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HAVE UK SMALL ENTERPRISES BEEN VICTIMS OF THE 'CREDIT CRUNCH'?

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INTRODUCTION AND RESEARCH OBJECTIVES

During the past year and a half, the world economy has experienced its severest recession since the 1930s (World Bank 2009; IMF 2009a). The crisis has led to the collapse, Government bail-out or partial nationalisation of major financial institutions in the US and Europe; to major programmes of fiscal and monetary reform; and to support for businesses and homeowners in the UK and elsewhere (HM Treasury 2009; IMF 2009b). There are emerging signs that the worst may be over, although recovery is likely to be slow (IMF 2009c). Most advanced economies have experienced falling output, although the crisis has been particularly keenly felt in the UK (Weale 2009) because of the degree of dependence on the hard-hit financial services sector and the high level of household indebtedness (e.g. OECD 2009; Simpson 2009). The UK has experienced falling Gross Domestic Product (GDP) for five consecutive quarters (ONS 2009a) and has undergone a decline in output equivalent to an annual drop of 5.5 per cent, a greater fall than the 3.5 per cent predicted by the Chancellor for 2009 (HM Treasury 2009). Other macroeconomic indicators reflect the decline in business activity. Unemployment has risen from 1.73 to 2.47 millions (7.9 per cent of the working age population) in the year to July 2009, Bank of England interest rate remains at a record low of 0.5 per cent, and the Retail Price Inflation index is currently negative, standing at -1.3 per cent. Some suggest the UK recession has finally bottomed out, reporting no change in output in the three months to September 2009 (NIESR 2009), although growth in the rest of 2009 and 2010 is expected to be 'fragile' (CBI 2009).

Popularly referred to as the 'credit crunch', commentators have expressed concern about the anticipated adverse impacts of the current recession and financial crisis on UK businesses through a reduced supply of credit (House of Commons Treasury Committee 2009) to add to the effects of declining demand. Small and medium-sized enterprises (SMEs), in particular, are argued to be particularly vulnerable to changing capital market conditions (e.g. FSB 2009a; FPB 2009). Given their contribution to output and employment, restricted access to finance is a major potential constraint on national economic performance. Official UK data sources show that businesses have suffered during the recession. One-in-120 active companies in England and Wales went into liquidation in the year to June 2009 through compulsory liquidation and creditors' voluntary liquidations (a 39 per cent year-on-year increase) or other corporate insolvencies during the same period (a 23 per cent increase). Individual insolvencies, which are relevant to unincorporated firms, also increased 27 per cent in the year to June 2009.[1]

This paper investigates whether, and to what extent, a sample of London-based small businesses have been victims of the 'credit crunch'. Although economic activity in London is not as weak as in the rest of the UK, it has been described as 'sluggish' (GLA Economics 2009). Specifically, the study investigates:

- the effects of the 2008/9 recession and financial crisis on small enterprises;
- small firms' adaptations to the 'credit crunch', with a particular focus on financial management and finance-seeking practices;
- the links between firms' financial practices and performance.

[1] http://www.insolvency.gov.uk/otherinformation/statistics/200908/index.htm

Next, we consider research and contemporary commentary on how recession and financial crisis influence small business financing. The second section proposes a conceptual framework for understanding the mechanisms through which the 'credit crunch' shapes small firm financing and subsequent performance outcomes. Then the methodological approach is outlined before presenting the findings and conclusions.

RESEARCH ON SMALL BUSINESS FINANCING AND CONTEMPORARY COMMENTARY ON THE 'CREDIT CRUNCH'

There is a large literature on small firms' sources of finance and the existence and size of a purported 'finance gap' in the UK, where SMEs have profitable opportunities but lack sufficient funds to exploit the opportunity (e.g. Fraser 2005; Jarvis 2006; Mason 2006; Wyer et al. 2007). Recessions, particularly those originating from financial crises, it might be argued, are likely to aggravate any such finance gap through their impact on the supply of finance to firms. Such downturns have been more severe and persistent than others, and recovery tends to be slower, especially when highly synchronised across countries (IMF 2009b: ch3). The current crisis produced major liquidity problems for the banks (Peston 2008; Cable 2009) that, in turn, have influenced lending practices. The Bank of England (2009a) reports that the three months to September 2009 witnessed the weakest flow of total net lending to UK businesses since the monthly series began in 1998 and that small firms face tougher lending criteria than large companies. Small businesses have increased their demand for both secured and unsecured lending in the three months to September 2009 but the supply of credit has decreased slightly (Bank of England 2009b). Moreover, likely policy changes mean that the banks may be forced to hold more cash in reserve and this will limit the growth in the supply of credit during 2009 and 2010 (IMF 2009c).

Considerable evidence has accumulated that SMEs in the UK have experienced difficulties accessing finance during 2008-9 and with cash flow (e.g. SERT 2009a, b, c). The Forum of Private Business report late payment and poor cash flow as the 'key issue' cited by their Economic Downturn Panel sample of September 2009, more important than lack of sales, banks' tardy decision making and the cost of bank lending (FPB 2009). The UK Department for Business Innovation and Skills bi-monthly 'business barometer' for June 2009 found that 44 per cent of SMEs reported difficulties accessing finance, including 33 per cent unable to access any finance at all, and 71 per cent of SMEs offering credit reported late payment as a problem (IFF Research 2009). The Scottish Government (2009) reports that the approval rate for finance applications has fallen, particular for micro firms where only 60 per cent report being able to secure any amount of finance, compared with 82 per cent in 2007, and for high-growth businesses, where approvals have declined from 79 per cent to 44 per cent during the 2007-9 period. A June 2009 study demonstrates that more than a million SMEs report payment delays, an increase of 65 per cent on a year ago, although the amount owed to individual SMEs has fallen from £38,000 to £28,000, suggesting there may have been a marked increase in the numbers owed small amounts (BACS 2009). The Federation of Small Businesses reports that many small firms are now waiting up to four months to be paid by large customers who often demand discounts for payments made within agreed, or customary, terms (FSB 2009b). In the context of difficult economic conditions, even short delays for small payments might impact severely on small business survival. But, there is

also evidence that small businesses are using cash flow and bank deposits to repay loans and overdrafts, giving rise to a net repayment of lending in July 2009 (BBA 2009).

Much commentary and analysis is based on survey data, reporting on owner-managers' perceptions of the 'credit crunch' and its effects on business performance. While this is useful evidence, such accounts often say little about the precise circumstances under which finance-related issues become prominent for particular SMEs, how business owners adapt to changed conditions, and with what consequences for business performance. This study attempts to address how and why SME owners have adapted to the 'credit crunch' in the ways they have, with a particular focus on financing activities.

ANALYTICAL FRAMEWORK: HOW DOES THE 'CREDIT CRUNCH' INFLUENCE SMALL BUSINESS FINANCING AND PERFORMANCE?

The study conceptualises small business responses to the 'credit crunch' as dependent both on human agency and the wider social, economic and institutional structures that enable and constrain their activity. Among these structures are capital, product and labour markets. Capital markets inevitably influence business behaviour by supplying finance to SMEs for investment and working capital purposes, and to their competitors, customers and suppliers. SMEs' financing needs depend upon business objectives and existing resources. Ambitious investment plans and limited internal resources indicate a requirement for high levels of external finance.

The 'credit crunch', defined as general conditions of constrained supply of affordable finance, might be hypothesised to influence small firm financing in several ways, some constraining business owners from achieving their objectives, while others are enabling. First, and most obviously, where banks refuse to extend credit to SMEs in the form of term loans or overdrafts, this is likely to encourage owner-managers to seek alternative means of financing or to scale down investment plans and/or operate with a reduced cash flow. Clearly, such impacts depend on SMEs' participation in such markets. Where SMEs rely exclusively on retained earnings, personal wealth or informal sources of finance, then the 'credit crunch' exerts no *direct* influence on financing behaviour. Second, the 'credit crunch' impacts SMEs *indirectly* through the reduced credit available to customers, suppliers and competitors; these indirect effects may be enabling or constraining for small business owners. Customers might reduce expenditure, or switch to cheaper suppliers. Suppliers might tighten credit terms or, desperate for business, accept delayed payments. Competitors might be unable to fund their own investment and cash flow needs or, alternatively, be encouraged to innovate in products and processes with implications for their competitive position. The outcome of these direct and indirect impacts is difficult to predict in individual cases.

Both of these processes - constraining and enabling small businesses - occur simultaneously, influencing SME activities and performance. Identification of particular constraints and enablements in relation to external finance, however, tells us nothing about *how* or *why* SMEs act in the ways they do, or what the consequences of adaptation are. Business owners always possess *some* degree of choice as to the sources and level of finance used, although the nature and extent of these changes are likely to be shaped by their previous

decisions and actions, as well as those of finance providers. Constraints on the supply of finance might, for instance, encourage SMEs to innovate with regard to accessing or deploying financial resources.

METHODS, SAMPLING AND DATA

To investigate the influence of the 'credit crunch' on small businesses, the study involved a two-stage research design: a combined online/mail survey conducted during March-August 2009 (343 useable responses)[2]; and face-to-face interviews with 26 of those business owners conducted June-August. All businesses were independent, employing fewer than 250 employees, and were tenants of a major provider of industrial and commercial property in the capital. Sample businesses varied by principal activity, employment and turnover size (Table 1). Most were micro businesses, operating in business, finance and professional services, and turning over less than £500k a year. The profile of the interview sample was broadly similar to that of the mail/online survey group.

Table 1
Business Samples: Online/Mail Survey and Interview Study

	Online/mail survey (% of sample)	*Interviews (% of sample)*
Micro (< 10 employees)	75.8	84.6
Small (10-49 employees)	20.1	11.5
Medium (50+ employees)	4.1	3.8
Manufacturing	10.8	3.8
Construction	4.4	7.7
Wholesale & retail	14.6	23.1
Information & communication	15.2	15.4
Business, finance & professional services	41.4	34.6
Healthcare & education	4.4	7.7
Other services	9.3	7.7
Less than £50k turnover in last financial year	11.7	11.5
£50-100k	10.2	15.4
£100-249k	20.1	26.9
£250-499k	15.2	23.1
£500-999k	11.4	11.5
£1m and above	18.7	11.5
No data	12.8	0
N	**343**	**26**
Note: percentages do not sum to 100 due to rounding.		

[2] A further 29 respondents provided only business profile data. These have been excluded from the dataset.

The interview sample was purposely constructed to include businesses reporting a wide range of performance outcomes since the start of 2008, from significantly increased sales or profit margins, through to significantly decreased sales or profit margins. The online/mail survey generated primarily quantitative data on the perceived effects of recession, business responses, changing patterns in the use of finance and finance-seeking behaviour, and actual and anticipated performance. The quantitative material provides descriptive data within which to contextualise the interview findings and permits statistical tests to evaluate the significance of differences between subsample groups at various levels of confidence. The interviews produced detailed qualitative data on business responses, linking these to owner-manager motivations, the business and market context, and to performance outcomes. Survey data was drawn upon in the interviews to prompt respondents. The study is of *surviving* businesses and does not, therefore, provide comparative data from non-survivors.

IMPACTS OF THE 'CREDIT CRUNCH' ON SMALL BUSINESS FINANCING

A deteriorating macroeconomic environment of falling GDP does not impact every small business in the same way or with the same consequences for financial management practice and business performance. The nature, timing and duration of the impact of recession and the 'credit crunch' for particular enterprises – as well as their responses and the performance outcomes achieved – are variable. Business owners might perceive the impact of recession in a variety of ways, all of which have financial repercussions - through falling sales or profit margins, increasing customer late payment and bad debt, tightening credit terms from lenders and suppliers, and via other sources. Others note similar impacts (SERTeam 2009a, b, c). Clearly, for some SMEs, the recession has been a period of business opportunity.

Online/mail survey respondents were asked whether the value of sales and profit margins had increased, decreased or stayed the same between the first quarter of 2008 and the first quarter of 2009. This period was considered sufficiently wide to encompass the start of the downturn[3] and to provide an adequate period over which performance change could be measured. The results demonstrate the range of performance outcomes achieved (Table 2). More firms reported lower sales and profit margins than higher figures, but the data show that many firms were able to improve performance: a quarter of businesses achieved higher sales revenues, and one in five achieved higher profit margins during the period. Other sources also demonstrate the wide variability of SME performance with regard to sales, employment, investment and selling prices (SERTeam 2009c).

[3] When the study commenced, the UK recession was officially dated as starting in Q3, 2008. Subsequent revisions to the GDP statistics led to the recession being officially re-dated to Q2. One might defend the choice of Q1, 2008, therefore, as a suitable benchmark on the grounds that business owners might have already been considering, or implementing, changes to products and practices *in anticipation of* recession. Public debate of forthcoming recession in the UK arguably extends at least as far back as September 2007, when a run occurred on the Northern Rock Building Society.

Table 2		
Business Performance Changes Between Q1, 2008 and Q1, 2009		
	Value of sales	*Profit margins*
Significantly higher	10.8	6.4
Slightly higher	15.7	14.0
About the same	19.2	27.4
Slightly lower	28.0	28.9
Significantly lower	23.9	20.4
No data	2.3	2.9
N	**343**	**343**
Source: online/mail survey		

Late payment and cash flow difficulties are not new experiences for small firms (Wilson 2008), although the recession appears to have exacerbated them (BACS 2009; FPB 2009). Respondents were asked whether their business had experienced positive or negative effects, either strong or slight, in relation to a number of potential recession-related effects since the start of 2008 (Table 3). Here we distinguish the five specific 'finance-related' effects most likely to reflect the influence of the 'credit crunch' from other types of effect - availability of bank loans/overdrafts, late payment by customers, bad debt or uncertainty over customer payments, credit periods and/or credit terms from suppliers, and cash at bank – while recognising that each of the other potential effects also has implications for business finance and performance.

Combining responses, 92 per cent of respondents reported a strong or slight negative effect associated with at least one of the five specific finance-related effects (39 per cent reported at least one strong negative finance-related effect).[4] Taking each effect separately, the proportions reporting strong or slight negative effects were: late payment (64 per cent); bad debts or uncertainty over customer payment (55 per cent); reduced cash at bank (49 per cent); tighter credit periods and/or credit terms from suppliers (34 per cent); and availability of bank loans/overdraft (24 per cent). These findings again highlight the heterogeneity of SME experience; firms do not all experience the 'credit crunch' in the same way. Together, the findings demonstrate the pressure on cash flow that many small firms have experienced during the current recession. Lower performing firms with regard to sales and profit margins, defined as those reporting the same or lower performance compared with a year earlier, were significantly more likely to report *any* negative finance-related effects than higher-performing businesses.[5] Lower-performing firms were also more likely to report negative cash at bank effects than higher-performing businesses. This is suggestive that finance-related effects have contributed to poor performance in these cases.

[4] In calculating this figure, and others in the paper, cases with missing data on the variables of interest are excluded.

[5] Chi-square tests have been used to determine levels of statistical significance. Relationships reported as significant are significant at the 5 per cent level, unless otherwise indicated.

Table 3
Experience of Recession-related Effects

	Strong Positive Effect (%)	*Slight Positive Effect (%)*	*No Effect (%)*	*Slight Negative Effect (%)*	*Strong Negative Effect (%)*	**N**
Finance-related Effects						
Late payment by customers	1.8	2.4	31.4	38.0	26.3	**334**
Bad debt or uncertainty over customer payments	1.2	0.9	42.8	38.9	16.2	**334**
Cash at bank	1.8	5.1	44.1	30.8	18.1	**331**
Credit periods and/or credit terms from suppliers	0.9	1.8	63.7	24.6	9.0	**333**
Availability of bank loans/overdrafts	2.1	3.0	70.6	13.2	11.1	**333**
Other Types of Effect						
Cost of supplies	2.7	5.4	43.6	35.1	12.9	**333**
Falling value of sterling	3.9	9.6	42.9	25.8	17.7	**333**
Transport costs	2.1	5.1	50.9	33.0	8.9	**336**
Energy costs	0.9	4.2	54.9	30.7	9.2	**335**
Staff motivation/effort	3.4	15.2	55.8	21.3	4.3	**328**
Ease of staff recruitment	7.5	21.6	61.9	5.1	3.9	**333**
Other	6.7	6.7	0	6.7	80.0	**15**

Notes: Ns vary due to exclusion of cases with missing data. Row percentages do not sum to 100 due to rounding.

Source: online/mail survey

In summary, sample businesses varied in their experience of finance-related effects, and of other types of effect. There is no single 'recession' or 'credit crunch' effect on SMEs, although the vast majority had experienced at least one type of finance-related effect. Some firms were affected severely by a range of finance-related factors, while others were much less affected, and many businesses achieve high levels of sales and profit performance. Although the results caution against over-generalising about the effects of the so-called credit crunch on small firms, the evidence also suggests that where finance-related impacts are experienced, they may contribute to lower levels of sales and profit margin performance.

BUSINESS RESPONSES TO THE 'CREDIT CRUNCH'

Business responses under recession conditions are influenced by the nature and extent of the impacts experienced (Geroski and Gregg 1997). Survey respondents were asked which actions, if any, from a prompt list they had taken since the start of 2008 (Table 4). Responses were categorised under nine broad types, listed in order of frequency of response:

- changes in sales and marketing;
- changes in markets;
- changes in employment;
- changes in products and/or services offered;
- changes in finance;
- changes in owner/manager behaviour;
- changes in production/business processes;
- changes in business organisation;
- changes in premises.

The results show that most firms had made multiple responses. Sample businesses reported implementing a mean of 8.1 actions (from the prompt list of 39) to improve or maintain business performance since the start of 2008. Almost all businesses (94 per cent) reported taking at least one of the listed actions. SME responses have been highly diverse during the recession although most combine cost-reduction and revenue-generating activities – what might be termed an 'ambidextrous' approach: 87 per cent of the sample reported *both* types of action. The specific actions most frequently cited were: 'introduced new or improved products or services' (58 per cent), 'personally working longer hours' (58 per cent) and 'increased sales effort' (56 per cent).

Interestingly, given the public debate about the 'credit crunch', it is perhaps surprising that so few respondents reported specifically finance-related actions, as defined here, although cash flow management is a common weakness in small businesses. Almost three in ten owner-managers (29 per cent) reported 'renegotiating terms with suppliers' but fewer than one in five reported any of the other specified actions – including 'reducing debt to external sources' or 'reducing investment expenditure'. Official statistics suggest that business investment has declined 22 per cent in the year to June 2009 (ONS 2009b). In contrast to the arguments of many commentators, this might indicate the limited demand for credit on the part of small business owners, as some sources report (Intuit 2009).

Table 4	
Actions Taken to Increase or Maintain Performance Since the Start of 2008	
Actions Taken	*% of sample*
(a) Changes in sales and marketing:	*82.8*
Increased sales effort	56.3
Reduced selling prices, or held price rises below inflation	26.5
Increased advertising & promotional expenditure	24.5
Reduced advertising & promotional expenditure	14.3
(b) Changes in markets:	*76.7*
Selling to new types of customer	47.5
Selling more to existing customers	40.2
Selling in new geographic markets	27.4
(c) Changes in employment:	*72.6*
Reduced numbers employed	31.2
Introduced wage/salary freeze	19.5
Introduced new working practices	19.0
Increased use of external labour (e.g. sub-contractors, freelancers, agency temps, casuals etc)	17.8
Increased numbers employed	17.5
Taken greater care in recruitment of staff	14.6
Increased employee training	13.7
Increased use of unpaid family labour	5.2
Reduced employee training	2.6
(d) Changes in products and/or services offered	*64.4*
Introduced new or improved products or services	57.7
Reduced the range of products/services offered	8.7
Increased use of intellectual property (e.g. patents, registered design, registered trademarks, copyright)	5.0
(e) Changes in Finance:	*64.4*

Renegotiated the cost of supplies	28.6
Invested personal savings	19.2
Shortened payment periods from customers/creditors	15.5
Reduced debt to external sources	14.3
Extended payment periods to suppliers	13.1
Reduced investment expenditure	12.0
Increased debt financing	6.7
(f) Changes in Owner/Manager Behaviour:	*63.3*
Personally worked longer hours	57.7
Cancelled personal holidays	23.0
Sold personal assets to compensate for poor business performance	5.2
Other changes in owner-manager behaviour	6.1
(g) Changes in production/business processes:	*52.5*
Used new suppliers	34.7
Invested in new equipment	25.9
(h) Changes in business organisation:	*38.8*
Made changes in managerial roles/functions	32.4
Made changes in the management team	15.7
(i) Changes in premises:	*28.6*
Relocated the business to cheaper premises	15.7
Opened new branches or outlets	7.0
Closed branches or outlets	5.0
Negotiated a change in the duration of the lease	2.9
N	**343**
Notes: respondents were asked to report actions from a prompt list, and could indicate all, some or none from the list. Italicised figures refer to those reporting *any* of the actions within each of the nine categories.	
Source: online/mail survey	

Firms experiencing the five specific finance-related effects were significantly more likely to implement finance-related responses to improve or maintain business performance since the start of 2008. For instance, those reporting negative late payment effects were significantly more likely to report action to shorten payment periods from customers/ creditors, to extend payment periods to suppliers and to reduce debt to external sources. Such responses do not, of course, guarantee higher sales or profit margins; they might simply stem the decline. The only significant relationships found were: those with higher sales were more likely to have reduced debt to external sources and less likely to have reduced investment expenditure; and those with lower profit margins were more likely to have extended payment periods to suppliers.

One owner-manager, having reported negative effects associated with all five specific finance-related effects in the survey, reported action on pricing in interview. By linking discounts to prompt payment, the business had improved sales and cash flow position albeit at the cost of reduced margins. The business had experienced a massive drop in annual sales from £750k to £300k in the last financial year. Various measures had been implemented to set the business on the path to a target of £1.2m in the next financial year, with the business reportedly on track – including employment reductions, the introduction of a 4-day week, relocation to smaller, cheaper premises and extending payment periods to suppliers.

> "Because we've had to negotiate better pricing or, even, better rates because we can get the money in quicker. So we've had to incentivise some of the sales and that has affected the bottom line, I suppose ... For some of our larger clients, they've said 'Look, we've got to cut our budget, what can you help us do?' We were like 'Ok, I'm happy to lower the daily rate slightly so there's a 10 per cent decrease in that. If you pay us quicker, we can give you 5 per cent for payment in seven days', kind of thing." (Business #1: Information management consultancy, 5 workers).

In summary, small business responses to the 'credit crunch' have been diverse, reflecting the particular circumstances and perceived need for adaptation. Finance-related responses are one type among many that SMEs have implemented but there are many other actions owner-managers might take that generate financial consequences. Some firms have introduced finance-related changes but other types of response have been more common. In the next section, we examine changes in firms' financing behaviour and explore the reasons for change.

CHANGING PATTERNS OF FINANCE

SMEs use a wide range of sources of finance to conduct their operations, including personal savings, investments from family and friends, as well as external formal sources such as bank loans and overdrafts, asset-based finance and trade credit (Fraser 2005). It might be hypothesised that the 'credit crunch' would lead small business owners to reduce use of bank loans and overdrafts for both supply- and demand-related reasons, and to increase their use of personal or informal sources of finance. On the supply-side, the evidence suggests that credit markets have tightened during the recession with small firms

experiencing difficulties accessing affordable finance (Bank of England 2009a, b; FSB2009b; FPB 2009). On the demand-side, small business owners might simply scale down their demand because they perceive no need for external finance to achieve their aims. Where SMEs face diminished demand for their products and services, external finance for investment and working capital purposes may be judged unnecessary. SME owners might also be discouraged from applying for finance, believing finance providers to be reluctant to supply. On the other hand, some SME owners might increase the demand for external finance, in order to deal with actual, or anticipated, cash flow difficulties. The data can be explored to throw light on the question as to whether supply- or demand-side explanations carry more weight.

Survey respondents were asked about their use of different sources of financing and whether there had been any change in financing since the start of 2008 (Table 5). Half of the sample (50 per cent) reported using some form of external finance since the start of 2008, with 34 per cent dealing with any effects of recession solely from their own resources (16 per cent provided no data on this issue). This is a lower figure than the 80 per cent reported by Fraser (2005) in a survey of 2,500 UK SMEs. The dominant purpose for accessing external finance during this period was for working capital, although a number of firms also used it to buy fixed assets, to develop new products and services, or to undertake a marketing campaign. The need for increased working capital provision is typically associated with increasing pressure on cash flow, although this might also reflect business expansion as well as tightening credit conditions.

The big picture is one of limited change in the pattern of financing. For eight of the 10 types of external finance, the most common response was that the business had never used it. The vast majority of respondents (79 per cent), for example, reported never receiving a bank loan and 50 per cent had never used an overdraft. The interview data illustrates the aversion to debt, which is a common attitude expressed by small business owners. Several respondents celebrated their self-reliance, claiming that had they been saddled with debt, business performance would have been much weaker and, in some cases, might have led to closure. This might be particularly the case with micro firms with limited resources and sales revenue. A furniture designer/manufacturer, suffering declining sales in the early months of 2009, responded by injecting personal savings, believing the business would have folded in the present recession if it had debts to service.

> "I'm terrified of having debts at the moment ... Traditionally, I've had my money in National Savings or something, earning 7 or 8 per cent interest or more. That's gone down to effectively nothing at the moment. That money's just sitting around. So, rather than taking on credit card debt, it makes much more sense to invest from personal savings if I need to pay for a particular piece of equipment, or cover a bill that I can't quite meet from earnings in a month, or something like that." (Business #3: furniture designer/manufacturer, 3 workers)

Table 5

Changes in the Use of Different Types of Finance by Firms 2008-9

	Increased Use (%)	*No Change (%)*	*Decreased Use (%)*	*Never Used (%)*	**N**
Bank overdraft	17.1	28.0	4.9	50.0	**286**
Bank loans	3.7	13.4	4.1	78.8	**269**
Business credit cards	12.3	50.2	5.8	31.8	**277**
Personal credit cards	11.2	39.7	8.2	40.8	**267**
Leasing or HP	6.5	30.8	5.8	56.9	**260**
Trade credit	10.7	46.0	1.5	41.8	**261**
Factoring etc	3.4	14.5	0.8	81.3	**262**
Grants or subsidised loans	3.1	9.3	0.4	87.3	**259**
Informal equity finance (i.e. family & friends)	7.3	12.7	0.8	79.2	**260**
Formal equity finance & business angels	2.7	10.5	1.6	85.3	**258**
Personal savings	22.1	24.4	3.3	50.2	**271**
Other types of finance	83.3	n/a	16.7	n/a	**6**

Notes: rows do not sum to 100 due to rounding. Ns vary due to exclusion of cases with missing data.

Source: online/mail survey

Of those reporting that they had used a particular source of finance at some time, for all types of finance, the most common response was 'no change' in use, as opposed to increasing or decreasing use. Firms that had traditionally relied on a combination of retained profits and personal savings, tended to continue existing practice during recession, rather than seek external finance. Such an approach presupposes owner-managers have access to adequate business and personal resources. Owner-managers often reduce their business drawings when revenues decline (Business #9: Estate agent/property management services, 10 workers). This contributes to firms' short-term resilience but, depending on resource levels, may not be sustainable for an extended period.

Aversion to taking on debt is also reflected in many owner-managers' preference for resourcing activities from retained earnings and personal wealth. The only sources of finance showing any significant increase among the sample were personal savings and bank overdrafts, both of which are often used in response to pressures on cash flow. Understandably, personal savings was the source most commonly increased (22 per cent), most frequently by lower-performing firms with regard to sales and profit margins.

Increasing use of external sources was reported infrequently (Table 5). One in six (17 per cent) reported increasing the use of bank overdrafts and 4 per cent increased their use of bank loans. Additional trade credit was obtained by 11 per cent of business owners. There was some evidence of 'bootstrapping' methods of finance – use of business and personal credit cards – although some also reduced their use of such methods: 12 and 11 per cent reported increased use of business and personal credit cards respectively. Both of these methods are considered convenient by business owners but very expensive and unlikely to be sustainable in the long-term.

Many businesses faced increasing difficulties as the recession resulted in an increase in payment delays by debtors. Not surprisingly, SME owners responded in kind, delaying payments to suppliers. Several respondents reported that suppliers were often amenable to adjusted payment terms, insisting they would rather take payment late than lose a customer and have no payment at all.

> "We had to push them out a little bit. It wasn't about credit limit, it was about saying to them: 'Look we are in a bit of a hole at the moment ... If we go skint, if we cease trading you'll get nothing or you'll get a small percentage in the pound. If you work with us, we can dig ourselves out of this hole because the balance sheet will be repaired'. They all have been supportive but we have let them wait for their money." (Business #21: removals and recycling service, 13 workers)

Increases in the use of external finance were often associated with one or more of the five specific finance-related impacts included in Table 2. Such correlations suggest that cash flow difficulties were a cause of changes in financing behaviour and, specifically, the substitution of one form of finance for another. Those reporting negative effects in terms of the reduced availability of bank loans and overdrafts were much more likely than those not reporting such negative effects to increase their use of business and personal credit cards, trade credit, informal equity from family and friends, and personal savings.

In summary, the evidence on SME financing challenges some of the more apocalyptic claims made by commentators regarding the impact of the 'credit crunch'. First, it suggests that the impact of the 'credit crunch' is less wide-ranging than some have envisaged. Most reported either never using particular sources or reported no change in their use of particular types of finance. Four in five business owners reported never having a bank loan and one in two had never used an overdraft. This suggests that credit market conditions have only a limited *direct* influence on SME behaviour and performance. Second, some businesses have increased their use of particular types of finance. These were primarily lower-performing firms in terms of sales and profit margins and those experiencing specific difficulties accessing bank finance, suggesting some degree of substitution in response to particular difficulties as falling sales reduce revenue.

UNSUCCESSFUL FINANCE-SEEKING

The 'credit crunch' might be hypothesised to influence the outcomes of SME finance-seeking in a number of ways. First, as the Scottish Government (2009) found, SMEs might experience a declining success rate in applications for finance during the downturn, reflecting tighter supply constraints. Second, it might also be hypothesised that SMEs are more likely to be discouraged from applying for external finance, anticipating that the banks (or other providers) will refuse it (Kon and Storey 2003). Reduced aggregate demand for bank credit might, paradoxically, lead to a higher success rate among those that do apply.

Survey respondents were asked if they had made any unsuccessful, or only partially successful, applications for finance from external sources since the start of 2008. Several owner-managers (32 per cent) reported an unsuccessful/partly successful application for at least one form of finance. Unsuccessful/partially successful applications were reported for bank overdrafts (18 per cent of the sample), new business credit cards (14 per cent), trade credit (12 per cent) and for bank loans (11 per cent). Fewer than 10 per cent had made an unsuccessful/partially successful application for any other types of finance, since the start of 2008.[6] These figures do not seem to be worse those Fraser (2005) reports. Using a 3-year reference period, he found that 16 per cent of businesses were rejected outright for an overdraft and more than one in three did not obtain the finance they wanted. For bank loans, the figures were 9 and 6 per cent respectively. In other words, these results suggest that unsuccessful applications for bank finance were not significantly higher since the start of 2008 than they had been in the pre-recessionary period.

In the present study, those businesses reporting negative impacts in relation to bank loans and overdrafts, bad debt or uncertainty over customer payments, suppliers' credit terms and cash at bank were significantly more likely to report an unsuccessful/partly successful application for finance than those not reporting negative impacts. Interestingly, there was no correlation between those making an unsuccessful/partly successful application for finance and either size measures (employment and turnover) or performance measures (sales or profit margins), although assets and track record are often argued to be important influences on bank provision of finance. This latter finding suggests genuine supply-side

[6] These figures are based on those responding to each of the questions. Approximately, one fifth to one quarter of the sample did not answer the questions. The figures would, therefore, somewhat lower than those reported in the text if the sample of 343 was used as the base.

constraints on SME access to finance during the 'credit crunch', but only for a minority of the sample.

Firms that had *not* applied for external finance since January 2008 were asked their reasons why not. The vast majority of business owners reported no need for external finance (72 per cent), 14 per cent suggested their application would not be successful and 9 per cent said they could not afford it. Other sources also identify lack of need as the key reason for not applying for external finance (Scottish Government 2009). Comparison with Fraser (2005) suggests the sample included a slightly higher proportion of discouraged borrowers, possibly reflecting the tighter credit conditions prevailing under recession conditions, but the differences were minor. The data suggests that demand-side reasons were the primary cause of owner-managers' not seeking external finance, linking finance-seeking with the perceived lack of profitable business opportunities. Higher-performing firms with regard to sales and profit margins were significantly more likely to report no need for external finance, suggesting that revenue was sufficient for current needs.

In summary, despite the publicity given to the effects of the banking crisis on small firms, the direct effects in terms of increasing the difficulty of obtaining loans and overdrafts seems to have affected only a minority of firms. This is arguably due to many firms' limited reliance on bank finance and to their scaled-down business plans in what is currently a very difficult trading climate for many SMEs. It should be recalled that the survey includes only survivors and predominantly consisted of small and micro enterprises rather than medium-sized companies. Whether non-survivors had a higher propensity to rely on bank finance and that failure to acquire it on affordable terms contributed to their non-survival is not known.

CONCLUSIONS

The purpose of the paper has been to consider whether, and to what extent, UK SMEs have been victims of the 'credit crunch'. The 2008/9 UK recession has been reported as the worst since the 1930s, involving the near-collapse of the banking system. It might be expected, therefore, that a large proportion of small businesses have been affected by credit restrictions with impacts on investment and working capital. Whilst the empirical results cannot be generalised from London to other regional or national contexts, the scale of the recession and the associated 'credit crunch' in Britain lead us to expect stronger impacts on small firms there than in some other European countries. The two-stage research design reported on here has enabled us to provide a more nuanced view of how the 'credit crunch' has influenced small business financing and performance than studies based on survey evidence alone. Several major findings are presented.

First, small firms have experienced the 'credit crunch' in a wide variety of ways. Some firms report negative finance-related effects such as late payment from customers, tightening credit terms or bad debt or uncertainty over payments but others do not. Moreover, firms reported wide variation in sales and profit margin performance, despite the reduced access to credit. Simplistic arguments that all small businesses *necessarily* suffer during periods of generalised credit restrictions must be rejected. Businesses, even small ones, are often able to chart a path through difficult conditions to ensure survival and, possibly, for some, higher

levels of performance. How small businesses adapt to changing conditions necessarily influences performance.

Second, small firms' adaptations to the 'credit crunch' are diverse. Sample businesses differed considerably in the number and type of actions taken to improve or maintain business performance during the recession period. Firms adapted through product innovation, working longer hours and increased sales effort, and also, but less commonly, by specific finance-related actions, including renegotiating the cost of supplies. The limited importance of most finance-related actions suggests that other actions are considered more appropriate in prevailing circumstances or, alternatively, that finance-related actions cannot be implemented, either because they are not directly under the control of the owner-manager or because financial managment is not one of the latter's strengths.. No particular mode of adaptation to the 'credit crunch' can guarantee a high level of performance, or even business survival, during recession.

Third, SME adaptations and performance are contingent upon a wide range of organisational, market and wider institutional factors. The resources available, the coincidence of ownership and management, and credit market conditions are key influences on business response and performance. Because of limited resources SMEs are often vulnerable to falling sales, late payment, bad debt or uncertainty over payment, and tightening credit terms, and they may lack the capacity to adapt adequately to 'credit crunch' conditions. Financial management is a good example of how the effects of recession and firms' responses to it are influenced by previous behaviour. Owner-manager aversion to debt is a feature of many small businesses and a preference for self-financing may protect SMEs, for a while at least, from tightening credit conditions. Many small businesses have avoided the direct impacts of the 'credit crunch' because they rely exclusively, or mainly, on internal sources of finance, including business and personal wealth, although the sustainability of such an approach is likely to be affected by a combination of the size of their resource base and the longevity of recession. Moreover, the success of any adjustment is always contingent upon the actions of others. Competitors, for example, will adapt more or less effectively in the current climate.

To conclude, UK small businesses are not universally victims of the 'credit crunch'. Small business owners are able, through their own activities, to demonstrate some degree of resilience, and to avoid the worst impact of restrictive credit market conditions. To what extent SMEs can sustain their resilience in the long-term depends on resources and firms' wider capability to adapt products and practices, including financial management, in a way that secures survival and high levels of performance. The 'credit crunch' constitutes an environmental shock with which SMEs must deal but its precise impact is contingent upon how businesses respond given the resources to hand.

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