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EUROSISTEMA
CENTRAL BANK OF MALTA

ACCESS TO FINANCE IN 2020

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BOX 1: ACCESS TO FINANCE IN 2020[1]

Small and medium-sized enterprises (SMEs) face challenges that vary from those of large scale enterprises, especially when it comes to complying with regulations and access of information, markets and finance. In particular, SMEs typically have very limited opportunities for capital market financing.

In addition to these challenges, SMEs are facing a difficult economic environment brought about by the COVID-19 pandemic. According to the Survey on Access to Finance of Enterprises (SAFE) which was conducted by the European Commission in cooperation with the ECB between 7 September and 16 October 2020 across 14,055 enterprises in the European Union (EU), EU SMEs recorded significant declines in turnover, profits and employment amid a sharp fall in economic activity, despite accommodative financing conditions and improved access to public financial support such as guarantees. The balance sheets of enterprises deteriorated for the first time since the GFC.

The SAFE provides valuable information on the financial situation of SMEs in Malta and across the EU, with specific emphasis on the need for and availability of external financing.[2] This box reports on the financing conditions and related challenges that SMEs faced during 2020.

The financial situation of SMEs

Survey results show that between April and September 2020 – the reference period for the latest survey – SMEs in Malta and in the European Union experienced a sharp deterioration in activity and financial performance, because of the difficult economic environment brought about by the COVID-19 pandemic and the related containment measures. This deterioration occurred despite generally accommodative financing conditions. Turnover and profits decreased, reflecting the sharp fall in economic activity. On balance, 64% of SMEs in Malta and 44% in the EU reported a decline in turnover, while profits fell for 70% of domestic SMEs and 45% of SMEs across the EU.[3] In Malta, the decline in turnover was the strongest recorded since 2011, when a net 40% and 63% of SMEs reported a decline in turnover and profits, respectively.[4] The higher incidence of companies reporting lower turnover and profits in Malta may reflect the larger share of respondents in trade and services, which include the sectors hit hardest by the pandemic.[5]

The decline in economic activity and profits also impacted the investment and hiring decisions of SMEs. On balance, 20% of SMEs in Malta reported a decline in investment in plant, machinery or equipment, compared with 8% of SMEs in the EU. Meanwhile, on balance, 13% of domestic SMEs reported a decline in the number of employees, compared with 10% in the EU. These developments are a sharp turnaround from 2019 when 35% and 28% of SMEs in Malta had reported a net increase in investment and in the number of employees. At the same time, the survey confirms that the labour market has been relatively resilient given the scale of contraction in activity, as the net share of firms reporting lower employment was much smaller than that reporting lower turnover. Furthermore, the share of firms reporting a lower staff complement was similar to that in the EU, even if the survey reveals a much stronger incidence of firms with decreasing turnover in Malta.

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[2] According to the 2019 SBA Fact Sheet, 2018 estimates for SMEs in Malta show that these were responsible for 77.7% of employed persons and 81.8% of value added generated. In the EU28 these were responsible for 66.6% of persons employed and 56.4% of value added. SMEs in Malta and in the EU make up 99.8% of all enterprises https://ec.europa.eu/docsroom/documents/38662/attachments/20/translations/en/renditions/native

[3] According to SAFE 2020, the financial state of SMEs in the EU has deteriorated in recent survey results, though the sharp decline in the last year is to a large extent the result of the COVID-19 pandemic.

[4] Figures from SAFE are rounded, in line with the approach followed by the ECB when commenting on SAFE results.

[5] In Malta, 88% of participating firms were classified in these sectors, compared to 75% in the EU.

Regarding the costs of labour and other costs, on balance, 8% and 11% of SMEs in Malta claimed that these increased in 2020. These figures compare well with those for the EU. They are, however, significantly lower than in 2019, when 73% and 60% of Maltese SMEs experienced a net increase in labour and other costs, respectively. Such developments were also observed in the EU.

Sources of finance used by SMEs

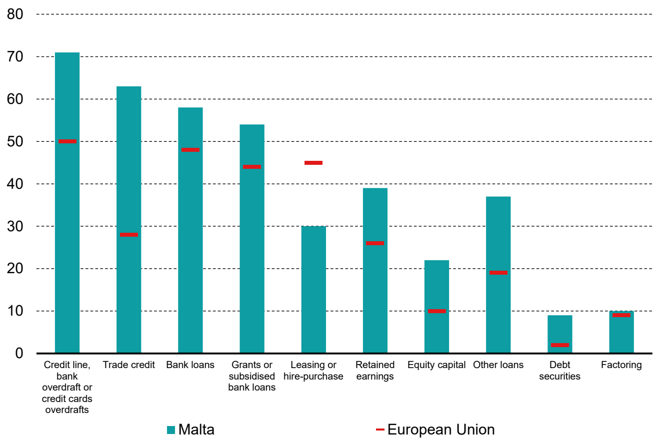
In 2020, domestic SMEs continued to prefer bank-related products such as overdrafts and credit lines and, to a lesser extent, bank loans over market–based products and other sources of finance (see Chart 1). While the share of SMEs in Malta that used credit lines, bank overdrafts or credit cards, or that expected to use them in the future remained unchanged when compared with a year earlier, the relevance of this type of financing has been consistently decreasing – falling gradually from 83% in 2016 to 74% in 2018 and 71% in 2019 and 2020. Meanwhile, the share of firms that used bank loans in the past or considered using them in the future has been largely stable over the years, and remained unchanged in 2020 – at 58%. Similar developments were observed across the EU. Half of the respondent SMEs in the EU used credit lines, bank overdrafts or credit cards, or expected to use them in the future, a marginal decline from 51% in 2019. Meanwhile, the share of those that used bank loans in the past or considered using them in the future rose slightly to 48% from 46% a year earlier.

By contrast, the share of SMEs in Malta and in the EU that considered grants or subsidised bank loans as being relevant to their enterprise increased. During 2020, this share edged up to 54%, from 40% a year earlier. Similarly, the share of SMEs in the EU that mentioned this type of financing as being relevant rose from 31% in 2019 to 44% in 2020. This likely reflects the introduction of policies aimed at supporting the flow of bank credit to enterprises during the COVID-19 pandemic, such as loan moratoria and subsidised loans for firms hit hardest by the pandemic. Furthermore, the share of domestic SMEs that considered trade credit relevant to their business rose to 63% when compared with 56% a year earlier as businesses might have considered this type of financing to fill liquidity gaps triggered by the pandemic.

Chart 2 reports on the use of different types of funding sources during 2020 both in Malta and in the EU. Credit lines or overdraft were used most often. The share of domestic SMEs using this type of financing has fallen from around 50% in 2019 to 41% in 2020. Nevertheless, it remained above that for the EU, where a third of SMEs resorted to this type of credit. Meanwhile, the use of bank loans fell to 12% in Malta from 16% a year earlier but rose to 18% from 15% in the EU.

The SAFE shows that the share of SMEs in Malta that used bank loans in 2020 fell to 12% from 16% in 2019. By contrast, this share rose from 15% to 18% in the EU. While 44% of domestic SMEs did not use bank loans, 39% replied that they considered them irrelevant for their enterprise. These

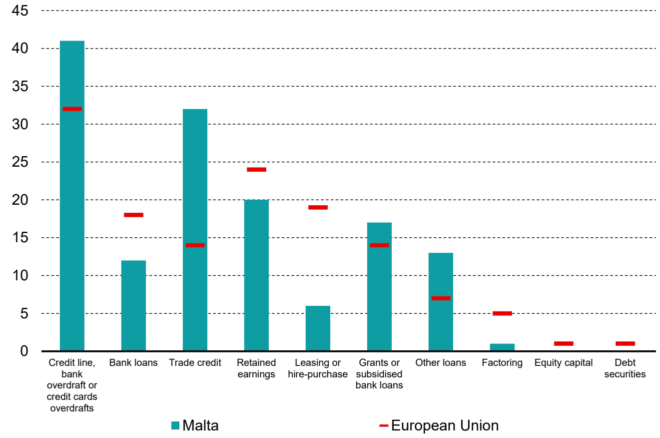
Chart 1
SOURCES OF FINANCE DEEMED RELEVANT BY SMEs
(used in the past or consider using in the future; percentage of respondents)



Source: SAFE (2020).

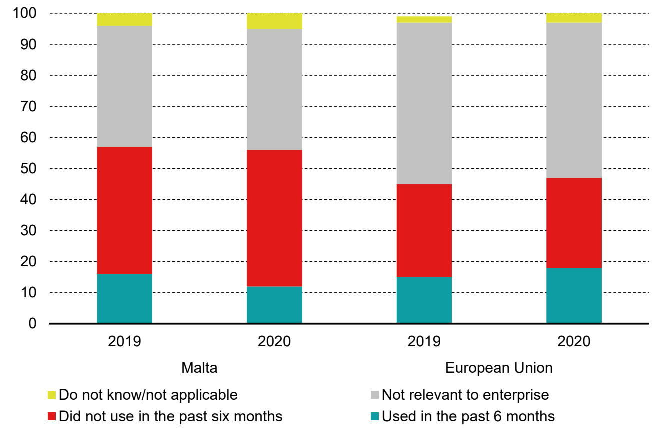
figures were broadly similar to those made in 2019. However, these contrasted with replies from their EU counterparts. In the EU, 29% of SMEs claimed that they did not use bank loans in the six months preceding the survey, while at 50%, half of the SMEs replying to the SAFE stated that bank loans were irrelevant for their enterprise. These figures were largely similar to those reported a year earlier (see Chart 3).

Chart 2
SOURCES OF FINANCE USED BY SMEs IN 2020
(over the preceding 6 months; percentage of respondents)



Source: SAFE (2020).

Chart 3
NEW LOANS OR LOAN RENEWALS
(percentage of respondents who took new loans or renewed the loans in the past six months)



Sources: SAFE (2019); SAFE (2020).

When asked to elaborate on why bank loans are not deemed relevant, 69% of domestic SMEs stated that they did not need this type of financing compared with 73% in the EU, while 12% reported that interest rates or prices were too high as opposed to 8% of their EU counterparts. A further 5% of domestic SMEs claimed that no bank loans were available, while 13% cited other reasons.[6]

In the EU, only 3% reported that bank loans were unavailable, while 16% of SMEs mentioned other reasons. EU figures were largely unchanged from those reported in 2019 In Malta, the composition of responses changed more significantly. The share of SMEs that cited bank loan unavailability or that this type of financing was not needed fell, while the share of respondents citing high interest rates and other reasons rose from a year earlier (see Chart 4).

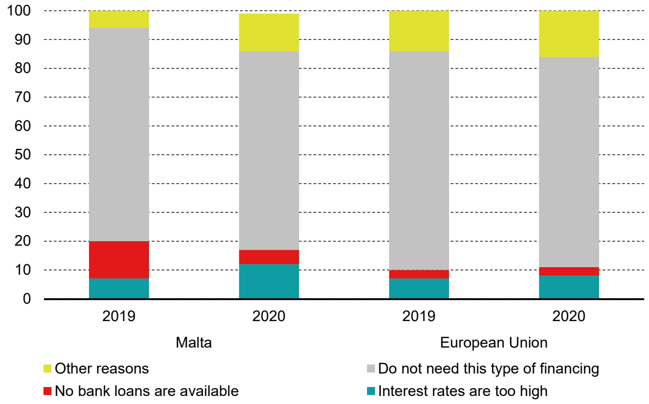
Although the relevance and need for trade credit increased compared to 2019, the share of SMEs that used trade credit fell to 32% from 38% in the previous survey. Nonetheless, the proportion of domestic SMEs that used this type of finance remained significantly above that in the EU, which stood at 14%. Some countries continued to make greater use of trade credit as a source of financing compared to other countries in the EU. Survey results rank Ireland (46%), Poland (33%) and Malta (32%) as the countries with the highest usage of this source of financing as opposed to countries such as Latvia, France and Germany where only 6% of SMEs relied on this type of financing. A lower use of trade

[6] 'Other reasons' include insufficient collateral or guarantees, reduced control over the enterprise, too much paperwork and unspecified reasons.

credit by domestic SMEs during the COVID-19 pandemic might reflect the fact that on balance, 9% of firms claimed that the willingness of business partners to provide trade credit during the period under review deteriorated. By contrast, a net 5% of firms had reported an improvement in the 2019 survey.

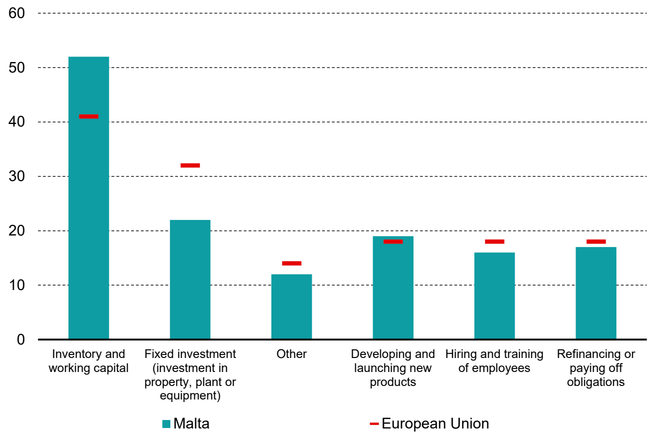
The share of SMEs that used retained earnings or proceeds from the sale of assets during 2020 fell further. It stood at 17% in 2020 compared to 25% in 2019 and 33% a year earlier. Following these successive declines, this share stood almost at par with that in the EU. However, whereas in Malta, 55% of SMEs stated that this method of financing is not relevant to their enterprise, this share stood at 70% in the EU. The decrease in the share of domestic firms that used this type of financing in 2020 possibly reflects lower earnings from the disruption of business activity since the outbreak of the COVID-19 pandemic.

Chart 4
REASONS WHY BANK LOANS ARE DEEMED IRRELEVANT FOR BUSINESS
(percentage of respondents who replied that bank loans were irrelevant for their enterprise)



Sources: SAFE (2019); SAFE (2020).

Chart 5
USES OF EXTERNAL FINANCE
(over the preceding 6 months, percentage of respondents)



Source: SAFE (2020).

The share of SMEs that used leasing or hire-purchase fell to 6% in 2020 from 16% in 2019, mirroring a reduction in the EU, which stood at 19%. Hence, the share of domestic SMEs making use of this method of financing remained below that in the EU. Meanwhile, the use of other loans such as those from family and friends, a related enterprise or shareholders, fell marginally to 13% from 14% a year earlier. During the same period, domestic SMEs made no use of equity and debt securities. In fact, debt securities, factoring and equity capital remained the three sources of finance that were least used in Malta and across the EU.

Chart 5 shows the purpose for which SMEs in Malta and in the EU used external financing obtained during 2020. In line with previous years, 52% of domestic SMEs resorted to external finance for inventory and working capital, a higher proportion than 41% of SMEs in the EU, though in the latter case, this was the highest share recorded over the past years. A smaller share of domestic SMEs (22%) used external financing for fixed investment in property, plant or equipment, compared with

32% in 2019 and in the EU. Meanwhile, the proportion of SMEs in Malta that used external financing for the development and launching of new products fell significantly to 19% from 34% in the preceding year, and consequently was more in line with the share of 18% in the EU. Similarly, at 16%, the share of domestic SMEs that used external financing for the hiring and training of employees was around half that of 30% in 2019, yet only marginally below the 18% recorded among respondent firms in the EU. Almost a fifth and around a tenth of domestic and EU SMEs, respectively, were likely to use external finance to refinance or pay off obligations and for other purposes. These reasons were cited somewhat less often by domestic SMEs than their EU counterparts.

Most pressing problems facing SMEs

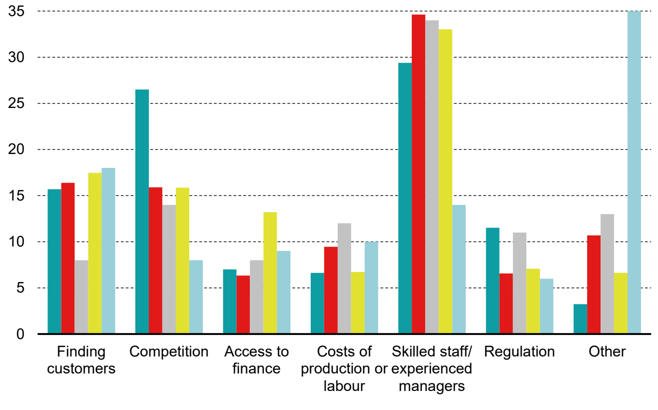
Chart 6 provides a breakdown of the most pressing problems that SMEs faced between 2016 and 2020. Compared with past years, 35% of domestic SMEs have reported 'other problems' than those listed in the survey as the most challenging issues that they faced in 2020, likely reflecting new challenges brought about by the pandemic. This share has risen significantly from 7% a year earlier and is considerably higher than that of 18% in the EU, though even in the latter case, it has risen significantly from around 8% in the previous three years.

SAFE 2020 describes the 'other problems' category as consisting of issues related to taxes, cash flow and liquidity, bureaucracy, exchange rate fluctuations, political instability and economic crisis, as well as Brexit and COVID-19. However, it notes that three quarters of EU enterprises that reported 'other problems' to be most urgent indicated that they were most worried about COVID-19. Indeed, if the pandemic were included as a single separate category, it would have been the third most pressing problem of EU enterprises. Meanwhile, a small share of enterprises – less than 0.5% – mentioned Brexit as the 'other problems' that they found most pressing. The other issues were mentioned by 25% of these enterprises.

During the same period, 18% of SMEs in Malta considered the problem of finding customers for their products or services as their most pressing problem, up marginally from 17% a year earlier. However, it remained below the share of 21% of SMEs in the EU, where it was cited as the most pressing problem experienced by SMEs across the EU.

The share of respondent SMEs that cited the availability of skilled staff or experienced managers as the most pressing problem fell significantly to 14% in 2020, compared with a third in the preceding three years. This share also fell below that in the European Union, where it stood at 19%. Nevertheless, there is significant disparity across countries. Staff availability is still considered as a most pressing problem for SMEs in Austria, Belgium and Germany, where it was cited by around a fourth of respondents, yet it is least of an issue for SMEs in Greece and Spain, where the issue was mentioned

Chart 6
MOST PRESSING PROBLEM FACING FIRMS
(percentage of respondents)



Source: SAFE (2020).

by a tenth of respondents. The declining importance of this problem in Malta and across the EU over the past year was corroborated by the European Investment Bank Survey on Investment and Investment Finance 2020.

Other non-financial barriers that undermine firm growth include costs of production and labour, a burdensome regulatory framework as well as competition. The share of SMEs in Malta that consider costs of production or labour as a most pressing problem rose from 7% in 2019 to 10% in 2020. Such costs were mentioned as a most urgent problem by 12% of SMEs in the EU, with this share remaining fairly constant since 2015.

By contrast, the proportion of domestic SMEs that considered competition as the most pressing problem halved in 2020 when compared with a year earlier. This share also dropped for SMEs in the EU, such that in 2020 competition was considered as the least important problem.

Meanwhile, access to finance was considered among the least important obstacles. The share of SMEs in Malta that considered access to finance as a most pressing problem declined from 13% in 2019 to 9% in 2020 – a rate that is close to that reported in 2018 and the rate of 10% reported by SMEs in the EU. According to SAFE 2020, access to finance remains a very pressing problem to SMEs in Greece, where as last year it was mentioned by around a fifth of participating firms, and least of a problem in Luxembourg (5%).

Terms and conditions of bank loan financing

Survey results show that 71% of domestic SMEs believe that the availability of bank loan financing remained unchanged during 2020, as against 58% across the EU. Meanwhile, 16% of domestic SMEs claimed that the availability of bank loans improved, as opposed to 13% which claimed that the availability of bank loans deteriorated. Consequently, a net share of 2% reported improved access to this source of funding in Malta, an improvement over a negative net balance of -8% recorded in the previous year. By contrast, in the EU the net share reporting an improvement decreased to 4% from 9% a year earlier.

At the time of the survey, 80% of domestic SMEs anticipated unchanged availability of bank loans in the six months ahead compared with 51% of SMEs in the EU. While 7% of domestic SMEs anticipated an improvement, 12% expected the availability of bank loans to deteriorate, such that on balance, 4% of surveyed SMEs predicted a deterioration. This compares favourably with a net negative balance of 8% in 2019 and of 15% in the EU.

Table 1 shows firms' assessment of interest rates and other costs of financing. The proportion of domestic SMEs which reported a net decrease in interest rates stood at 14%, a turnaround from 8% which reported a net increase a year earlier. During the year under review, 14% of domestic SMEs reported a decrease in rates, while none of those interviewed reported an increase. Meanwhile, 84% of participating firms claimed that interest rates were unchanged during 2020, compared with 56% in the EU. On balance, at -4%, a smaller share of SMEs in the EU reported a fall in interest rates, as 17% of SMEs reported an increase in the level of interest rates, whereas 21% were faced with lower rates.

With regard to developments in the cost of financing other than interest rates, 69% of SMEs reported an unchanged level of costs such as charges, fees and commissions, a significant increase from 37% of SMEs in 2019. By contrast, the share that reported higher costs fell from 63% in 2019 to 10% in 2020, while those that reported declining costs rose from 0% in 2019 to 21% in 2020. Results for 2020 diverge from those observed in the EU, where 28% reported an increase in non-interest rate costs and only 7% reported a decrease, resulting in a net positive balance of 20%. This was the first

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

	Malta					European Union				
	2016	2017	2018	2019	2020	2016	2017	2018	2019	2020
Level of interest rates										
increased	2	24	13	8	0	12	17	23	17	17
unchanged	78	76	80	92	84	47	56	57	56	56
decreased	21	0	1	0	14	36	22	15	21	21
net balance	-19	24	13	8	-14	-24	-5	7	-5	-4
Level of cost of financing other than interest rates (e.g. charges, fees, commissions)										
increased	13	50	47	63	10	33	33	34	33	28
unchanged	78	50	51	37	69	52	55	56	55	59
decreased	4	0	0	0	21	10	7	5	6	7
net balance	9	50	47	63	-10	23	26	29	27	20

Source: SAFE (2020).

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.

The 'net balance' is the difference between those respondents reporting an increase and those claiming a decrease in in interest rates and cost of financing, respectively.

time since 2016 when, on balance, domestic SMEs registered a fall in the level of interest rates and the level of cost of financing other than interest rates. This may have partly reflected the availability of subsidised loans under the MDB CGS.

Credit demand and supply

The SAFE also provides information on the demand for finance by participating firms to complement replies on the availability of financing (supply). Table 2 shows the number of firms that applied for bank loans, trade credit, bank overdraft and credit lines since 2016. The proportion of SMEs that applied for the latter facilities rose marginally to 26% compared with 24% in 2019. During the same period, the share of those that did not apply because of possible rejection fell to 3% from 8% a year earlier, while the proportion of those that did not apply for other reasons rose to 20%. Slightly more than half the surveyed firms – 51% – did not apply because of sufficient internal funds. This was above 36% of SMEs in the EU which did not apply for the same reason.

During 2020, the proportion of domestic SMEs that applied for bank loans stood at 20%, above the proportion of 16% that applied for such financing in 2019. While just 1% of respondent firms did not

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				
	2016	2017	2018	2019	2020	2016	2017	2018	2019	2020	2016	2017	2018	2019	2020
Applied over the past 6 months	27	16	42	24	26	26	16	22	16	20	28	30	48	32	29
Did not apply because of possible rejection	2	2	2	8	3	0	3	1	6	1	0	5	0	1	1
Did not apply because of sufficient internal funds	45	31	32	48	51	50	33	45	53	59	51	18	32	29	44
Did not apply for other reasons	20	45	23	14	20	23	43	25	16	19	18	38	16	28	23

Source: SAFE (2020).

apply because of possible rejection, almost a fifth failed to apply for other reasons. A higher share of 59% – compared with 53% in 2019, and 35% of SMEs in the EU – did not seek bank loans due to sufficient internal funds.

The percentage of respondents that applied for trade credit declined for the second consecutive year, and stood at 29%, marginally below that of 31% in the EU. Survey results show that a significantly higher share of respondents (44%) did not apply because of sufficient internal funds compared with 29% a year earlier. Only 1% did not apply for fear of rejection, while 23% did not apply for other reasons.

Conclusion

The SAFE 2020 reports on the financial situation of SMEs in the midst of the COVID-19 pandemic. It notes that turnover and profits of SMEs in Malta and in the EU were severely impacted by adverse economic activity, even though financing conditions were generally accommodative. For the first time since 2016, the number of domestic SMEs that reported lower levels of interest rates and other costs of financing exceeded those that reported an increase.

Bank financing remained the most used source of external financing. While usage rates surpassed those in the EU, the share of respondents that resorted to this type of financing fell. Similarly, the proportion of those that resorted to retained earnings and trade credit declined, despite a higher perception that the latter type of financing could help fill liquidity shortages. The majority of Maltese SMEs reported that they had enough internal funds not to require loans, as against a minority of EU firms.

Survey results show that during the period under review, SMEs in Malta and in the EU made higher use of grants or subsidised bank loans. This reflects measures taken by the Government and the Central Bank of Malta to alleviate liquidity shortfalls as a result of the pandemic. As at end December 2020, 1,928 loans were subject to a moratorium on loan repayments, amounting to €695.9 million, or 5.9% of total outstanding loans to Maltese residents. Meanwhile, 537 facilities, covering total sanctioned lending of €408.1 million, were approved under the MDB CGS, with the aim of providing loans for working capital.

Access to finance was among the least pressing of obstacles during the period under review, largely surpassed by ‘other problems’ such as the pandemic and Brexit. As could be expected, in a period of low demand, the previously pressing problem of labour shortages dampened considerably, though it remained the third largest issue for Maltese firms.