

Access to Finance for Insular SMEs

Gozo Business Chamber

Mr Joseph Borg

‘Are European Policies suitable do help doing business on Islands’

Public Hearing organised by the EESC, ESIN and Insuleur

5th April 2019

Scope: The scope of the public hearing would be to question if access to finance for insular SME is more difficult that for continental SME from all points of view (information, existing European and National instruments etc) and if specific instruments should be adopted on European level to reduce this gap.

The European Commission helps small and medium-sized enterprises (SMEs) to overcome weaknesses in the financial markets by working with various financial institutions to provide them with funding.

This is done using EU financial instruments to increase the opportunities for small businesses to obtain finance from banks, through guarantee providers, and via venture capital funds.

As indicated by the Communication from the European Commission on an ‘Action Plan to improve access to finance for SMEs’ (2011) “SMEs often face significant difficulties in obtaining the financing they need in order to grow and innovate”.

According to a policy note published by the Central Bank of Malta it is highlighted that:

Access to finance is a critical component for the development of firms, since a firm that cannot respond to an investment opportunity loses out on raising its income. Indeed, it is especially crucial for SMEs, whose financial needs differ significantly from those of large enterprises.¹

As indicated by today’s title of the Public Hearing we have convened to discuss whether European policies are suitable to help doing business on islands. One cannot help but outline that while the difficulties faced by SMEs are significant, the difficulties being faced by SMEs on islands are greater, as they have added costs and difficulties which they have to face. They may also face added difficulties in the sense of information asymmetries, i.e. lack of information. While today’s digital world will surely help in keeping SMEs on islands connected to the world practical information sessions which are generally held on the mainland can prove really useful if they are held on islands.

In Malta in 2017 97.3 per cent of registered units were micro entities as they employed less than 10 persons². Malta as a country already faces a number of difficulties as it is already

¹ Sandra Zerafa, Access to finance for firms in Malta: Estimating the impact of reduced credit. Policy Note Central Bank of Malta (July 2017) (on-line) : <https://www.centralbankmalta.org/file.aspx?f=61637>

² NSO, *Business Demographics: 2012-2017* (2 May 2018) (on-line) : https://nso.gov.mt/en/News_Releases/View_by_Unit/Unit_B4/Business_Registers/Documents/2018/News2018_068.pdf

an island. The difficulties faced by the island of Gozo which depends on the main island of Malta, are even greater, as it suffers from what is generally termed as the double insularity factor, as it is an island within an archipelago of islands. And most importantly it is not the main island in the archipelago. In fact the main port and the airport are found on the main island of Malta. Other difficulties include the lack of infrastructure e.g. a second fibre optic link between the two islands which make the risks of doing business in Gozo even greater.

Traditionally Maltese entrepreneurs tend to prefer to go for debt type of financing rather than equity, as they prefer to retain control of their organisation (Peter James Sant, 2014)³. In a study published by the Central Bank of Malta it was highlighted that “SMEs in Malta continued to attach heavier reliance on bank financing when compared with their EU counterparts”.⁴

A number of financial instruments have also been launched in Malta and are specifically targeted to SMEs. Such financial instruments provided by financial intermediaries in Malta focus principally on interest rate reduction, and reduced collateral obligations.⁵ Examples of such financial packages in Malta include the popular JAIME financing package offered by Bank of Valletta under the SME Initiative Portfolio with funding from the EU under ERDF allocated to the Government of Malta and Horizon 2020 and by the European Investment Bank.⁶ Another example is the InnovFin SME guarantee scheme which supports research and innovation activities in small and medium businesses helping them to gain access to a source of lower cost finance.⁷

The Malta Development Bank also caters for SMEs which would otherwise not be accommodated by private sector intermediaries and different promotional initiatives are now in the pipeline. But are these enough?

The government in Malta has acknowledged the difficulties faced by Gozo and has positively discriminated for enterprises located on the island by increasing the thresholds when it comes to particular schemes. Nonetheless, what applies to Malta applies also to Gozo and that includes also the parameters imposed by the State Aid framework which caters for remote regions, but not islands. Thus, enterprises located on the island of Gozo have to carry a higher burden of expenses in terms of transportation costs as the main market is located in the main island of Malta. Thus the government has created a number of schemes under the *deminimis* framework which help to as much as possible neutralise the added transportation costs faced by Gozitan businesses in the manufacturing and agricultural sectors. The objective is to put Gozitan businesses on a level playing field as their Maltese counterparts. However, though beneficial the funds obtained through these schemes decrease the possibilities in accessing other funding under other schemes which are being administered under the *deminimis* framework, and which include also the financial instruments targeted towards SMEs. How are we going to resolve this impasse?

Gozo like many other islands in Europe experiences a very contradictory situation. Regions in Europe are classified as NUTS 1, 2 or 3. Due to its size and population, Gozo lies at the NUTS 3 level, i.e. it is considered as a region for statistical purposes only. In order to apply for EU structural funds, a region needs to be at level 2. Malta and Gozo together are on NUTS 2 level and so can apply for such EU Structural Funds together. The government in Malta has tried to reach a more equitable distribution of funds by ring-fencing 10 per cent of

³ Peter James Sant (2014), *SMEs access to finance next steps* (27 November 2014), in Themaltaindependentonline (on-line) : <http://www.independent.com.mt/articles/2014-11-27/business-news/SMEs-access-to-finance-next-steps-6736126467>

⁴ Sandra Zerafa, *Survey on Access to Finance (SAFE) in 2017*, in *The Central Bank of Malta Quarterly Review 2018: 2* (on-line) : <https://www.centralbankmalta.org/file.aspx?f=61856>

⁵ <file:///C:/Users/Inspiron%203721/Downloads/financial-intermediaries.pdf>

⁶ <https://www.bov.com/content/bov-jaime-financing-package>

⁷ <https://www.apsbank.com.mt/en/innovfin>

these funds for Gozo. In reality this is the minimum and Gozo can benefit much more than that.

There are also instances of positive discrimination such as example with respect to the schemes administered by Malta Enterprise, the country's economic development agency. In the case for example of the Investment Aid Tax Credits, while beneficiaries have to have thirty full time employees, any employee stationed in Gozo is counted as a 1.5 full time equivalent.⁸ Another scheme is the micro invest scheme. Through this scheme Malta Enterprise approves a tax credit equivalent to 45% of eligible expenditure. An additional bonus of 20% (that is a total of 65% tax credit) applies to undertaking operating in Gozo. While the capping per single undertaking is for € 50,000 over a three year period, for those entities operating from Gozo that capping is increased to € 70,000.⁹

As indicated by the Communication from the European Commission on an 'Action Plan to improve access to finance for SMEs' (2011) "SMEs will be a source for growth and jobs in Europe only if their access to finance is improved" (p. 14). The argument for SMEs based on islands is that access to finance needs to be facilitated further, if we really believe that SMEs are a catalyst for positive change to improve the economy on islands. However, even if we do this step, the root problem still remains. All of these schemes are tied to the *Deminimis* framework. Consequently, while the government may positively discriminate towards islands such as Gozo, thus putting islands at par when going for such schemes such as 'access to finance', the current position of state aid regulation puts islands into a disadvantaged position. That is why, we as representatives of insular chambers lobby for a change in the *Deminimis* framework.

Other difficulties however, need to be targeted as well. It is useless to have schemes which facilitate access to finance if SMEs are not properly informed about their utilisation. Even when it comes to information asymmetry, we as the Gozo Business Chamber have tried to provide access to information on current schemes to all our members by organising various information events including those relating to access to finance. On a national level the Government has launched an app on information for various schemes available on a national level. However, one-to-one contacts remain very important to help businesses on islands make the next step.

As a Chamber we are promoting the idea of have 'access to finance' packages targeted specifically towards islands like Gozo, dependent islands on the mainland, or on a main island as it is in our case.

However, the root problem i.e. that of a state aid regulatory framework which does not cater for the specificities of islands remains, and if this is not tackled islands can never be put at par with business on the mainland.

⁸ https://www.maltaenterprise.com/sites/default/files/Guidelines%20version%203.2_1.pdf

⁹ <https://www.maltaenterprise.com/sites/default/files/Micro%20Invest%20Incentive%20Guidelines%20version%207.pdf>