

Policy Briefing

Demand for external finance by environmentally-motivated SMEs: an exploration of geographical disparities and potential in relation to Net Zero

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Using UK Longitudinal Small Business Survey (LSBS) 2017-2021 annual data waves and geographical and digital accessibility indices, the paper investigates how regional disparities and peripheral location impact on the use and demand for external funding by green UK SMEs and social enterprises (SEs). Green SMEs are defined by the LSBS as those that declare having environmental goals as their sole or primary business objective, and those that have green objectives but prioritise profit-making. Social enterprises have social or ethical goals, generate income from trading activities, and use resultant profits to further those goals. Although the paper focuses on geographical disparities, it also examines whether the rise of digital finance and FinTech has changed how SMEs obtain external finance. The relationship between green external financing and SME skills and capabilities, future business intentions, industrial sectors and other business environment characteristics, such as urban versus rural location, local deprivation index, is also analysed.

Key findings

Our main findings, based on the analysis of the LSBS data and on econometric analysis, suggest that:

- Peripheral location is a hurdle for the obtention of bank-based external finance (loans, overdrafts and credit cards). SMEs prioritising environmental aims rely more on government grants and less on financial services than those that prioritise profit-making.
- Digital accessibility is altering the way SMEs approach their finances. It reduces the use of government grants. Higher digital accessibility has a significant positive impact on the demand for bank-based external finance.
- However, physical access to a bank is still important for green SMEs and SEs. Broadband access helps diversify sources of external finance, but so far it has not replaced the need for physical access to financial services.

The vast majority of all green SMEs are located in the South East of England, but the high density of green SMEs in Northern Ireland and the North West of England is noticeable. Scotland has the lowest density of green SMEs, and they tend to be located along the Glasgow-Edinburgh axis. Social enterprises also tend to agglomerate around large urban centres.

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- Both SEs and green mission SMEs are less represented in the 20% most deprived areas (8% and 12%, respectively). In the 20% least deprived areas there are similar proportions of SEs and green mission SMEs (27% and 28%, respectively).
- More SMEs have become green between 2017-2021. Only 10% of all SMEs have no environmental objective in 2021, against 30% in 2017.
- Around 80% of green SMEs expect to have about the same number of employees in the next 12 months; significantly more SEs intend to increase employment than SMEs.
- More environmentally-oriented SMEs than those without green goals had an increase in turnover in the past 12 months, and more SEs than SMEs expect turnover growth in the next 12 months.
- Three-fifths of UK SMEs with environmental objectives know about two or more UK SME energy efficiency related programmes. However, over half of the SMEs without green objectives have no awareness of energy saving schemes.
- The energy saving schemes that matter for SEs are different from those for green mission SMEs. About 39% of SEs are aware of the Energy Savings Opportunity Scheme, but only 1.2% are aware of The Renewable Heat Incentive. Around a third of SEs and SMEs are aware of the Private Rented Sector Energy Efficiency Regulations. Overall, however, only 3.6% of all UK SMEs that rent their premises are aware of this scheme.

Policy implications

- **The UK government needs to extend -and develop- schemes that increase the availability of external finance for green SMEs and SEs, irrespective of their geographical location.** Government policies such as the “nationwide gigabit-broadband by 2030” target presented in the Levelling Up White Paper in February 2022, and the 2017 Open Banking scheme could have major impacts on SMEs’ access to external finance.
- **An improved, coherent, national programme of SME Net Zero awareness,** with support and advice for SMEs to becoming Net Zero is required. Whilst the latest LSBS wave demonstrates that the number of SMEs without an environmental goal has declined since 2017, there is insufficient investment especially from SMEs that prioritise profit over green objectives.
- There is a need for further research on the implications of geographical peripherality -and specifically on the closure of bank branches- on the demand for banking services by SMEs. We found strong evidence that despite the increase in broadband coverage in all regions of the UK, being located close to a bank branch still matters for accessing bank loans. Is this a fundamental aspect of financial services or is it a remnant of a traditional way of banking that will disappear when digital finance becomes the default way of banking in the UK?
- There is a national data question to raise as per the lack of data on R&D investment and equity by UK SMEs. The LSBS is insufficient to capture this or a whole range of potentially useful aspects of decarbonisation practices SMEs might undertake in their business models.

Full paper link: <https://www.enterpriseresearch.ac.uk/our-work/publications/>