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Exploring the Success and Barriers to SME Access to Finance and its Potential Role in Achieving Growth

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All views expressed in this presentation are those of the authors only

Introduction

Aims:

(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; the characteristics of SMEs that are successful in accessing finance, growth oriented and discouraged.

Methods:

- Descriptive and regression analysis of LSBS 2015 (n=15,002) – binary logit regressions for: seeking finance, overall access to finance, access to specific types of finance, discouragement
- Qualitative interviews with 6 Oxford Innovation frontline staff who deliver specialist finance and business support to potential high growth SMEs - to test data findings with practice

Key General Descriptive Findings

Key LSBS 2015 descriptive data (unweighted, focus on last year data):

- 36% sought and use some form of external finance in last 5 years
- 19% sought external finance in last year
- Credit cards (51%), bank loans (43%), overdrafts (42%), leasing (36%), factoring (9%), grants (7%), equity (6.5%), P2P (4%).
- working capital cash-flow (51%), equipment (42%), growth (7%) and R&D (3%)
- Median £75,000: 27% obtained under £25,000, 32% received between £100,000 and £1m and 13% received over £1m.
- 62% applied only once, 20% applied 3+ times
- 83% received funding, 11% still in transaction, 6% none
- Indications of increasing use of P2P and equity (from SBS 2014)
- Access to finance is highly significantly correlated (<.001) with employment and sales growth (current and forecast)
- Use of finance advice is negatively associated with access to finance

Key Findings (regressions beyond .05 level)

Who applies for external funding?

- Larger SMEs employers (3+ partner/directors). Associated with greater perceived capability to access external financing
- Younger SMEs est.<5 years more likely to apply for finance
- Capital intensive sectors e.g. primary, manufacturing, transport
- Ethnic minority owned businesses and those in less deprived areas

Who gets external funding?

- Larger SMEs, obtaining larger amounts, better management resources, perceived financial access skills, and 3+ partner/directors
- Self employed least successful and those established <5 years
- Accommodation and catering sectors least successful

Who is discouraged?

- Smaller SMEs and younger SMEs <5 years establishment
- Firms with poor capabilities to raise finance and less than three directors/managers.
- Women-led and ethnic minority led businesses

Qualitative findings - Testing data with practice

- **The experience of Oxford Innovation practitioners broadly confirmed the main findings from the LSBS data analysis** e.g.:
  - Types and amount of finance sought during previous 12 months (working capital for cash-flow; less R&D - tax credits unlikely to be perceived as external finance)
  - Larger firms (emp. size) with stronger management resource significantly more likely to access external finance (explained by risk appetite among lenders/investors)
  - Borrower discouragement among firms which are young/micro, no partners or directors, minority ethnic led, and SMEs with declared poor capabilities to accessing finance (busy “fighting fires” day-to-day; need updated business plans)
  - Business growth (previous year and predicted for next year) highly correlated with access to external finance (firms which experience actual growth or expected growth - and can demonstrate this with evidence - more likely to access external finance)
  - No strong correlation between no. of applications for external finance and past sales growth – this might suggest application success more related to strength of future growth predictions than past growth, but more likely to indicate future growth predictions revised down as a result of not receiving external finance

Firms will not grow without “correct” funds - need to ensure most appropriate finance at right stage of development

Qualitative findings - Testing data with practice

A few surprising observations…

- **Firms that used external finance finders and advisors were significantly less successful at accessing external finance and more likely to make more applications**
  - Important to distinguish between "distressed" early stage firms that engage advisors and those that do so as part of a calculated plan for growth
  - Approach of the distressed firms to raising funds not necessarily "tactical" or "strategic" but "reactionary" (requiring immediate "cash-injection")
  - Influential role of "trust and links" between finance finders and advisors – difference between long-term relationship advisors and those that provide short-term services
  - Incentive/remuneration method for advisors may also play a role in achieving positive outcomes for firms

Conclusions – initial recommendations

- Government ought to complement its efforts on the external financing supply side by stimulating demand-side for finance to ensure quality propositions are put in front of investors – requires support to improve capacity development amongst business advisors, a better join-up in the business support landscape, and enhanced provision and take-up of investor readiness support
- Access to finance problems are focused on Resource-Based problems – e.g. young, small, inexperienced entrepreneurial teams, often not suited to trad 'bank' finance and discouraged – lacking knowledge and suitable advice networks
- Older distressed SMEs also struggling and discouraged
- Concerns over value and types of business finance access advice – who provides what and timing of advice (whether too late)?
- Clear need for demand-side entrepreneurial IRP and education on availability and suitability of alternative sources of e.g. early stage finance and financing models

Limitations:

- LSBS 2015 not large enough to collect robust equity and alternative P2P finance data – especially for young potential HG SMEs
- LSBS lacks adequately information on types of external business advisor support
- Problems calculating fully or partially funded applications
- R&D funding (e.g. tax credits) – requires data linking
- Need to track businesses over time to fully understand finance and growth linkages