



Irish SME credit supply and demand: comparisons across surveys and countries.

Sarah Holton and Fergal McCann

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Abstract

This letter provides a consistent picture of Irish SME credit supply and demand up to March 2012 across two data sources: the European Commission and European Central Bank *Survey of Access to Finance of Small and Medium Enterprises* (SAFE) and the Mazars SME lending demand survey, commissioned by the Department of Finance. The data report that the Irish rejection rate for credit applications is the second highest in the euro area, while Irish SMEs are among the most likely to have faced increased collateral requirements, increased interest rates, or lower loan quantities. On the demand side, the data depict Irish credit demand, as measured by changes in firms' reported need for external financing, to be at or close to the euro area average, while application rates for credit are slightly lower than average. The difference between Ireland's ranking on demand and application rates is partly explained by a share of discouraged borrowers, who have demand for credit but do not apply for credit, that is double the euro area average.

⁰E-mail: sarah.holton@centralbank.ie; fergal.mccann@centralbank.ie. We thank Trevor Fitzpatrick, Lars Frisell, Stefan Gerlach and Kieran McQuinn for comments on an earlier draft. The views expressed in this paper are those of the authors and do not necessarily reflect those of the Central Bank of Ireland or the ESCB. Any remaining errors are those of the authors.

1 Introduction

By March 2012, the volume of credit outstanding to non-financial, non-property related ("core") private enterprises in Ireland had decreased to 2005 levels (see Figure 1). Figure 2 shows that gross new lending to SMEs amounted to €407m in Q1 2012. This represents a decrease of 29.6 per cent from Q4 2011 and is down from over €700m in Q4 2010. In Ireland, the relative effects of supply and demand-side pressures on this decline in credit have been the subject of much discussion. The aim of this Letter is to assess the relative position of Irish credit demand and supply in a European context using the two main SME survey data sources available for Ireland from September 2011 to March 2012: the European Central Bank and European Commission's *Survey of Access to Finance of Small and Medium Enterprises* (SAFE) and the Mazars *SME Lending Demand Survey* (Mazars).

Our results suggest, firstly, that the conclusions concerning Irish SMEs' credit supply and demand do not vary depending on the results of the Mazars or SAFE survey. Secondly, in placing the Irish results from both surveys in a European context, we highlight four broad findings: credit demand in Ireland lies close to the European average; Ireland has the second highest share of discouraged borrowers (firms who do not apply for a loan despite requiring credit) in the euro area; rejection rates for loan and overdraft applications in Ireland are among the highest in the euro area; changes in terms and conditions associated with new bank credit in Ireland are also among the least favourable in the euro area.

Compared with the previous survey round, which covered March 2011 to September 2011, the latest period is characterised by very mild improvements for Ireland in both surveys: credit demand appears to have increased very slightly, while rejection rates appear marginally lower and the unfavourable changes in terms and conditions are less severe. The improvements on the supply side (rejection rates and changes in terms and conditions) must be interpreted with caution however, as in each instance, despite slight improvements, Ireland still remains in a very unfavourable position relative to the euro area average. Moreover, the results only refer to changes over the past six months and so follow a long period of deterioration.

Estimating the extent of supply and demand-side shifts in the credit market is of particular interest at present in the Irish economy. A demand-driven credit decline requires the same mix of policy responses that are typically used to stimulate demand in the domestic economy. A decline in credit resulting from a supply restriction arguably requires more immediate action, given the potentially serious impact on economic growth from supply-side credit constraints.¹ International literature has found that credit constrained firms are more likely to close down or shed employment, less likely to invest in technology, spend on marketing, or enter export or import markets (see, for example, Campello et al. (2010), Berman and Hericourt (2010), Mach and Wolken (2011)). It is to be expected, given the fall in economic activity in Ireland since 2008, that rejection rates would be above the European average. While the summary statistics presented here do not provide direct econometric evidence of supply-side constraints, previous work from the Central Bank has shown that high rejection rates in Ireland cannot be fully explained by weak demand or the quality of the pool of potential borrowers in Ireland, thus suggesting that the high rejection rates observed in Ireland represent, in part, supply-side credit constraints faced by Irish SMEs (see Holton et al. (2012), Kelly et al. (2012) and Lawless and McCann (2011)).

It is important to note that analysis of survey data is one of a number of ways in which the distinction between credit supply and demand can be made. Studies in other countries have relied on quantitative modeling of credit flows to identify shifts on the demand and supply side. Using survey-based measures does limit our analysis to qualitative measures such as the share of firms applying for a loan, the share rejected for a loan or the share of firms reporting changes in terms and conditions. We cannot, using surveys, analyse the *volume of credit demanded by or available to firms*. In Ireland, balance sheet data on SMEs is not currently available, so such quantitative techniques are currently not possible. One advantage, however, of survey-based measures relative to such quantitative outputs is that surveys such as SAFE and Mazars provide direct measures of supply and demand-side experiences of firms, whereas quantitative methods rely on the quality of the empirical model, which can vary greatly depending on the infor-

¹We interpret the term "credit constrained" to refer to a firm that would have been deemed creditworthy under an alternative regime, but who now cannot access credit due to a shift in the supply curve, which could be brought about by changes in banks' funding costs, risk aversion, or incentives to decrease loan exposure.

mation available to the researcher.

The Letter proceeds as follows: Section 2 explains the data in more detail; Section 3 reports measures of credit demand; Section 4 reports credit rejection rates and changes in terms and conditions associated with credit. Section 5 concludes.

2 Data

Two firm-level survey data sources are used in this Letter. The first is the Survey of Access to Finance of Small and Medium Enterprises (SAFE), from the European Central Bank (ECB) and European Commission (EC). This survey is carried out on a six-monthly basis. The most recent survey, for October – March 2012 covers 485 Irish SMEs.² The second data source is the Mazars SME Lending Study (hereon “Mazars”), commissioned by the Irish Department of Finance, covering the six months October – March 2012 with a sample size of 1,505.³ Both of the above surveys have distinct advantages. In terms of sample size and thus generalizability to the population of Irish SMEs, the Mazars survey is seen to be the most useful. Up to now, however, the results of the Mazars report have not been compared to those for any other country, due to its Irish focus. For this reason, it has been hard to interpret the absolute results of the Mazars study in any context. The SAFE survey, however, allows this gap in the analysis to be bridged. An identical set of questions is asked of SMEs across euro area countries. For issues of sample size and representativeness, only countries with sample sizes in SAFE above 500 in the period March – September 2011 are included in this analysis.⁴

Where possible, SAFE results are presented for a combination of bank loans and overdrafts, so as to make them as comparable as possible to results from the Mazars study, which focuses on all types of bank credit facility.

3 Credit demand

The demand for financing can be measured in a number of ways. One common measure is the share of firms that apply for a loan facility. While a useful measure of the demand faced by lending institutions, this measure may misrepresent the underlying level of demand amongst firms. One potential source of mismatch between underlying demand and that faced by lenders lies in a breakdown in borrower-lender relationships, by which firms who need financing either no longer apply for loans, or switch to alternative financing sources.

To capture underlying demand for financing, we use responses from SAFE to the following question for bank loans and overdrafts: *For each of the following items, please tell me if your needs increased, remained unchanged or decreased over the past 6 months?* Table 1 reports the net percentage increase in demand for bank loans and overdrafts in the latest six month survey period September 2011 to March 2012, the previous period March 2011 to September 2011, along with the sample size in the most recent period.⁵ For bank loans, Irish SMEs appear marginally above the euro area average, with a net percentage of 11 per cent reporting an increase in needs. For overdrafts, the net percentage of Irish SMEs reporting increased needs is 25 per cent, which is above the euro area average of 19 per cent. In neither case, relative to other euro area countries, does it seem that underlying demand for bank financing is particularly depressed.

Comparing the net percentages in demand in the most recent period with March to September 2011, we see that underlying demand for both loans and overdrafts in Ireland appears to have risen between September 2011 and March 2012. The net percentage increase for bank loans has risen from 8 to 11 per cent, while for overdrafts it has risen more substantially from 18 per cent to 25 per cent. Also in both periods, Irish demand was higher than euro area demand.

²An example of the SAFE survey, along the questionnaire can be found at <http://www.ecb.int/stats/money/surveys/sme/html/index.en.html>.

³An example of the Mazars study, along the questionnaire can be found at <http://www.finance.gov.ie/documents/publications/reports/2011/mazarbasklend.pdf>.

⁴A small number of large firms, with more than 250 employees, are included in the SAFE survey. In all analysis in this paper, these firms have been omitted so as to focus solely on SMEs, as is the case in Mazars. The SAFE survey contains survey weights for each firm based on country, sector and firm size group. Each result presented from the SAFE data has been adjusted to account for these survey weights, which make the results as representative of the population of SMEs as possible for each country.

⁵The optional responses to this question were either “increased”, “unchanged” or “decreased”. The net percentage increase is calculated as the percentage of firms that reported an increase minus those who reported a decrease. We exclude those firms that responded “don’t know” when calculating all percentages.

Having identified the relative position of the underlying demand for bank financing among Irish SMEs, the demand for credit, as experienced by lending institutions is now measured. Table 2 ranks countries according to the share of firms that applied for a bank loan or overdraft in the period October - March 2012. The results depict Ireland as having a below-average application rate for external financing, with 33 per cent of firms having applied. However if the Mazars result is used, the Irish application rate of 38 per cent is slightly above the euro area average of 36 found in the SAFE survey. For both the SAFE and Mazars result, compared to the previous survey round, the application rate has risen slightly from September 2011 to March 2012.

One potential explanation for the discrepancy between underlying demand and demand as seen by lending institutions lies in SMEs' perceptions of lending institutions. Table 2 ranks countries according to the share of firms that did not apply for bank loans or overdrafts due to their belief that they would be rejected. Ireland's position as the second-highest ranked country in terms of discouraged borrowers reconciles somewhat the difference in Ireland's ranking for applications and underlying demand.

To summarise, credit demand, as measured by changes in firms' need for external financing, does not appear significantly different from the European average in Ireland. Irish firms' application rates for bank and other external financing are below the European average, although not by a very large degree, and not at all when using the results of the Mazars survey. The share of firms that demand, but do not apply for, credit due to their belief that they will be rejected is double the euro area average.

4 Supply-side credit conditions

In the SAFE survey, firms are asked with respect to both bank loans and overdrafts "If you applied and tried to negotiate for this type of financing over the past 6 months, did you:"

1. Applied and got everything
2. Applied and got most of it (BETWEEN 75% AND 99%)

3. Applied but only got a limited part of it (BETWEEN 1% AND 74%)
4. Applied but refused because cost too high
5. Applied but was rejected

Table 3 reports the results for each country for the period September 2011 to March 2012, with the figures for March-September 2011 included for comparison.⁶ The results show that the rejection rate for Ireland (24 per cent) is highest after Greece among the sample countries and is well above the euro area average of 12 per cent. It is important to note that Ireland's ranking as having the second highest rejection rate in the euro area holds when using the Mazars rejection rate of 28 per cent.⁷ Further analysis from Holton et al. (2012), Kelly et al. (2012) and Lawless and McCann (2011) estimates that these high rejection rates cannot simply be explained by demand-side problems such as weak economic activity or borrower characteristics, but that they are caused to some extent by supply-side, "credit-crunch" factors.

For both SAFE and Mazars, the rejection rate in Ireland for bank credit has fallen slightly since September 2011, from 29 to 24 and 30 to 28 per cent, respectively. Although these small changes are positive, in absolute terms it must be emphasised that the Irish SME credit market is still characterised by the second-highest rejection rates in the euro area.

Along with refusal rates for new loan applications, the terms and conditions associated with bank financing are also of enormous importance. Table 4 reports the net percentage increase in interest rates, collateral requirements and on the size of loan facilities offered by banks. This Table shows that in the most recent survey the net percentage of Irish SMEs reporting an increase in interest rates is just slightly below the euro area average. As the survey is based on changes over a half year period, rather than absolute levels, this only tells us that changes in Ireland over that particular half year were similar to the euro area average, whereas in previous periods, the percentage of firms reporting an interest rate increase in Ireland was higher than the euro area average. For instance, in the previous survey round, from March to September 2011, the net percentage of firms reporting an increase was at 74 per cent, well above the euro area average of 58 per cent. This tallies with research in Kelly et al. (2012) indicating that

⁶Firms responding with (1) are classed as "accepted", firms responding (2) or (3) are classed as "partially accepted", while firms responding (4) or (5) are classed as "rejected", thus making the results from the SAFE and Mazars comparable.

⁷This figure excludes firms whose credit application decision was pending at the time of the survey.

spreads above EURIBOR for small loans in Ireland have been rising in the post-crisis period. Notably, the countries that are above the euro area average in terms of interest rate increases are Portugal, Spain, Italy and Greece, suggesting an impairment in the monetary transmission mechanism for these countries.

In terms of credit tightening other than that related to price, Table 4 shows that the net percentage of Irish SMEs reporting that collateral requirements increased is 51 per cent, higher than the euro area average of 38 per cent. This was similar to that which was reported in the previous round, when the net percentage tightening was around 55 per cent compared to the euro area average of 35 per cent.

Table 4 also reports that Ireland has the lowest share of firms reporting a net increase in available loan size after Greece. Along with high rejection rates reported in Table 3, this finding suggests that, even where financing is secured, another form of quantity rationing is taking place in Ireland. Again this finding is similar to the previous survey conducted from March to September 2011.

Further research from Kelly et al. (2012) suggests that the tough credit conditions experienced in Ireland are not explained by firm-level characteristics such as size, turnover, sector, ownership structure, capital position, profitability or prospects for internal funds, again

suggesting that supply-side factors are feeding through to tough credit conditions for real economy firms.

5 Conclusion

This paper aims to present an integrated view of credit supply and demand by utilising two different survey data sources and placing all results in a European context. The results can be summarised into a number of key findings. The underlying demand for external finance among Irish SMEs does not appear different from the European average. Application rates for credit are comparable to the euro area average; however these may understate financing needs, particularly in countries like Ireland. The share of “discouraged” Irish SMEs who do not apply for credit due to the belief that they will be rejected is the second highest in the euro area, suggesting that steps must be taken to improve perceptions of lending institutions among potential borrowers. On the supply side, Ireland’s share of firms that were rejected when applying for a loan or overdraft is the second highest in Europe, regardless of whether the results of the Mazars or SAFE survey are used. Moreover, the terms and conditions on Irish firms’ bank financing, particularly non price in the most recent survey are reported to be among the tightest in the euro area.

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Tables and Figures

A Data Appendix

Unlike in other Tables, in Table 2, the Mazars and SAFE surveys are not compared. In the SAFE survey, the question that is relevant for my Table 2 is the following:

For each of the following ways of financing, could you please indicate whether you:

1. Applied for them over the past 6 months;
2. did not apply because you thought you would be rejected;
3. did not apply because you had sufficient internal funds;
4. or did not apply for other reasons?

The result reported in Table 2, 14 per cent, is the total for firms that responded with (2).

In Mazars, you have the following, for the "bank related reasons", along with 9 borrower-related reasons:

1. because of possible rejection
2. have been turned down before
3. thought there were too many terms and conditions
4. thought it would be expensive
5. thought/believe the banks are not lending
6. it takes too long for the banks to make a decision
7. application process too difficult/issues with the process/too much hassle
8. don't trust the banks.

The authors felt that, given the wider range of options available to SMEs in the Mazars survey, a comparison between response (2) in the SAFE and (1) in Mazars, did not represent an accurate comparison. A firm that responded to Mazars with 1, 2, 3, 4, 5, or 8 might conceivably be a firm that responds to SAFE with 2. The share of firms responding with (1) to Mazars was 6 per cent, while the share of firms responding with one or more of answers (1) to (8) in Mazars was fifteen per cent.

B Figures

Figure 1: *Outstanding credit to all non-financial, non-property related private enterprises, 2003-2012.*

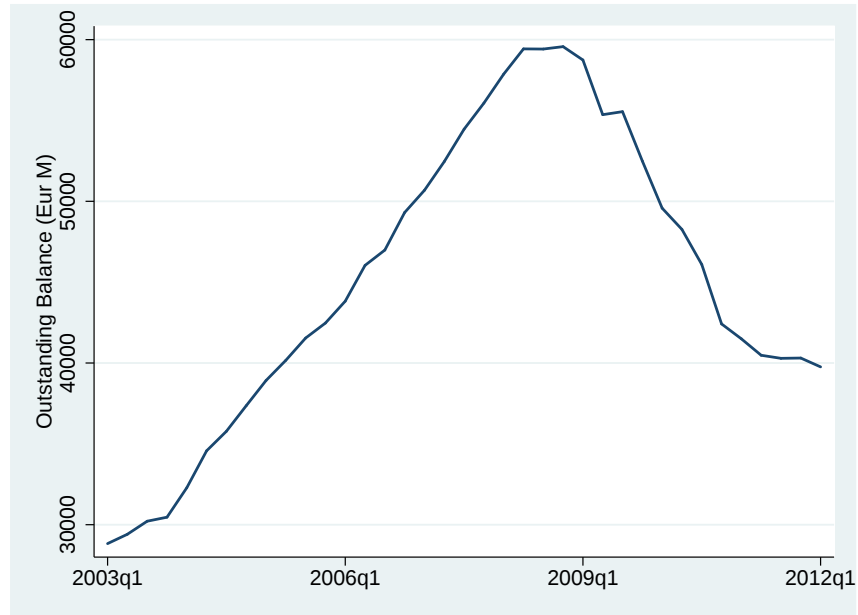


Figure 2: *Gross New Lending to non-financial, non-property related SMEs, 2010-2012.*

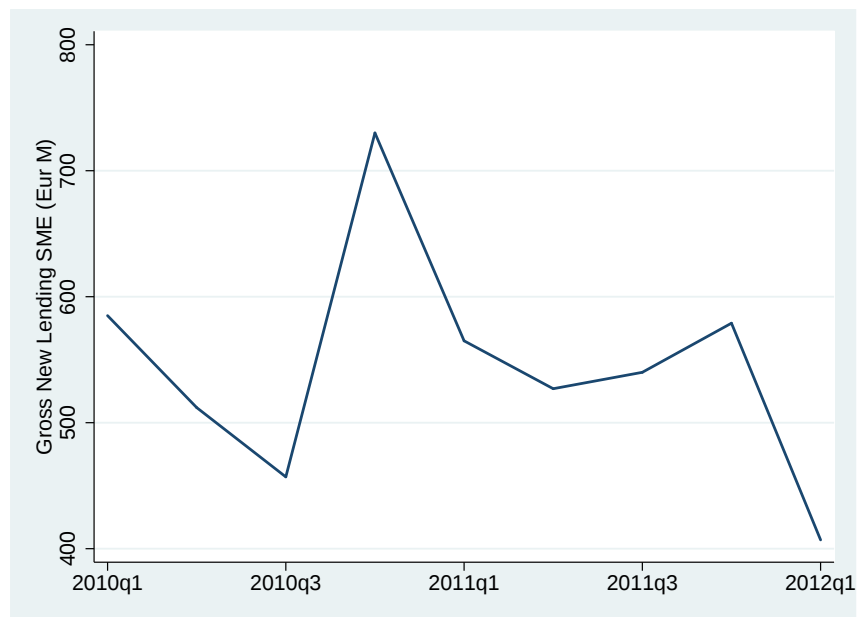


Table 1: Changes in underlying demand for bank loans and overdrafts, Sept 2011 - March 2012, Net percentages (percentage increase-percentage decrease) ranked from lowest to highest

Loans				Overdrafts			
Country	Net % Mar 2012	Net % Sept 2011	Sample Mar 2012	Country	Net % Mar 2012	Net % Sept 2011	Sample Mar 2012
NL	-7.9	-11.4	323	NL	0.9	3.6	383
AT	-5.7	-2.8	314	FI	1.1	3.4	283
FI	1.2	-8.5	331	AT	2	7.5	322
DE	1.6	-4.9	584	DE	6.4	-0.9	582
BE	6.6	-2.6	365	BE	7.1	2.4	361
FR	8.5	13.3	829	FR	17.7	17.8	807
ES	9.7	7.2	732	Total	18.7	14.4	5,114
Total	10.2	6.9	5191	ES	21.4	21.9	646
IE	10.7	8.4	370	IE	24.8	17.7	422
PT	17.9	21.4	253	GR	27.2	22.3	292
IT	24.6	16.7	729	IT	36.1	23.9	743
GR	26.5	24.4	361	PT	36.4	31	273

Table 2: Share of firms that applied for bank loans or overdrafts or did not apply due to fear of rejection, Sept 2011 - March 2012, ranked from highest to lowest

Country	Fear Rejection Mar 2012	Fear Rejection Sept 2011	Country	Applied Mar 2012	Applied Sept 2011	Sample Mar 2012
GR	21.2	11	FR	43.2	45	900
IE	14.8	12.4	IT	42.7	35.1	900
NL	9.9	10.1	ES	39.9	38	904
ES	9.1	8.1	IE - Mazars	38	36	1,505
PT	9.1	8.4	Total	35.6	32.2	6,937
FR	8.1	6.6	AT	35.3	27.9	469
Total	7.3	6.1	BE	33.7	26	485
IT	7.2	3.7	IE	32.6	28	483
BE	5.5	5.4	DE	31.2	26.3	898
DE	3.4	4.5	GR	27.2	23.9	483
AT	1.9	2.3	PT	23.3	22.9	465
FI	0.7	0.9	NL	19.7	17.1	469
			FI	17.5	16.7	481

Table 3: Rejection rates for bank loans and overdrafts, Sept 2011 - March 2012, ranked from lowest to highest

Country	Full Reject Mar 2012	Full Reject Sept 2011	Sample Mar 2012
AT	1.3	4	169
DE	3.6	5.9	267
FI	3.7	2.6	79
BE	9.4	9.1	157
FR	9.6	11.8	383
Total	11.9	11.6	2,295
IT	13.5	10.8	395
PT	14.4	19.4	113
NL	15.7	28.4	78
ES	19.0	12.2	372
IE	24.2	28.5	133
IE - Mazars	28	30	571
GR	41.6	26.3	149

Table 4: Changes in terms and conditions on bank financing, Sept 2011 - March 2012, Net percentages (percentage increase-percentage decrease) ranked from lowest to highest

Interest Rates				Collateral				Available Loan Size			
Country	Net % Mar 2012	Net % Sept 2011	Sample Mar 2012	Country	Net % Mar 2012	Net % Sept 2011	Sample Mar 2012	Country	Net % Mar 2012	Net % Sept 2011	Sample Mar 2012
DE	-10.8	25.8	263	PT	20.9	24	88	GR	-34.6	-36.1	154
AT	18	49.1	160	DE	21.5	23.6	265	IE	-30.4	-37.1	126
FI	18.1	22.3	83	AT	28.3	32	167	PT	-21.3	-15	102
NL	22.7	45.7	87	NL	28.4	23.1	90	ES	-18.1	-15.2	376
BE	23.1	21.6	156	Total	37.7	35.3	2,290	IT	-11.6	0.6	402
FR	34.7	42.9	378	FI	38.1	27.1	85	Total	-1.3	2.1	2,297
IE	39.8	73.8	133	FR	38.6	38.7	376	NL	1.3	1.4	92
Total	44	57.5	2,312	IT	38.9	32.3	398	BE	5.4	3.8	154
PT	65.8	71.2	108	BE	42.1	23.6	159	AT	9.2	24.8	167
ES	78.8	83.3	384	IE	50.8	54.6	127	FI	11.4	8.5	81
IT	78.8	78.2	404	GR	53.4	49.6	153	FR	13.2	12.7	373
GR	79	69	156	ES	57.4	47.9	382	DE	15.1	17.7	270