

Policy Briefing

Longitudinal Exploration of the Role of External Finance in Helping SMEs Achieve Growth, Higher Productivity and Potential in Relation to their Transition to Net Zero

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This report examines the multifaceted determinants of SME growth and productivity, drawing on a 2020-2023 panel from of the LSBS survey Wave 9. These secondary data were longitudinally explored through descriptive and regression analysis to address the following research questions:

RQ1: What determines differences in SME growth and productivity in terms of business characteristics, capabilities, export-orientation, future business intentions, and performance? (referencing LSBS sections A, B, C, G, J, N, P, and R)

RQ2: What are the impacts of different types of business support and of external finance on SME performance and ambition? (referencing also LSBS sections H, J, K, and P)

RQ3: Are SMEs' NZ transition objectives and future environmentally oriented business intentions related to SMEs growth and productivity? (referencing also sections D and E)

Key significant findings highlight the critical role of firm-level characteristics, particularly size, age, sector, environmental and strategic orientation, in shaping both growth ambitions and productivity outcomes. Firms with employees, formal business plans, and separate premises consistently demonstrate stronger growth orientation and higher productivity, suggesting that organisational capacity and strategic planning are foundational to performance enhancement. Access to external finance was found to be positively associated with improved turnover and employment outcomes, particularly during periods of economic recovery.

The panel analysis also allowed tracing how the adoption of environmental objectives evolved and influenced productivity between 2021 and 2023. A growing number of SMEs embraced environmental goals -some as their sole focus, others in addition to financial aims- and by 2023, those prioritising environmental objectives were significantly more likely to rank in the highest productivity quartile. This marked a notable shift from 2021 and highlights a strengthening link between environmental commitment and productivity performance.

These findings indicate that aligning UK SMEs' increasing environmental concerns and actions with appropriate policy instruments which combine finance and support to SMEs (e.g. through a national programme) could facilitate green sustainable growth and productivity.

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Key Findings

Growth ambitions and productivity

- **Firm size and employment capacity drive growth ambitions**

Firms with employees, especially micro (1–9 employees) and small (10–49 employees) SMEs are significantly more likely to aim for sales growth than sole proprietorships. Employment capacity appears to be a strong indicator of growth orientation.

- **Strategic and structural characteristics influence growth intentions and productivity.**

SMEs with formal business plans, separate premises, and non-family ownership are more likely to pursue growth. Family-owned, woman-led, and MEG-led businesses are less likely to aim for expansion, possibly due to structural or systemic barriers. Woman-led and MEG-led firms are underrepresented in higher productivity categories. Firms with up-to-date business plans and separate business premises are also significantly more likely to be in higher productivity bands. Lack of business planning and infrastructure correlates with lower productivity.

Sector and firm age matter: Transport, retail, and hospitality sectors show stronger growth ambitions than business services and other service sectors. Younger firms (especially 6–10 years old) are more growth-oriented, while older firms (20+ years) tend to maintain operations rather than expand. Larger and older firms, especially in production and construction sectors, consistently outperform smaller and younger firms in productivity. Micro firms (1–9 employees) show increasing productivity with size, while sole proprietors dominate the lowest productivity bands. *But geographic factors are less influential:* Region and urban/rural location show minimal impact on growth ambitions, with similar distributions across growth and non-growth firms.

- **Innovation and export orientation drive productivity gains**

Innovation is consistently associated with moderate productivity improvements across years. Exporting firms show a shift toward higher productivity over time, though export participation remains low. The data from 2020 to 2023 suggest a robust relationship between export activity, innovation, and productivity. Exporting firms and those introducing new goods are more likely to be found in higher productivity bands. Non-exporting firms dominate the lower productivity ranges and exhibit greater productivity variability.

Access to external finance, growth and productivity

- **Limited use and accessibility of external finance**

A significant proportion of SMEs consistently report using no external finance, with usage declining post-pandemic. Many businesses rely on short-term, high-cost instruments like credit cards and overdrafts, suggesting constrained access to affordable finance. Government grants played a temporary role between 2020 and 2023. Government grants, especially Covid-related, peaked in 2020–2021 but declined sharply by 2023. Non-Covid grants also fell, indicating a shift away from direct public support.

- **External finance positively influences turnover and employment**

Firms that obtained external finance showed better turnover and employment outcomes than those that did not, especially in 2021–2023. Chi-squared tests

confirm a statistically significant association between finance access and employment changes.

- **Profitability enhances access to finance**

Profitable firms were more likely to secure external finance, with access peaking in 2022. This trend reflects lender preference for financially stable firms, potentially excluding viable but currently unprofitable businesses.

Environmental objectives, growth ambitions and productivity

- **Growth-oriented and productive firms are more environmentally engaged**

Firms aiming to grow sales and those with higher productivity are more likely to offer environmental solutions and prioritise social and environmental goals. Environmental engagement increases with productivity, peaking in mid-range and high productivity bands.

- **Energy efficiency measures are driven primarily by cost reduction**

Businesses implementing energy efficiency actions are mostly motivated by financial savings, especially among growth-oriented and productive firms. Environmental or reputational concerns are secondary and more prevalent among mid-range productivity firms. However, there is a low adoption of energy efficiency measures across all firms, likely due to challenges such as landlord-tenant issues or lack of property ownership. Despite the benefits, only 15% of businesses reported installing energy efficiency measures in 2023. Adoption is more common among productive firms, but overall uptake remains modest.

- **Awareness of energy-saving schemes is uneven and correlated with productivity**

Higher productivity firms show greater awareness of schemes like the Renewable Heat Incentive and Energy Savings Opportunity Scheme. Lower productivity firms exhibit limited awareness, suggesting informational and resource gaps.

Policy and Practical Implications

This report proposes several policy measures to enhance SME growth, productivity, and net zero transition, as outlined below. Policy recommendations emphasise the importance of planning and longer-term horizons which will require policy continuity to build SME confidence and encourage strategic investment. These recommendations align with recent critiques of short-term public policy approaches, such as the shortcomings of the Shared Prosperity Fund (SPF), which have failed to adequately address long-term national strategic priorities (see Maher et al., 2025)¹.

1. Support for business growth and productivity

- **Strategic planning and infrastructure:** Offer grants and advisory services for business planning; improve access to affordable premises through local development schemes.
- **Sector-specific initiatives:** Tailor growth strategies for key sectors like transport, retail, hospitality, and services to encourage diversification and innovation.

¹ <https://news.exeter.ac.uk/faculty-of-environment-science-and-economy/government-must-overhaul-sme-climate-policy-with-less-focus-on-low-hanging-fruit/>

- **Inclusive growth:** Launch support programmes for underrepresented groups (e.g., woman-led and MEG-led businesses) and for businesses in deprived areas.
- **AI and Innovation:** Encourage AI adoption among SMEs to accelerate productivity improvements. This could include AI voucher schemes, digital skills training programs, and subsidised access to AI tools specifically designed for smaller businesses.
- **Export:** Promote grants and advisory services for SME firms to help them navigate the complexities of exporting. Firms deemed suitable for exports could be provided with tailored services to include mentoring and workshops from experienced exporters.

2. Improve access to external finance for growth and productivity

- **Long-Term Finance:** Implement credit guarantee schemes specifically designed for long-term financing that match investment horizons, alongside targeted grant funding to support investment in capital assets and non-current infrastructure.
- **Affordable finance options:** Develop low-interest loans and increase SME awareness of alternative financing models (e.g., peer-to-peer lending, asset-based finance).
- **Enhanced financial support mechanisms:** Improve the design and delivery of financial support, especially during economic shocks.
- **Inclusive lending practices:** Support viable but non-profitable firms through guarantee schemes and inclusive credit screening.
- **Targeted grant programmes:** Reintroduce and tailor grants for innovation, digitalisation, and green transition.

3. Support environmentally oriented aims to drive growth and productivity

- **Incentivise environmental engagement:** Encourage SMEs to integrate environmental solutions into their business models.
- **Promote energy efficiency:** Expand subsidies and cost-saving schemes for energy-efficient upgrades, especially for smaller firms.
- **Raise awareness of green and energy-efficiency schemes:** Launch outreach campaigns to improve visibility and uptake of energy-saving initiatives.
- **Create a national support programme of green business growth** offering consistent and widespread outreach to SMEs that:
 - brings together environmental business models with low-cost green incentivising investment and
 - supports offering energy and digital efficiency gains to stimulate growth.

Finally, the LSBS data set is limited by its biennial measurement of green orientation and reduced (one third cohort) collection of environmental investment data. This, combined with a lack of data relating to internal investment and the high level of longitudinal survey participant attrition, undermine research capability to determine the lagged impacts of green net zero investment on SME performance and productivity outcomes. Improved scale and clarity of SME green investment data collection is urgently required.

Full paper link:

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