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EXECUTIVE SUMMARY
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Exploring the success and barriers to SME access to finance and its potential role in achieving growth

Dr Robyn Owen
Middlesex University
r.owen@mdx.ac.uk

Tiago Botelho
University of East Anglia
T.Dos-Santos-Botelho@uea.ac.uk

Osman Anwar
SQW
OAnwar@sqw.co.uk

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Research Questions

The primary objectives of the research were to examine: (i) the UK SME demand for external finance in terms of reasons for seeking, amount and types of finance sought; (ii) the level and reasons for borrower discouragement; (iii) the association between use of external finance and SME growth, and the characteristics of SMEs that are successful, growth oriented and discouraged.

Methodology

Our approach included initial quantitative exploration of the Longitudinal Small Business Survey (LSBS) 2015, a survey of 15,502 SMEs representing all types of SMEs in the UK. This initially included descriptive data, focusing on the external financing requirements of surveyed SMEs during the year prior to survey, examining key characteristics associated with finance access success, discouragement and growth orientation. Regression analysis was then used to sift out the key factors in relation to seeking external finance, success in accessing external finance (both overall and for different broad types of finance) and discouragement.

We then explored our key findings for greater explanatory insights through six qualitative semi-structured telephone interviews with frontline staff from Oxford Innovation responsible for assisting potential high growth and innovation focused SMEs with external financing.

Key Findings

There was widespread consensus between the descriptive analytical evidence from the LSBS 2015 and the qualitative business finance support provider interviews that obtaining external finance is significantly associated with SME growth.

Almost one in ten (9%) surveyed SMEs were discouraged (i.e. had external financing needs but did not apply), a third of which had applied for finance in the year prior to survey but then gave up and revised down their growth aims. This indicated that some growth oriented SMEs may grow faster if they could gain timely access to sufficient external funding.

Almost one fifth (19%) of LSBS 2015 surveyed SMEs had sought external finance in the year prior to survey: mostly relating to bank finance (43% loans and 42% overdrafts), credit card finance (51%) and leasing (36%). There were signs that demand for equity (6.5%) and P2P finance (4%) is rising in substitution for bank finance for younger, smaller SMEs.

The main reasons for seeking external finance were for working capital (51%) and equipment (42%). Only 7% mentioned growth finance and just 3% R&D. Surveyed finance advisors questioned whether R&D finance was under reported, insufficiently accounting for R&D tax credits.

The median level of funding received was £75,000: over a quarter (27%) obtained under £25,000, whilst one eighth (13%) received over £1m.

The majority of those seeking external finance (62%) only applied once, with one fifth applying three or more times. Persistence pays; the vast majority of applicants

(83%) obtain at least some external financing, 11% were still in transaction and only 6% received nothing.

Regression analysis revealed the significant (<.05 level) characteristics of the surveyed SMEs:

Who applies for external funding?

- Larger SMEs employers with 3 plus partner/directors and greater perceived capability to access external financing.
- Younger SMEs established for up to 5 years were more likely to apply for finance.
- Capital intensive sectors e.g. primary agricultural and manufacturing SMEs.
- Ethnic minority owned businesses and those in less deprived areas.

Who gets external funding (where received at least some external finance applied for)?

- Larger SMEs, obtaining larger amounts of finance, with better management resources and perceived financial access skills, and 3 or more partner/directors.
- Self employed were least successful and younger SMEs established for up to 5 years.
- Accommodation and catering sectors were least successful.

Who is discouraged?

- Smaller SMEs (notably zero employee and micro employer) and younger SMEs established under 5 years.
- SMEs with perceived poorer capabilities to raise finance and with less than three directors/managers.
- Women-led and ethnic minority led businesses.

Key Recommendations

From a policy perspective the main findings suggest that government ought to complement its efforts on the external financing supply side by stimulating the demand-side for finance to ensure that quality propositions are put in front of investors. This will require improved eco-system support through capacity development amongst business advisors, a better join-up in the business support landscape, and enhanced provision and take-up of investor readiness support (SQW, 2016; Baldock et al. 2015).

Policy

1. Better education for entrepreneurs on understanding their risk profile, the variety of finance available and identifying finance that suits their risk profile
2. Provision of investment readiness support which targets those that need it most – younger, smaller high growth businesses with particular attention to ethnic-minority, women-led and rural businesses.
3. Guidance and tools for smaller/younger businesses to improve their financial management and business development
4. Improve the all round financing ecosystem integrating entrepreneurial support with a full range of suitable financing along the finance escalator.
5. Enhancing existing datasets to provide more granular analysis of key factors in the future (see LSBS data recommendations).

LSBS data

1. The relationship between financial planning and discouragement could be explored further in future LSBS surveys, exploring firms' adaptation to a lack of external financing and the extent to which this stunts potential growth or strengthens business models.
2. Current LSBS data collection makes it difficult to calculate (i) whether businesses receive all of the external funding that they required and (ii) the extent of any shortfall in required external funding.
3. Collection of R&D tax incentive (tax credits) data might provide a greater indication of the extent of R&D financing required.
4. Despite the expanded LSBS size, the data is insufficient to conduct any robust examination of the financing requirements of young potential high growth SMEs and aspects of equity and new alternative financing (e.g. P2P, reward/donation and equity crowd funding). This can only be achieved by additional bolt-on sampling.
5. It is important that the LSBS is able to ascertain what type and source of external financing advice and assistance was received. This would help to examine demand-side and support network failures.

NEXT STEPS?

Future LSBS research should track the relationship between access to external finance and actual growth performance over time, including assessing how those that seek external finance but are discouraged actually perform.