Analysis

Banks' share in corporate finance has increased in Finland

Financial stability | 09 June 2015 | Pertti Pylkkönen

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The financial difficulties of small and medium-sized enterprises in the euro area are gradually easing. Finance surveys indicate that access to finance has continued to be unconstrained in Finland, but the terms and conditions of loans are tightening. Collateral requirements are increasing, as is the use of various loan covenants in corporate finance.



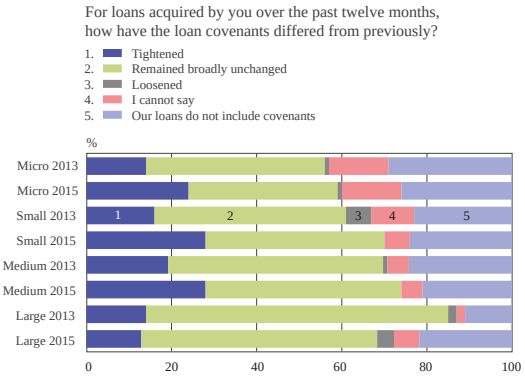
Lending rates in Finland below euro area average

In the distressed euro area countries, non-financial corporations' access to finance has been constrained for several years already. The stock of corporate loans granted by banks has contracted, and hence corporate sector indebtedness – bank loans and debt securities issuance relative to GDP – has begun to decrease slightly in several euro area countries. However, the tight financing conditions for euro area businesses would appear to be gradually easing. The decision of the Governing Council of the ECB to initiate the expanded asset purchase programme has improved the functioning of the bank-centred credit markets for euro area businesses.

The rate of contraction in the aggregate volume of bank loans to euro area non-financial corporations has slowed notably in recent months. Finance surveys carried out among euro area corporations also indicate an improvement in their access to finance. The surveys further suggest that interest rate margins have narrowed and other credit terms and conditions have eased in several countries.[1]

The interest rates on new corporate loans granted by Finnish banks have long been among the lowest in the euro area but have been increasing in recent months. At present, however, they are still below the euro area average (Chart 1).

Chart 1.



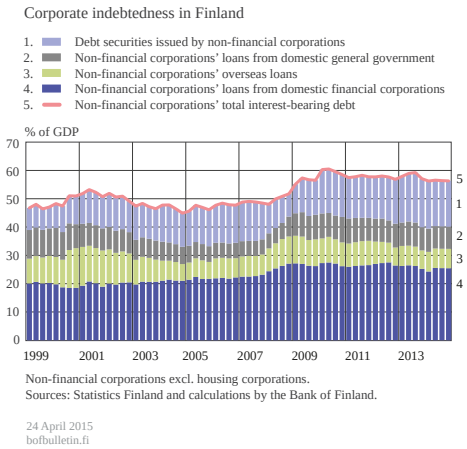
Source: Data from the Bank of Finland's Business Finance Survey.

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Financing costs increasing slightly

According to the Business Finance Survey conducted by the Bank of Finland in winter 2015, there have been no notable changes in access to finance. However, the survey indicates that the smaller the firm, the more impediments it faces and the higher its financing costs are. Collateral requirements have tightened and the use of loan covenants is increasing (Chart 2).

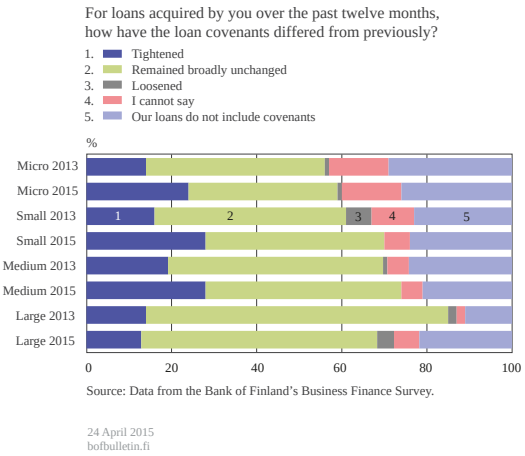
Chart 2.



A tightening in corporate finance is also suggested by the growing number of enterprises that have failed to obtain or have decided not to acquire new financing. There have been two divergent trends in the acquisition of new financing: over the past year, small enterprises have obtained or have attempted to acquire a larger amount of new funding than before, whereas medium-sized and large enterprises have reduced acquisition of external finance. Small enterprises' financing needs have related primarily to working capital. Larger enterprises have strengthened their financing structures and have also increased the acquisition of finance for machinery and equipment. Large enterprises further reported that they are slightly increasing external financing for the funding of investments.

The Business Finance Survey indicated that costs related to production and labour force were the most pressing problems faced by enterprises. Problems associated with demand for products and services have also increased. Business regulation is perceived to have increased from the previous survey round (2013). Access to finance continued to constitute a smaller problem than the above-mentioned factors (Chart 3).

Chart 3.



Source: Data from the Bank of Finland's Business Finance Survey.

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Condition of banks not an obstacle to growth in financing

The volume of short and long-term funding raised by Finnish enterprises on the markets contracted during 2014. The volume of bonds issued by enterprises declined by almost 10 percentage points during the year, and the volume of certificates of deposit also fell slightly. Borrowing from employee pension institutions has also been on a declining trend, while the volume of loans from banks has increased steadily. The share of finance companies in corporate finance has begun to grow. The banking sector's average capital adequacy has remained strong, and the condition of the banks does not present an obstacle to growth in corporate finance.

With respect to the alternatives for corporate finance, there are signs of nascent growth in new actors such as various alternative investment funds and crowdfunding. This will help single enterprises obtain funding outside the banking sector, but the volumes have so far been limited from the perspective of the corporate sector overall.

Operating environment has been difficult for years

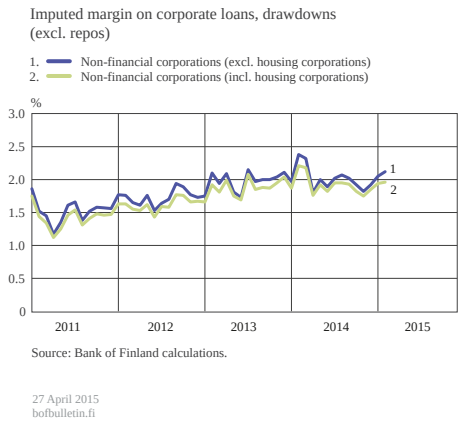
The operating environment for Finnish businesses has been difficult for years already, due to the ongoing restructuring in the corporate sector. Changes in the electronics and forest industries, in particular, have been strongly evident in the sluggishness of economic developments in Finland. Subdued domestic demand has also weakened the profitability of enterprises operating in Finland, e.g. firms in the trade and services sector.

Businesses have adjusted their activities and costs to the changes in the operating environment. Consequently, the corporate sector has remained profitable, but the profit share, i.e. the share of

profits in value added, has declined.[2]

With weakening demand for products and services, the corporate investment rate has been decreasing for several years and the capital stock is deteriorating. The sluggishness of investment has been reflected in demand for debt financing, and the total volume of interest-bearing debt of Finnish non-financial corporations has contracted slightly, despite the positive growth in bank loans (Chart 4).Company-specific differences in profitability and indebtedness are, however, considerable. For example, almost half of SMEs have no debt.[3] There are also significant differences in the profitability and indebtedness of listed companies, and there are many highly-indebted firms listed on the stock exchange.

Chart 4.



The economic recession has not been reflected in a growth in bankruptcies.[4] Neither has there been any alarming growth in banks' impairment losses. In 2014, impairment losses totalled over EUR 180 million. Relative to the corporate credit stock (excl. repurchase agreements), impairment losses were 0.10% of the credit stock in 2014. Banks' nonperforming assets related to corporate credit have also remained at a reasonable level, despite the difficult economic environment. At the end of 2014, nonperforming assets related to corporate credit amounted to EUR 2.5 billion, which was 3.5% of the credit stock. The growth in nonperforming assets was due to the harmonisation of the definition for these assets within the EU.[5] Nonperforming assets in accordance with the old definition contracted slightly in 2014.

European Capital Markets Union

In winter 2015, the European Commission published a Green Paper on building a Capital Markets Union. The purpose is to deepen the European financial markets and improve corporate access to

finance. A particular aim is to foster SMEs' access to finance. Greater diversification in business funding alternatives will also help increase the stability of the European financial system. When implemented, the Capital Markets Union will also enhance Finnish companies' access to finance.

Notes

1. 'Survey on the access to finance of enterprises' (SAFE, November 2014) and 'The euro area bank lending survey, 1st quarter 2015' (April). ↑
2. Statistics Finland (2014) Quarterly sector accounts. 4th quarter. ↑
3. Federation of Finnish Enterprises (February 2015) PK-yritysbarometri ('SME barometer') 1/2015. ↑
4. Statistics Finland (2015) Bankruptcies. ↑
5. For the change in the definition, see the Financial Supervisory Authority (1 April 2015) Valvottavien taloudellinen tila ja riskit ('Financial position and risks of supervised entities') 1/2015. ↑

Keywords

access to finance, Capital Markets Union (CMU), corporate finance