# The relevance of company size in accessing bank finance: A determining factor for Spain´s SMEs

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**Latest ECB data point to a general improvement in access to finance across the euro area, albeit more so for large companies than for SMEs. Nonetheless, many firms perceive a worsening of credit conditions, with SMEs seeing the greatest deterioration.**

*The most recent survey on access to finance conducted by the ECB published in April 2014 reveals improvement in the availability of credit to euro area companies relative to six months earlier. While survey data show firms are more optimistic regarding availability of credit now and in the near future, results indicate many firms still perceive credit conditions, such as interest costs, non-interest costs, and collateral requirements have worsened. This is particularly evident among the responses of SMEs. SMEs face financing constraints across all countries. However, the difference between financing conditions of large companies and SMEs in Spain is significant, with Spanish SMEs paying the highest spreads on bank loans* versus *large companies within the euro area. Thus, although recent data show that new credit for SMEs is rising in Spain and perceptions of Spanish businesses about the future, including those of SMEs is improving, given the importance of SME´s to the productive fabric of the Spanish economy, broadening their access to finance is key to sustain the economic recovery.*

It is a well known fact that small and medium-sized enterprises (SMEs) have more difficulty accessing finance than larger firms. In principle there are arguments for the importance of size in obtaining external financing, one of them being information asymmetry. Thus, in the case of SMEs, lenders find it more difficult to obtain information about the firm and the project due to be financed (as they are smaller, unaudited companies, with less transparent information, less collateral, etc.), such that they tend to demand more collateral and charge higher borrowing costs to compensate for the moral hazard and the resulting adverse selection. In some cases, the lender may not be willing to provide finance at all, and consequently turn down the loan application.

*In Spain, according to 2013 figures, 99.9% of firms are SMEs and they account for an above average share of employment (74.8%) and value-added (64.8%) relative to the EU-27.*

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Although there are arguments justifying the constraints on SMEs' access to external financing, the data presented in this article suggest that the cost increment they pay is excessive. Moreover, costs vary widely from one country to another, suggesting that there are additional factors underlying the differences observed. As a result, specific measures targeting SMEs need to be implemented to improve their access to finance. This is all the more important given that in many countries the majority of firms are SMEs and they account for a large share of the economy's value-added and employment. This is the situation in Spain, where, according to 2013 figures, 99.9% of firms are SMEs and they account for an above average share of employment (74.8%) and value-added (64.8%) relative to the EU-27.

In this context, this article explores the differences that exist between SMEs and large Spanish businesses in terms of conditions of access, and compares the situation in the different countries of the euro area. One message that emerges clearly is that, whereas SMEs face tougher conditions accessing finance in all countries, the difference between the borrowing costs of large companies and SMEs is bigger in Spain, with the latter paying up to 229 b.p. more for bank loans than large companies – the greatest difference within the euro area. Consequently, given the importance of SMEs in the Spanish economy's productive fabric, improving their access to finance is essential in order to support the recovery.

*SMEs face tougher conditions accessing finance in all countries, however, the difference between the borrowing costs of large companies and SMEs is bigger in Spain, with the latter paying up to 229 b.p. more for bank loans than large companies – the greatest difference within the euro area.*

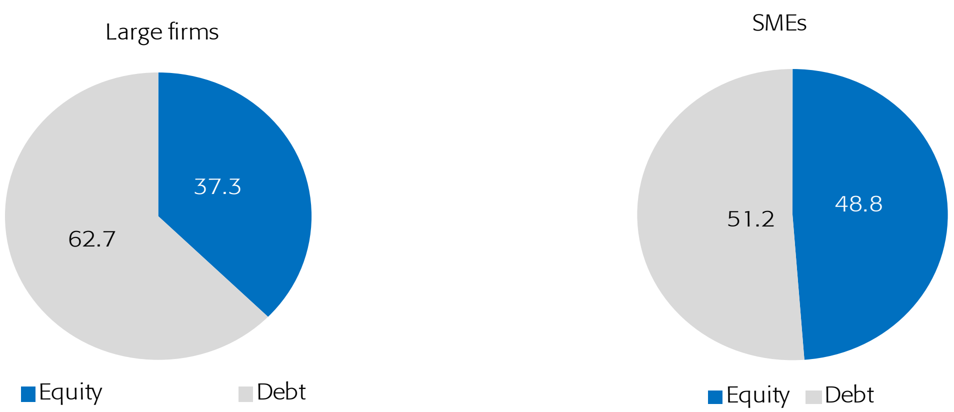
## Firms' financial structure: SMEs *vs.* large companies

The most recent information available (2012) on Spanish businesses' financial structure disaggregated

Exhibit 1

**Financial structure of non-financial corporations in Spain, 2012**

**a) Percentage structure of total liabilities**

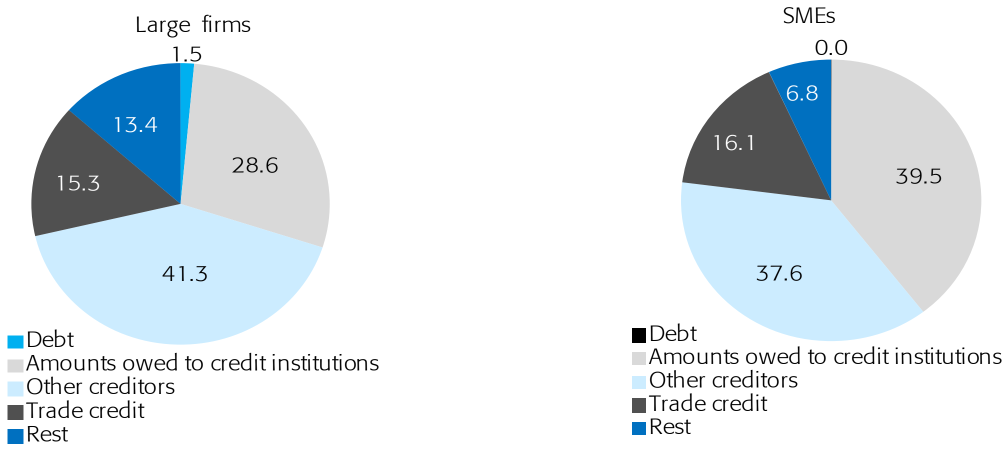



*Source: BACH.*

Exhibit 1 (continued)

**Financial structure of non-financial corporations in Spain, 2012**

**b) Percentage structure of debt**




*Source: BACH.*





by size reveals the importance of financing from own resources for SMEs, as this represents 48.8% of total liabilities. This is 11.5 percentage points (pp.) more than among large companies (Exhibit 1), and is the first indicator of the difficulties SMEs have obtaining external finance.

As regards the composition of external finance, the main difference between large companies and SMEs is in the relative share of bank financing. This accounts for 11 pp. more of finance among Spanish SMEs' than large companies, making up 39.5% of total external finance. Non-bank lending (including intra-company loans) is more significant among large companies (41.3% *vs.* 37.6%), as in the case of debt financing, although it is somewhat less important in the case of Spain's large companies (1.5% of external finance). By contrast, trade credit represents a share of external finance that is somewhat higher among SMEs than large companies (16.1% *vs.* 15.3%).

## Size and cost of bank finance

The tighter constraints SMEs face when accessing external financing translate into higher interest rates on bank loans. This fact can be illustrated using the ECB's information on bank lending rates for new transactions broken down by loan size. It is reasonable here to attribute loans of less than one million euros to SMEs and larger loans to large firms.

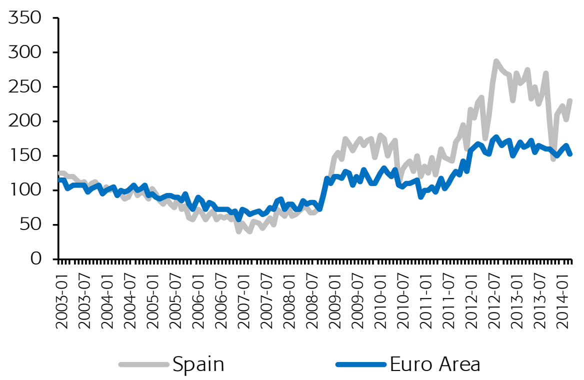
As Exhibit 2 shows, Spain's SMEs have always paid higher interest rates on their loans than the country's large companies. However, this cost increment has varied over time. Thus, in contrast to the narrowing of the spread between 2003 and 2007, the spread has grown as much as six fold since the financial crisis broke out in the summer of 2007, peaking at 288 b.p. in September 2012, compared with a level of around 50 b.p. in the first half of 2007. Since the peak, the spread has again narrowed, although in March 2014 it was still well in excess of pre-crisis levels (229 b.p.).

Exhibit 2

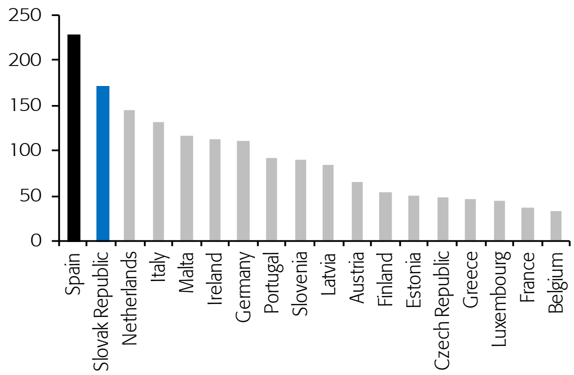
**Difference in interest rates on loans of less and more than one million euros to non-financial corporations**

**Basis points**

**a) Spain *vs.* euro area**




**b) Ranking in March 2014**




*Source: ECB.*



The higher cost of bank financing is a common feature of SMEs in the euro area, although during the crisis the effect of company size was more pronounced in Spain. Indeed, in March 2014 Spain was in first place on the euro area's rankings in terms of the difference between the interest rate on a loan of less than a million euros and one of over a million euros. The range of variation is extremely large, as there are countries in which the spread is less than 40 b.p. (e.g., France and Belgium) and others in which it is over 200 b.p. (Spain).

## Business size and availability of finance

Although the ECB's six-monthly survey on conditions of access to company finance puts the emphasis on SMEs, it also offers disaggregated information for both large companies and SMEs in the main euro area countries (Germany, France, Italy and Spain), and distinguishes between micro, small and medium-sized enterprises[2]. The most recent survey, published on April 30th, 2014, refers to the position of companies between October 2013 and March 2014. And as well as offering information on the four countries mentioned, it also gives aggregates for euro area companies. The Exhibits below show information both from the last survey and the preceding one on the situation in April to September 2013. This makes it possible to see whether the conditions of access to bank credit have improved or worsened over the last six months.

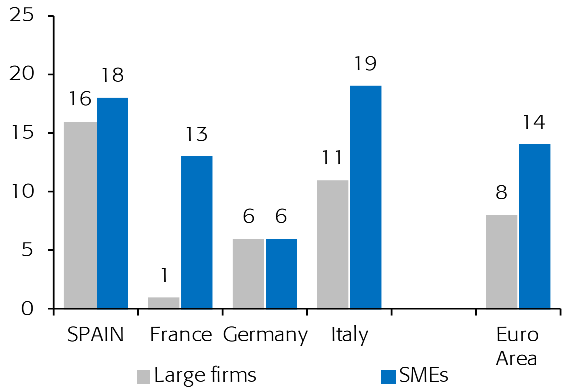
Exhibit 3 shows the percentage of companies stating that access to finance is the most pressing problem they face, where the alternatives were finding customers, competition, production costs, availability of qualified managers, and regulation.

[2] Microenterprises employ fewer than 10 workers and have a balance sheet or turnover of less than 2 million euros. Small enterprises employ between 10 and 49 workers and have a balance sheet or turnover of less than 10 million euros. Medium-sized enterprises employ fewer than 250 workers and have an annual turnover not exceeding 50 million euros, and/or an annual balance sheet total not exceeding 43 million euros.

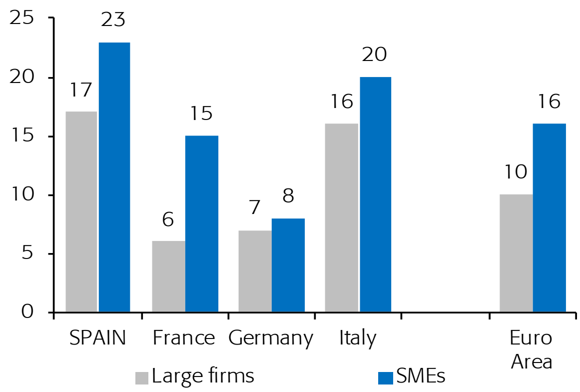
Exhibit 3

**Percentage of firms whose main problem is access to finance**

**a) October 2013 to March 2014**




**b) April 2013 to September 2013**




*Source: ECB.*

In the case of Spanish firms, 18% of SMEs identified access to finance as their main problem, compared with 16% of large companies. In the euro area the percentage of SMEs reporting external financing to be their main problem is also higher, at 14%, which is 6 pp. more than among large companies. Of the countries represented, the country in which the largest share of SMEs report this problem is Italy (19%, 1 pp. more than in Spain). In general, the problem of access to finance is most severe among SMEs, with the difference between large companies and SMEs also being considerable (12 pp.) in France. Only in Germany is there no difference between large companies and SMEs (6% identify access to finance as their main problem).

## Fear of rejection: An indicator of credit constraints

The ECB survey offers evidence about the constraints companies face when seeking to obtain bank credit through the question of whether they have applied for a bank loan and, if not, whether this was due to fear of rejection.

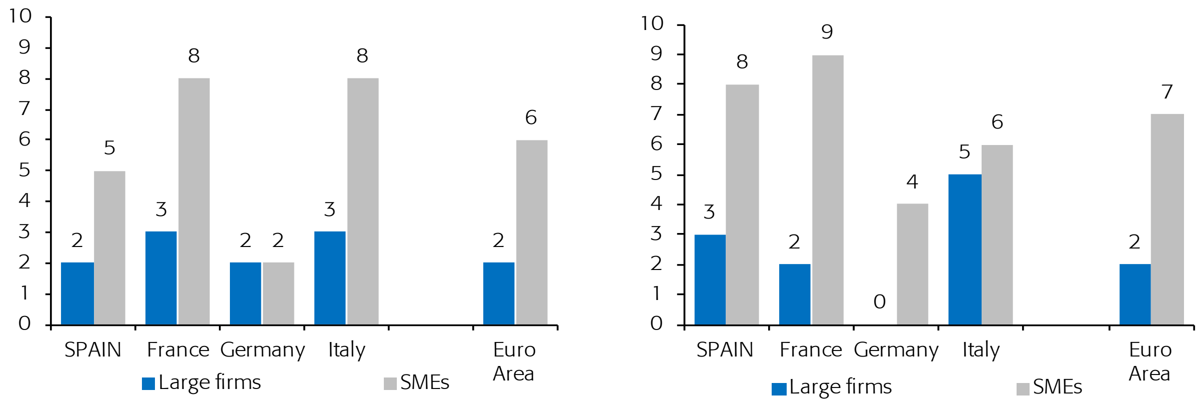
Exhibit 4 shows the answers to this question and again reveals how SMEs face more serious financing constraints than large companies. Across the euro area, an average of 6% do not apply for a loan out of fear of rejection, compared with 2% of large companies. In Spain, the difference is 3 pp. with percentages of 5% and 2%, respectively. The biggest difference is found in France and Italy, with a gap of 5 pp. between the 8% of SMEs and only 3% of large companies that do not apply out of fear of rejection. The smallest companies face the tightest restrictions on access to credit. In the case of Spanish firms, while 6% of microenterprises fear rejection, 3% of medium sized enterprises do.

What is the rejection rate once a company has applied for a bank loan? As Exhibit 5 shows, the difference in Spain's case is substantial, as whereas just 2% of large companies have their loan applications turned down, the rejection rate rises to 10% among SMEs. The difference between large companies and SMEs is also significant in the euro area (9 pp.) as a whole. However, in Germany, there is hardly any size-related difference in the rejection rate, as the percentage is 1% among SMEs and 2% among large companies.

Exhibit 4

## Percentage of firms that do not apply for a bank loan out of fear of rejection

**a) October 2013 to March 2014** **b) April 2013 to September 2013**

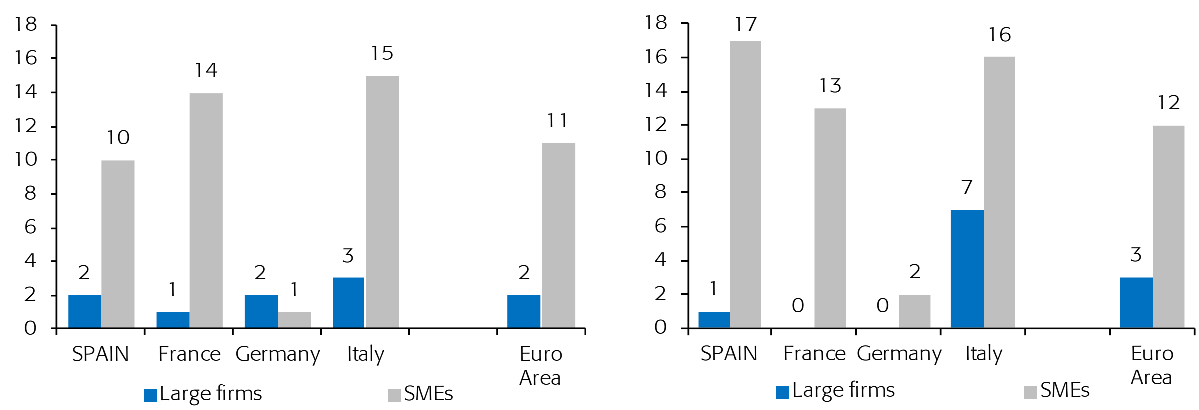



*Source: ECB.*

Exhibit 5

## Percentage of firms whose loan application has been turned down

**a) October 2013 to March 2014** **b) April 2013 to September 2013**




*Source: ECB.*

## Availability of bank credit and borrowing conditions according to company size

Do firms consider the availability of bank lending to have improved? In the case of Spain, the situation in the latest ECB survey has improved considerably since the previous round. While the percentage of firms that consider the availability of credit to have improved currently exceeds that considering it to have worsened (the net difference in answers is 16 pp. among SMEs and 10 pp. among large companies), in the previous survey the opposite was the case (-7 pp. among SMEs and -6 pp. among large companies). Moreover, given SMEs' worse starting point, it is good news that the net positive percentage of answers is higher among SMEs.

The improvement large firms have seen in access to bank lending in Spain in recent months is common to the euro area as a whole. However, this is not so in the case of SMEs. Thus, in the euro area the percentage of SMEs that consider the availability of credit to have worsened exceeds that considering it to have improved, with the difference being 4 pp. Moreover, among the countries examined, it is among Spanish SMEs that the perception of the availability of bank credit has improved most, in contrast to the situation of SMEs in France and Italy, which present net negative responses of -14 pp. and -9 pp., respectively.

Apart from the issue of the level of availability of bank credit, it is also important to determine the conditions under which this financing is given, in terms of aspects such as the interest rate on the loan, other costs of finance (such as commissions paid) or the collateral requirements. In the first case, companies considering interest rates to have increased exceeded those considering them to have fallen by 9 pp. among euro area SMEs, compared with -15 pp. among large firms. Consequently, there is a big difference in the cost of bank finance in the euro area depending upon company size, with an increase in the interest rates paid by SMEs and a fall in rates paid by large firms.

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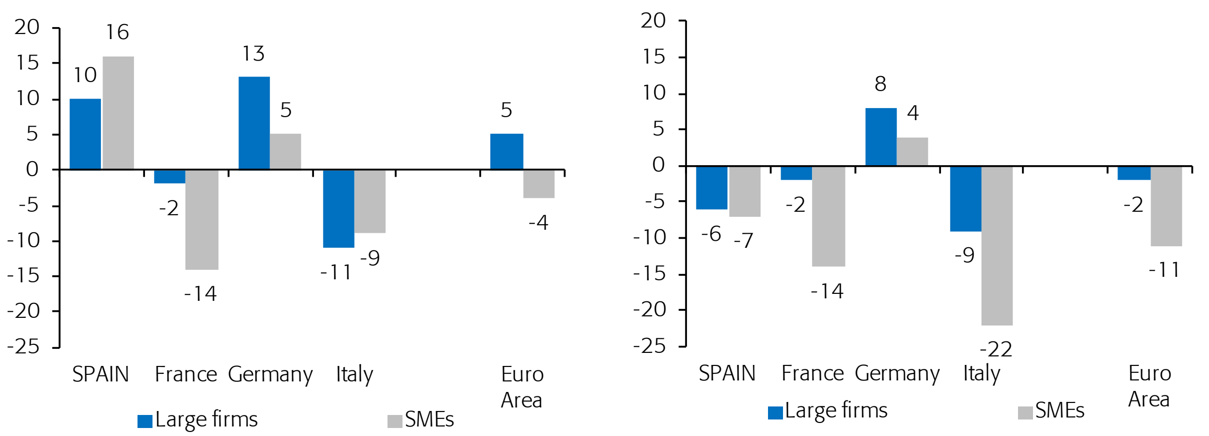
In Spain, the net percentage of responses from SMEs is much higher (31 pp.), as they have seen interest rates on bank financing rise to a much greater extent. The situation among large firms is completely different, as the percentage considering bank lending rates to have fallen

Exhibit 6

**Net percentage of companies answering that they consider the availability of bank loans has improved-worsened**

**a) October 2013 to March 2014** **b) April 2013 to September 2013**




*Source: ECB.*

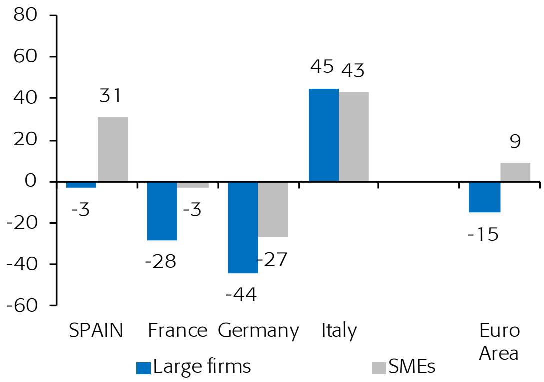
Exhibit 7

**Opinion of companies regarding the conditions of access to bank financing**

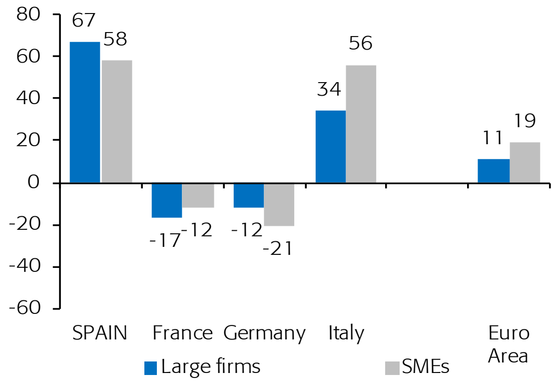
**Net percentage answers**

**1) Increase/decrease in interest rates**

**a) October 2013 to March 2014**

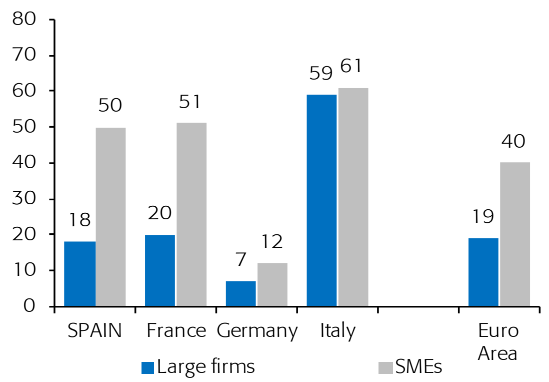



**b) April 2013 to September 2013**

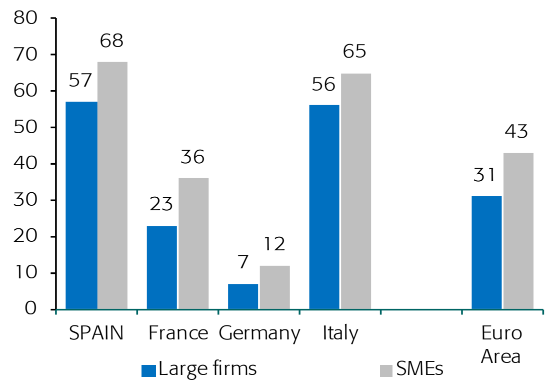



**2) Increase/decrease in non-interest costs**

**a) October 2013 to March 2014**

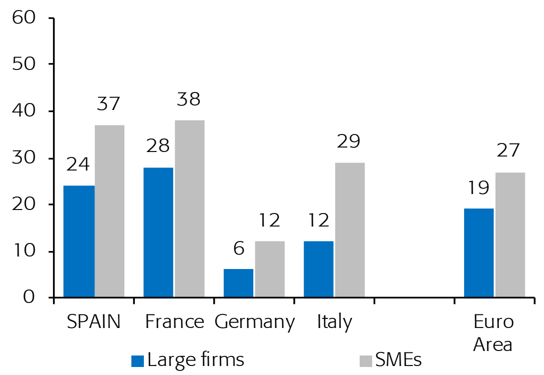



**b) April 2013 to September 2013**

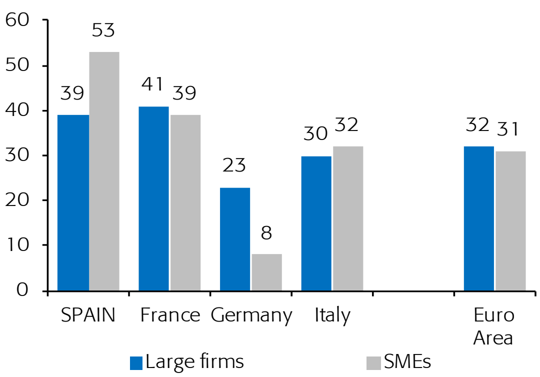



**3) Increase/decrease in collateral**

**a) October 2013 to March 2014**




**b) April 2013 to September 2013**




*Source: ECB.*

predominates. The data for Spanish SMEs is in stark contrast to that of SMEs in Germany and France, where the majority of firms consider banks to have cut their interest rates.

In the case of non-interest costs, SMEs, particularly those in Spain, have seen the biggest increases. The net percentage of Spanish SMEs answering the question "has increased/decreased" by citing an increase is 50 pp. This is 32 pp. more than among large Spanish firms and 10 pp. more than among euro area firms of the same size. In the euro area, as in all the countries looked at, SMEs have seen their costs rise to a greater extent, with net percentages of positive replies to this question that are higher in all cases among SMEs than large firms.

Spanish SMEs have also seen the requirement for collateral rise most when applying for bank loans, with the net number of respondents to the question of whether they have increased or decreased being 37 pp. compared to 24 pp. among large companies. This share is common to euro area companies as a whole.

## Firms' opinions over banks' willingness to provide finance

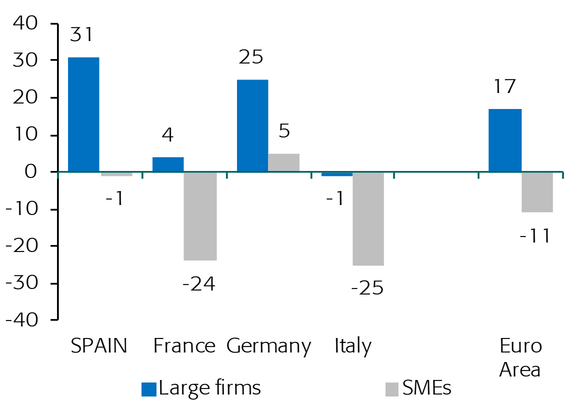
To shed some light on the exchange of accusations between the banks ("there is no solvent demand") and firms ("there is a restriction on supply") to explain the drop in bank credit, one of the questions of interest on the ECB survey is that asking firms to give their opinion about the banks' willingness to provide credit. As Exhibit 8 shows, SMEs blame the banks for the difficulties borrowing to a much larger extent, with a net "improved/worsened" response of -11 pp. in the euro area, compared with a positive response, in net terms, of 17 pp. among large firms. In Spain, the net percentage is also negative (-1 pp.) among SMEs, compared with a highly positive value (31 pp.) for large firms. In France and Italy too, SMEs that consider the banks to have become less willing to grant credit predominate, something that is not the case in Germany. In any event, even in Germany, large firms perceive a bigger improvement in banks' willingness to grant credit than do SMEs, with a net percentage of replies in this direction 20 pp. higher than that of SMEs.

Exhibit 8

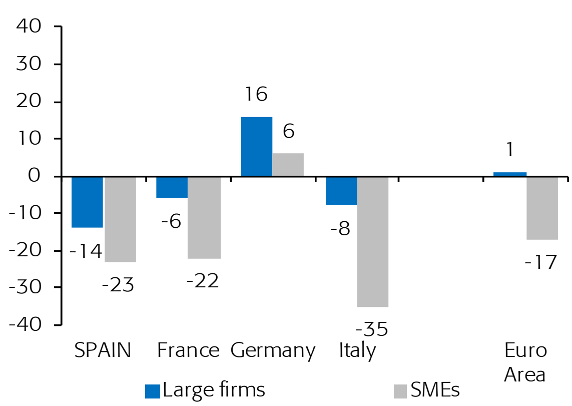
**Firms' opinion of banks' willingness to provide finance**

**Net percentage answers (improved/worsened)**

**a) October 2013 to March 2014**




**b) April 2013 to September 2013**




*Source: ECB.*

## Firms' expectations about the recovery in credit

Will the availability of credit for businesses improve and are there differences according to company size? To answer this question, the ECB asked companies whether they expected access to bank finance to improve or worsen over the coming six months. As Exhibit 9 shows, the euro area's large firms are much more optimistic than its SMEs about future access to credit, as the difference in the percentage of firms that expect it to improve and those that do not is 11 pp., compared to 1 pp. in the case of SMEs.

In this case, the number of Spanish businesses that are optimistic also exceeds the pessimists, with the difference higher than the euro area average (31 pp. *vs.* 11 pp.). SMEs have improved their expectations about the future of bank credit, although the difference between the improve/worsen responses is smaller (13 pp.), but higher than the European average (1 pp.). In the other countries, large firms in general are more optimistic about access to bank credit, although in Germany there is no difference between SMEs and large companies. The case of France is noteworthy, as it is the only country in which SMEs expecting the availability of bank credit to worsen predominate.

## Bank credit to new financing operations: Large firms *vs.* SMEs

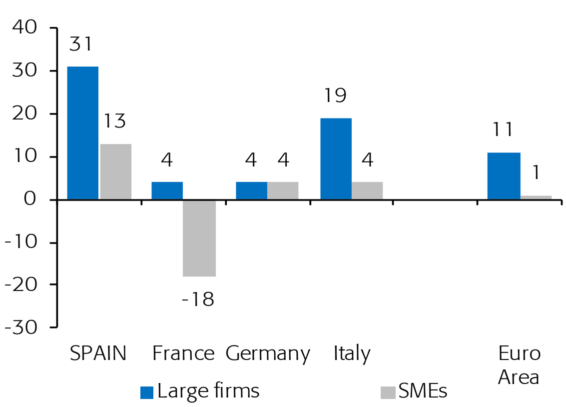
To round off this analytical tour of Spanish firms' access to bank credit as a function of size, it is worth examining recent developments in credit. The Bank of Spain provides information on new lending, distinguishing between transactions involving more or less than a million euros. This information needs to be interpreted with caution, as new transactions include refinancing, although under the Bank of Spain's new classification criteria in force since May 2013[3] these series will start to show the progress of genuinely "new credit" in recent months.

Exhibit 9

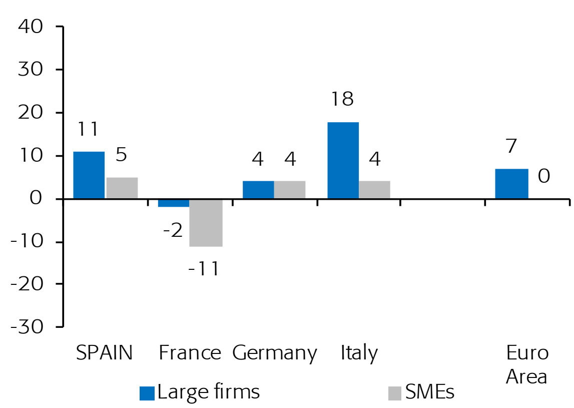
**Firms expectations of availability of bank financing in the next six months**

**Net percentage answers (will improve/worsen)**

**a) October 2013 to March 2014**




**b) April 2013 to September 2013**




*Source: ECB.*

[3] "Criterios para la aplicación de la Circular 4/2004 en materia de refinanciación y reestructuración de créditos" [Criteria for the application of Circular 4/2004 on refinancing and restructuring of credit] (Press release dated 31/04/2013).

Table1

**New credit transactions for Spanish non-financial corporations**

| | Millions of euros | | | Annual growth rate (%) | | |
|---|---|---|---|---|---|---|
| | Less than 1million € | More than 1million € | Total | Less than 1million € | More than 1million € | Total |
| May-13 | 11,362 | 19,153 | 30,515 | -16.1 | -44.4 | -36.4 |
| Jun-13 | 11,330 | 27,661 | 38,991 | -12.4 | -29.4 | -25.2 |
| Jul-13 | 12,442 | 21,409 | 33,851 | -6.9 | -31.2 | -23.9 |
| Aug-13 | 8,577 | 12,472 | 21,049 | -6.4 | -39.2 | -29.1 |
| Sep-13 | 10,517 | 20,771 | 31,288 | -1.4 | -0.8 | -1.0 |
| Oct-13 | 12,273 | 19,564 | 31,837 | 0.1 | -24.2 | -16.4 |
| Nov-13 | 11,576 | 20,279 | 31,855 | 4.7 | -9.8 | -5.0 |
| Dec-13 | 12,775 | 31,072 | 43,847 | 9.6 | 6.1 | 7.1 |
| Jan-14 | 10,973 | 17,842 | 28,815 | 5.0 | -16.9 | -9.7 |
| Feb-14 | 10,694 | 14,961 | 25,655 | 6.0 | -31.0 | -19.3 |
| Mar-14 | 11,795 | 18,767 | 30,562 | 5.1 | -16.7 | -9.4 |

*Source:* Bank of Spain.

Table 1 sets out the volume of new credit granted to non-financial corporations, expressed as a year-on-year growth rate since May 2013, distinguishing transactions involving more than a million euros from smaller ones. In the case of smaller loans, credit has been recovering since May 2013, with an increase in value of new credit since October 2013, with the growth rate at 5.1% in March 2014. The situation is diametrically opposite in the case of larger loans, as except for a one-off positive year-on-year rate in December 2013, in all the other months since May 2013 the rate was negative, dropping to -16.7% in March 2014. For total new credit it is still not possible to talk of recovery, as in 2014 the year-on-year growth rates were still negative, given that of the total transactions, around 65% were loans of over a million euros, for which the growth rates are most strongly negative.

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## Main messages and conclusions

The importance of SMEs in Spain and their high degree of dependence on bank financing makes an improvement in their access to finance essential to any strategy for economic recovery. The figures speak for themselves: 99.9% of Spanish businesses at the end of 2013 were SMEs and they accounted for 64.8% of value added (7 pp. more than in the EU-27 as a whole) and 74.8% of employment (8.2 pp. more than in the EU-27). And within SMEs, the majority are micro-enterprises (less than 10 employees and two million euros in assets), accounting for 40% of employment and 27.5% of the economy's value added. If we also take into account the fact that bank lending accounts for nearly 40% of Spanish

SMEs' external financing (just above 10 pp. more than for larger firms), it is clearly essential to improve their conditions of access to bank credit.

The data set out in this article lead to the conclusion that, in comparison with other euro area countries, the differences in the conditions of access to finance between SMEs and large firms are wider in Spain:

- Spain ranks first in the euro area in terms of the size of the difference between the interest rate paid by an SME (loan for less than one million euros) and that paid by a large company (loan for more than one million euros), with the spread in March 2014 standing at 229 b.p.

- 18% of Spanish SMEs report access to finance as their main problem, 4 pp. more than euro area SMEs and 2 pp. more than large companies.

- One indicator of the stricter financial constraints affecting SMEs than large companies is their fear of an application for a bank loan being turned down. In Spain, 5% of SMEs never even apply for a loan out of fear of being turned down, 3 pp. more than among large firms. And of firms that applied for a loan, just 2% of Spain's large firms said that they had been turned down, compared with 10% of SMEs.

- Spain's SMEs complain more than large firms about banks' increased demands for collateral and the bigger increase in non-interest costs (such as bank charges). Moreover, the percentage of Spanish SMEs (and also large firms) that state that the banks have tightened lending conditions is higher than the euro area average. SMEs also consider that the banks have become less willing to provide credit, which is in complete contrast with the perception of large companies.

These findings make it essential to put in place specific measures aimed at SMEs as soon as possible to improve their access to finance, in line with those set out in the draft bill on a law on business finance, and with some of the proposals recently made by the ECB in its latest report on financial integration. Europe is also very much aware of this problem, and has responded with European Commission initiatives to develop capital markets aimed at SMEs and those set out in its communication to the Council and the European Parliament on the long-term financing of the European economy.

Fortunately, the most recent data available show that new credit for SMEs (loans of less than one million euros) is rising in Spain, with positive year-on-year growth rates since October 2013, unlike the case of loans of more than one million euros. However, in the case of large firms, the contraction in bank credit can be offset by finance from other sources (intercompany loans, bond issues, etc.), which is difficult for SMEs whose ability to tap the markets directly for finance is limited.

Finally, the recovery in credit to SMEs revealed by the latest data on the progress of new credit is in line with the improvement perceived in the latest ECB survey on access to finance. Thus, comparing the findings of the most recent survey, published in April 2014, with that of six months earlier reveals an improvement in the availability of credit, although a bigger share of firms still take the view that conditions of access to finance have worsened (increased interest rates, charges, collateral requirements, etc.) than those who think they have improved. Moreover, the perception of Spanish businesses (and those of the euro area) about future expectations of the availability of bank financing have also improved, although much more so among large companies than SMEs.