced.

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

	Malta				EU			
	2015	2016	2017	2018	2015	2016	2017	2018
Level of interest rates[(1)]								
Increased	21	2	24	13	14	12	17	23
Unchanged	63	78	76	80	47	47	56	57
Decreased	16	21	0	1	33	36	22	15
Net balance[(2)]	6	-19	24	13	-19	-24	-5	7
Level of cost of financing other than interest rates (e.g. charges, fees, commissions)[(1)]								
Increased	22	13	50	47	30	33	33	34
Unchanged	74	78	50	51	53	52	55	56
Decreased	0	4	0	0	11	10	7	5
Net balance[(2)]	22	9	50	47	19	23	26	29

Source: SAFE.
(1) 'Do not know/not available' replies are not included in the Table. Hence, figures for the 'increased', 'unchanged' and 'decreased' do not add up to 100 in some cases.
(2) The 'net balance' is the difference between those respondents reporting an increase and those claiming a decrease in interest rates and cost of financing, respectively.

In 2018, the mean interest rate on bank overdraft and credit lines paid by SMEs across the EU amounted to 3.65%, higher than that of 2.04% reported a year ago. A significant degree of heterogeneity across countries prevails. The mean interest rate stood at 4.02% in Malta, below that registered in Greece (5.93%) and the United Kingdom (5.69%). Meanwhile, the lowest rates were observed in Finland (1.71%), Belgium (1.88%) and Austria (2.00%). Almost half of the EU countries registered an increase in interest rates charged to SMEs in 2018.

Credit demand and supply

A salient feature of the SAFE is the information it provides on the supply (availability of financing) and demand (need for financing). Table 2 shows the number of firms that applied for bank loans, trade credit, overdrafts and credit lines since 2015. The proportion of SMEs that applied for these facilities increased significantly in 2018 when compared with preceding years, though the rise in the share of those that applied for bank loans was more moderate. Meanwhile, the percentage of respondents that applied for trade credit increased substantially.

This survey round re-affirmed past trends: only a very small proportion of firms chose not to apply for these types of financing because they feared a possible rejection. The proportion of SMEs that chose not to apply because of sufficient internal funds rose only marginally. In contrast, as in the EU, a substantial increase was reported in the percentage of domestic SMEs which did not apply for bank loans of trade credit because they had sufficient internal funds.

SAFE results shed light 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 the success rate of loan applications between 2015 and 2018. In 2018, nine out of every ten firms that applied for bank overdraft, credit lines and cards, got everything. This share edged up compared with the preceding years. A similar proportion was reported in the case of trade credit. In contrast, the proportion of firms that were given the full amount of bank loans that they applied for dropped to 44% from 65% a year earlier. 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.

Table 2
FOR EACH OF THE FOLLOWING WAYS OF FINANCING, COULD YOU PLEASE INDICATE WHETHER YOU:

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	2018	2015	2016	2017	2018	2015	2016	2017	2018
Applied over the past 6 months	26	27	16	42	23	26	16	22	33	28	30	48
Did not apply because of possible rejection	0	2	2	2	0	0	3	1	0	0	5	0
Did not apply because of sufficient internal funds	51	45	31	32	49	50	33	45	45	51	18	32
reasons	17	20	45	23	23	23	43	25	16	18	38	16

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	2018	2015	2016	2017	2018	2015	2016	2017	2018
Applied and got everything	69	54	60	90	72	68	65	44	56	61	62	90
Applied and got most of it [(1)]	6	10	0	0	15	14	0	6	14	10	19	7
Applied but only got a limited part of it[(2)]	7	0	5	0	0	0	6	12	20	5	8	0
Applied but refused because cost too high	0	5	0	0	0	0	0	0	0	0	0	0
Applied but was rejected	7	5	8	0	8	0	9	13	0	5	5	0

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

Whereas no SMEs in Malta were rejected when applying for bank overdrafts or trade credit, slightly more than a tenth of firms that applied for bank loans had their application rejected.

Conclusion

SMEs have historically played a dominant role in the Maltese economy both in terms of value added generation as well as in the creation of employment. Hence, they have been significantly beneficial in making the economy less susceptible to idiosyncratic shocks. Looking forward into 2019, growth in SME value added is predicted to remain strong, increasing by an annual average of 9.0% between 2017 and 2019.[6]

The pace of growth of SMEs however, depends on a number of challenges. EIBIS 2018 reports that almost seven in ten firms (69%) in Malta reported operating at or above maximum capacity, above the EU average of 54%. This implies that firms need to invest more to meet higher production expectations in the future. Although the last survey round confirms that access to finance is the least pressing problem for domestic SMEs, improved access remains desirable, as support from retained earnings is bound to diminish as economic activity normalises. Labour shortages, moreover, remain a pressing problem, which firms have sought to address by increasing investment in human resources. The need for such investment can be expected to persist in a dynamic economy.

Survey results also show that although a smaller net share of firms reported a rise in interest rates, the net share of firms reporting increases in non-interest costs of financing increased markedly. Moreover, while the success rate of credit lines, bank overdrafts, credit cards and trade credit has increased, the share of respondents that applied for a bank loan and received the full amount was the lowest since 2015. In this regard, the Malta Development Bank can assist in the provision of funding at affordable costs for SMEs that may not be familiar with credit institutions.

[6] 2018 SBA Fact Sheet – Malta: www.ec.europa.eu/docsroom/documents/32581/attachments/20/translations/en/renditions/native.