ICAS

Reluctant borrowers? Examining the demand and supply of finance for high growth SMEs in the UK

Ross Brown
Neil Lee

RELUCTANT BORROWERS? EXAMINING THE DEMAND AND SUPPLY OF FINANCE FOR HIGH GROWTH SMES IN THE UK

by

Ross Brown
Neil Lee

Published by

ICAS

CA House 21 Haymarket Yards Edinburgh EH12 5BH

First published 2017

ISBN 978-1-909883-37-6
EAN 9781909883376

This report is published for the Strategy & Research Advisory Group (SARAG) of ICAS.

The views expressed in this report are those of the authors and do not necessarily represent the views of the Council of ICAS or SARAG.

Printed and bound in Great Britain by Rethink CMYK Ltd

CONTENTS

FOREWORD

High growth small and medium-sized entities (SMEs) are an important contributor to the economy and job creator in the UK. But is the demand and supply of finance to this section of the economy impeding growth? And if so, what can be done to improve access to finance and growth? Should funding initiatives be specifically targeted at high growth SMEs?

This report addresses these important questions by analysing the borrowing requirements of SMEs (high growth and non-high growth) and the factors that may deter or discourage such firms from borrowing. The research is based on a survey and interviews with high growth and non-high growth SMEs and interviews with banks, alternative finance providers and UK policy makers.

The research finds that there is strong demand from SMEs for external finance but that there is also a high number of discouraged borrowers with a lack of trust for banks a continuing issue. The impact on growth of being either reluctant or unable to borrow is significant – with 63% of survey respondents expressing the view that the absence of funding would lead to either more modest levels of growth, a clear reduction in growth or closure of the business.

The study finds no evidence that high growth SMEs suffer more problems accessing funding than other SMEs. In fact, high growth SMEs are generally more positive about the relationship they have with their banks than non-high growth SMEs. However, newer and smaller high growth SMEs do place much less trust in banks as sources of finance and this may be impeding growth. A key reason for this lack of trust are the conditions being attached to bank borrowing.

The report concludes with policy recommendations, suggesting that focusing purely on supply side measures will not be sufficient to address ongoing external funding issues for SMEs.

The ICAS Strategy and Research Advisory Group has been pleased to support this project. The views expressed do not necessarily represent those of ICAS, but we hope that the report will contribute to the important debate on how to encourage growth in the SME sector.

Lisa Evans
Acting Chair of ICAS Strategy and Research Advisory Group

June 2017

ACKNOWLEDGEMENTS

The authors are extremely grateful to ICAS for generously funding the research reported. The Strategy & Research Advisory Group and researchers are grateful for the financial support of The Scottish Accountancy Trust for Education and Research (SATER), now known as the ICAS Foundation (charity registered in Scotland SC034836). Without this support, exclusively from the SATER funds, the research would not have been possible. In particular, the researchers also wish to thank the invaluable help and support from Michelle Crickett, Amy Hutchinson and Ange Wilkie in helping undertake this research project. Thanks are also offered to members of the ICAS Business Policy Panel for their extensive comments on the survey instrument and help accessing interviewees. The authors are also grateful to Alex Stanley and Sophie Cadden for research assistance undertaken on various aspects throughout the duration of the project. The research team also wish to acknowledge Dr Suzanne Mawson, University of Stirling who undertook analysis of the FAME business database to enable identification of the sample of UK high growth SMEs. The usual disclaimer applies.

EXECUTIVE SUMMARY

Background and method

High growth firms are considered crucial for improving productivity and enhancing economic growth, yet little is known about their funding requirements.

This report outlines the findings of a major investigation of funding issues within high growth small and medium-sized enterprises (SMEs) in the UK. High growth SMEs are enterprises with average annualised growth in employees or turnover greater than 20% per annum, over a three-year period, and with more than 10 employees at the beginning of the observation period.

The research was informed by two overarching research questions: What are the borrowing requirements of non-high-growth firms; and what factors deter or discourage high growth firms from borrowing?

Methodologically, the work entailed both a survey questionnaire (n = 113) and in-depth interviews with equally sized samples of high growth SMEs (n = 8) and non high-growth SMEs (n = 8) drawn from a wide range of different sectors. In the main the respondents were financial directors or owner-managers within the firms. The work included analysis of both high growth and non-high growth SMEs to enable comparative analysis between the two cohorts. Given this methodological approach the findings have relevance for SMEs, irrespective of their growth level. A small number of banks, alternative financial providers and UK policy makers were also interviewed for the study.

Survey findings

There was strong demand for external finance within the sample of SMEs surveyed. Over 60% of firms sought to raise external finance over the next three years and half of all the firms had encountered difficulties obtaining external funding.

Another important finding was the relatively high number of 'discouraged borrowers' – i.e. firms who do not seek external finance for fear of rejection. In total 20% of the sample classified themselves as discouraged borrowers (i.e. 16 from a sample of 75 respondents).

It appears from the survey results that a considerable number of SMEs continue to have quite deep-seated concerns about their banks. Interestingly, it also appears this lack of trust seems to be correlated with the size of the SMEs – smaller SMEs are considerably less trusting of banks than larger SMEs.

Underpinning this lack of trust seems to be the conditions attached to bank lending, especially requirements for personal guarantees and bank covenants. Personal guarantees in particular were identified by over 70% of the sample. Some 20% of respondents also highlighted the issue of bank covenants as a barrier to borrowing. One final interesting finding from the survey results concerns the impact of SMEs being either reluctant or unable to borrow. Nearly half of all firms said that as a consequence they would experience more modest levels of growth.

Perhaps of even greater significance is the finding that around one in six firms (i.e. 17.3%) said that the absence of available funding would either result in a clear reduction in their growth or closure of the business.

Interview findings

The company interviews identified quite distinctive patterns in the perceptions of SMEs' access to finance. Many non-high growth SMEs were quite reluctant to borrow externally. This cohort seemed willing to sacrifice their growth targets in order to avoid becoming too reliant on external borrowings.

The high growth cohort, on the other hand, seemed much more receptive to external finance. This cohort was split between larger SMEs, who have access to conventional debt-based lending instruments (such as asset-based finance) and smaller, newer firms which were much more likely to be 'discouraged borrowers'.

Unsurprisingly, owing to a lack of demonstrable lending track record, smaller micro-firms were much more likely to use either equity forms of funding or seek recourse to new financial instruments, such as peer-to-peer lending or crowdfunding.

The supply-side interviews with banks and policy makers highlighted that funding remains problematic for some firms. The view persists amongst policy makers that supply-side measures seem the best solution to increase access to funding in SMEs.

The interviews with alternative providers of finance revealed their attractiveness to 'discouraged' bank borrowers. These new forms of funding seem to be filling part of the funding gap for reluctant bank borrowers. However, only a small number of SMEs either know about or use these forms of funding.

Conclusions

This report sheds important new light on some crucial, but overlooked, aspects of small business funding, namely the funding issues confronting high growth SMEs.

The findings endorse others who have found that high growth SMEs do not face any particular problems accessing funding compared to non high-growth SMEs. Overall, high growth SMEs seem much more positive about the relationship they have with their main lending institutions, especially those with relational banking arrangements with their main banks.

For high growth firms who are newer and smaller –especially start-ups- there is much less trust in banks as sources of finance for growing firms. It seems that these 'reluctant borrowers' have a negative impression of banks and that this may be impeding growth. A key factor shaping levels of trust seems to be the conditions attached to bank loans, especially requirements for personal guarantees and covenants.

Policy recommendations

Overall, the work suggests that supply-side measures alone will not be sufficient to overcome some of these deep-seated cognitive factors underlying the use of external funding.

Given the dominance of the UK's major four banks within the lending market for SME finance in the UK, greater competition is urgently needed. Encouraging new entrants, especially relationship lenders, to enter the UK's highly concentrated market would seem a particularly advantageous step to help increase competition within the market.

The report offers some demand-side recommendations policy makers could consider to help alleviate some of the difficulties firms face when seeking to obtain external finance. A strong implication from the work is the urgent need for greater competition within the lending market for SME funding.

From a supply-side perspective, banks could increase the number of relationship managers within their organisations to work directly with SME clients to help overcome the levels of disengagement within the SME business community. This could potentially facilitate reconnection with discouraged or reluctant bank borrowers.

Consideration should also be given to raising awareness levels of new financial providers such as peer-to-peer lenders and crowdfunding, especially in micro firms who are likely to be discouraged or reluctant bank borrowers.

1. INTRODUCTION

Context

Dating back to the middle of last century the importance of funding for growth-oriented small and medium-sized enterprises (SMEs) has been recognised as instrumental to enable economic growth (Hughes, 1997)[1]. According to Butters and Lintner, 'many small companies, even companies with promising growth opportunities, find it extremely difficult or impossible to raise outside capital on reasonably favourable terms' (1945, p.3). Since these early investigations, a very large body of literature has explored the perennial problems that new and young firms face when accessing finance (Cassar, 2004; Udell, 2015). However, until quite recently most of these studies typically fail to differentiate between typical small and medium-sized enterprises (SMEs) and rapidly growing firms.

High growth firms (henceforth HGFs) are recognised as key job creators and contributors to economic development and have become a major focus for policy makers. The most notable feature of these firms is their strong propensity to create new 'jobs' (Henrekson and Johansson, 2010; Coad *et al*., 2014). However, their impact was felt to be even more systemic than simply job creation. These firms were thought to have a dynamic 'Schumpeterian' effect on economies, by stimulating competition for incumbents leading to market exits, increasing the innovative capacity within industries and creating new market opportunities for other new entrants as suppliers or competitors (Coad *et al*., 2014; Brown and Mawson, 2016).

Consequently, HGFs have become something of a policy 'mantra' espoused by many governments across the OECD (The Organisation for Economic Co-operation and Development), (Lerner, 2010; Mason and Brown, 2013). This is particularly the case in the UK and other OECD countries, with an increased number of policy interventions designed to foster and support HGFs (Brown *et al*., 2014; Lee *et al*., 2016). Whilst numerous definitions exist, the commonly accepted definition is the following one proposed by the OECD:

> *...enterprises with average annualised growth in employees or turnover greater than 20% per annum, over a three-year period, and with more than 10 employees in the beginning of the observation period.* (OECD, 2008, p.61)

During the last five years, there has been a considerable body of academic research examining these firms. Henrekson and Johansson (2010) undertook a meta-analysis of the work which had been conducted by 2010 but the volume of research has proliferated since this time. While much of the early research examined their job-generating qualities, the literature is increasingly looking at the traits, behaviours, long term growth rates and geographical patterns of HGFs (see, for example, Du and Temouri, 2015; Autio and Rannikko, 2016; Geodhuys and Sleuwaegen, 2016; Li *et al*., 2016; Satterthwaite and Hamilton, 2016). Clearly a crucial issue enabling rapid growth is finance (Cassar, 2004; Dobbs and Hamilton, 2007). Indeed, one of the areas which has started to receive particular attention are the funding issues within HGFs (Rostamkalaei and Freel, 2016).

Interest in funding matters has heightened even further in recent times with the turbulence caused by the global financial crisis. Recent research points to the fact that SMEs are typically finding it much harder to obtain credit since the onset of the crisis (Cowling *et al*., 2012). This is particularly the case for innovative firms who tend to be the most growth-oriented SMEs (Schneider and Veugelers, 2010; Lee *et al*., 2015). Innovative SMEs located in peripheral parts of the UK seem to be particularly affected in this regard (Lee and Brown, 2016). Indeed, these problems facing SMEs have led some to claim that the so-called funding escalator for SMEs has broken (North *et al*., 2013).

While it would be expected that these problems have been felt to be particularly acute for high growth SMEs the evidence base on this count is limited and mixed. One of the first such studies found that access to finance in high growth SMEs tended to be problematic with growth firms less successful in loan applications that others (Freel, 2007). A perceived lack of funding was identified in one study as a key barrier to growth in UK HGFs (Lee, 2014). A study on access to finance in Belgian HGFs found that these firms did not encounter any additional problems obtaining funding and tended to rely heavily on internal resources to finance their expansion (Vanacker and Manigart, 2010). A more recent study funded by ICAS (The Institute of Chartered Accountants of Scotland) which examined the Small Business Survey also found that high growth SMEs found it no harder to be able to obtain funding than conventional non-high growth SMEs (Brown and Lee, 2014). Another earlier UK study of UK high growth SMEs also had similar findings (Vos *et al*., 2007).

However, these initial studies on funding issues in high growth SMEs tend to have limitations and may not tell the whole story for a number of important reasons.

First, they typically use heavily aggregated data sources which prevents a close inspection of various issues shaping the proclivity of firms to borrow from external sources. While we know that small firms are likely to view external sources of finance as a complement to internal sources to fund growth (Rostamkalaei and Freel, 2016), the rationale and nature of their lending decision making is less clear. Arguably, more finely honed research strategies are needed to properly inspect these complex issues.

Second, they mostly concentrate on firms' ability to obtain credit and fail to consider whether firms obtain credit at suitable terms. Higher credit prices rather than the inability to obtain credit may be a greater growth inhibitor to growing SMEs. Indeed, research on the Small Business Survey shows that in the UK 'growing firms hold more expensive loans' (Rostamkalaei and Freel, 2016, p.269).

Third, some observers have noted how some high growth SMEs increasingly seek alternative sources of finance (British Business Bank 2014; Brown *et al*., 2015). Rather than viewing banks as the only source of funding these innovative SMEs are increasingly seeking newer forms of funding such as equity crowdfunding, peer-to-peer lending and invoice trading (Baeck *et al*., 2014; Atz, U and Bholat, 2016; Nesta, 2016).

Fourth, they tend to focus on firms who have applied for credit, ignoring firms who may for various reasons decide not to use external finance. These so-called 'discouraged borrowers' (Kon and Storey, 2003; Freel *et al*., 2012; Fraser 2014) or 'reluctant borrowers' (Brown and Lee, 2014) are seen as a vital cohort to properly understand the ability of SMEs to obtain finance. High growth SMEs may be particularly susceptible to discouragement due to their ability to fund themselves from internal resources.

Finally, most studies tend to ignore the conditions attached to borrowing. Given the low levels of credit history within many SMEs, especially new firms such as start-ups, many lenders attached various conditions on loans such as personal guarantees and loan covenants (Rajan and Winton, 1995). These factors may, or may not, inadvertently dissuade firms from borrowing.

What this shows is that the evidence base surrounding funding issues in high growth SMEs remains partial and incomplete. Importantly, funding issues for high growth SMEs may not be the 'happy story' depicted by some authors (Vos *et al*., 2007). More research is therefore needed to help alleviate these knowledge gaps. This is especially important if policy makers are to be equipped with sufficient evidence to help policy making in relation to these important firms.

Research methodology

To address some of these evidence gaps, ICAS commissioned the authors of this report to examine the nature of funding issues within high growth SMEs in greater depth. The research was informed by two overarching research questions:

1. What is the nature of the borrowing requirements of high-growth firms?
2. What factors deter or discourage high growth firms from borrowing?

The work involved three main distinctive research components:

First, a survey questionnaire was constructed to examine some of these issues across a wide sample of SMEs across the UK. Full details of the survey can be found in Appendix 1. In total, 819 ICAS members were invited to participate in the survey which elicited 113 responses to the survey, a response rate of 14%. The respondents provide a good cross-section of ICAS members from different sizes of SME from a variety of different sectoral backgrounds.

Second, interviews were conducted with a sample of high growth SMEs and non-high growth SMEs. In total, we interviewed eight SMEs and eight high growth SMEs. The former cohort was identified through the initial survey questionnaire while the latter were identified through the business database FAME. The non-high growth cohort were self-selected so should be reasonably representative of the ICAS membership body overall. To be included in the high growth cohort, on the other hand, firms had to meet the OECD criteria for high growth outlined earlier in this chapter. In addition to these interviews the research team has just completed additional interview research on high growth SMEs for BIS (Department for Business, Innovation & Skills (now known as Department for Business, Energy & Industrial Strategy (BEIS)), which also informed their analysis (Lee *et al*., 2016). Third, five additional interviews were conducted with UK policy makers, (both central government departments and government agencies), two high street banks and three providers of alternative forms of funding for SMEs, such as equity crowdfunding companies. All companies and policy maker interviewees were guaranteed anonymity and will not be named within this report.

The remainder of the report is set out as follows. First, the report begins with an assessment of the survey findings produced during the research. Second, the findings from the company and policy maker and funder interviews are outlined and discussed. Third, the policy recommendations from the research are highlighted.

Finally, conclusions and suggestions for further research are proposed.

2. ANALYSIS OF QUESTIONNAIRE RESULTS

In order to examine funding issues within the population of SMEs as a whole, a unique survey instrument was constructed. The main group of companies targeted for the survey were ICAS members working in business. In total, 819 ICAS members were invited to participate in the survey.

In order to boost the response rate ICAS offered entry into a free draw to win an iPad to all those members who completed the survey. Following the initial circulation of the survey, numerous email follow-ups were issued to help boost the response rate.

In total 113 people from different businesses completed the survey. The survey therefore had a response rate of 14% which was below average for online surveys within organizational research (Baruch and Holtom, 2008). Owing to the nature of the sampling procedures a small proportion of these firms exceeded the SME size threshold. However, SMEs were by far the largest constituent population within the sample (n = 84%).

Not all respondents answered all the questions in the questionnaire, therefore, care must be taken when interpreting the responses to the questions with a low sample size. Indeed, many of the questions had lower response levels. In each table, we report the total number of responses in one column followed by the percentage of the sample in the column immediately adjacent.

How these sampling issues affected the nature of responses within the questionnaire is difficult to precisely estimate. There is nothing to suggest that the level of non-respondents inherently altered the findings reported. However, we cannot estimate whether the propensity to respond is likely to have been affected by the firm's experiences obtaining finance. What we can speculate is that this cohort of SMEs are likely to be better equipped than typical SMEs at assessing different financial options given that they employ ICAS members in senior managerial positions. Indeed, previous research shows that generally the greater financial literacy and financial contacts entrepreneurs have, the greater their ability to obtain funding (Seghers *et al*, 2012; Manolova *et al*, 2012).

Basic characteristics of the sample

The primary focus of this research is focused on SMEs and in this respect the businesses surveyed seem to represent a reasonable spread of different firm types (see Table 2.1). In terms of size: around a quarter employ fewer than 10 staff, 35% 10 - 49, 24% 50 - 249 and 16% 250+. This means there is a slight skew to larger organisations relative to the national stock.

Table 2.1 Firm size in the sample

Number of employees	Number of firms	Percentage of sample
250 + employees	17	16.0
50 - 249 employees	25	23.6
10-49 employees	37	34.9
0-9 employees	27	25.5
Total	106	100.0

As shown in Table 2.2, we also consider the legal structure of the organisations who responded. This is important because financing issues may influence organisations with different ownership structures. The vast majority of respondents to the survey are private limited companies (79%). This is very much in line with the demographic profile of SMEs as a whole across the UK.

A notable observation about the sample is the lack of sole traders. Given the nature of the sample, it might be slightly skewed towards larger firms than UK SMEs as a whole. Again, this bias towards towards larger SMEs may owe to the sample being derived from ICAS members. The benefit of this over-representation of larger SMEs means more are likely to be engaged in the use of external finance.

Table 2.2 Legal structure of firms

Legal structure	Number of firms	Percentage of respondents
Private limited company	79	79
Limited Liability partnership	9	9
Public limited company	6	6
Charity	4	4
Sole trader	2	2
Total	100	100

Note: Six firms did not respond.

Table 2.3 below shows the age of the firms surveyed. Older firms are often seen as less risky by lenders than younger organisations (Cowling *et al.*, 2012). Around 25% of respondent firms are aged under five years of age, but the vast majority (64%) are aged 10 years plus.

Table 2.3 Age of firms interviewed

Age	Number of firms	Percentage of respondents
10 +	61	64.2
6-10	10	10.5
3-5	14	14.7
1-2	6	6.3
<1	4	4.2
Total	95	100.0

Note: 11 firms did not respond.

Table 2.4 shows the sample by turnover. As would be expected given the evidence on firm size and age, a relatively large proportion of organisations in the sample have significant turnover: around a third have turnovers over 10 million. About 20% of these firms have a turnover over 20m, but there is a broad spread of turnovers in the sample.

Table 2.4 Turnover

Turnover (£)	Number of firms	Percentage of sample
20 million +	20	21.5
10 - 20 million	9	9.7
5 - 10 million	13	14.0
1 - 5 million	22	23.6
100k - 1 million	18	19.3
<100k	11	11.8
Total	93	100.0

Note: 13 firms did not respond.

Table 2.5 considers where firms go for business advice and support. This is important because the finance literature views such guidance for SMEs as important in obtaining external finance. Most companies sought advice from professional advisors (accountants, lawyers) (74%), their networks (56%), the board (51%), peers (31%). Other sources included the IoD (Institute of Directors) (5%), Chambers of Commerce (2%), Business Gateway (10%). This is consistent with the view that professional advice and advice from peers is important for firms to successfully obtain finance (Seghers *et al.*, 2012).

Table 2.5 Where do you go for business advice and support?

Source of advice	Percentage of firms
Professional advisors	74.1
Their networks	55.5
Board	50.6
Peers	30.8
Professional or trade representative body	28.4
Bank	28.4
Business gateway	9.9
Mentor	8.7
IoD	4.9
Local authority	2.5
Chamber of commerce	2.5

Note: 12 firms did not respond.

Growth

Both recent and past patterns of growth are considered in table 2.6. In the past year, only a minority of firms had experienced negative growth (13%). But similarly, high growth was comparatively rare: just under 19% of firms had experienced growth of 20% or above. However, firms were relatively optimistic about predicted growth: 22% of firms predicted growth of above 20%.

Table 2.6 Recent growth patterns

Rate of growth	Growth in past year		Predicted growth in next year	
	Number	Percentage	Number	Percentage
Negative	12	13.3	13	14.8
0 - 9%	40	44.4	32	36.4
10 - 19%	21	23.3	23	26.1
20 - 29%	7	7.8	9	10.2
30%+	10	11.1	11	12.5
Total	90	100.0	88	100.0

Note: 16 firms did not respond for growth in past year, 18 for predicted growth.

Respondents were asked the importance of seven different factors for growing their business (new capital investment, property and premises, R&D and new product development, acquisition of other firms, internationalisation, joint ventures, links with universities). Table 2.7 gives the results.

Of these, the most important factors for growing their business were reported as: capital investment (44% say important or very important); followed by R&D and new product development (40%); internationalisation (37%); new property or premises (29%). Joint ventures (22%), acquisitions (21%), and links with universities (17%) were viewed as the least important.

The perception that R&D and new product development will play such a large role in their future growth illustrates the importance of innovation in the growth process. The strong role attributed to internationalisation is also important as many less growth-oriented SMEs tend to 'stay at home' (Acs *et al.*, 1997).

Table 2.7 Factors important for growing your business

Factor	Percentage of firms saying important/very important
New capital investment	43.6
R&D and new product development	39.7
Internationalisation	37.2
Property and premises	29.5
Joint ventures	21.8
Acquisition of other firms	20.5
Links with universities	16.7

Note: 26 firms did not respond.

Access to finance

Table 2.8 gives data on the financing decisions of firms. Around 60% of respondents were looking to raise finance in the next three years, with 51% already borrowing in some form. Forty-five percent had made an application but had had difficulty obtaining finance from the first source they tried, while almost 80% sought external advice.

Table 2.8 Financing situation

	Percentage of firms seeking to raise finance in next three years	Already borrowers	Did you have any difficulties in raising external finance? (from first source)	Did you seek external advice before applying for finance? (of those who applied)
Yes	60.6	51.2	45.1	79.1
No	39.4	48.8	54.9	20.9
Number of responses	71.0	82.0	106.0	67.0

The most popular source of finance over the last five years was the bank loan (40%) or bank overdraft (34%). Retained earnings was next most popular (27%).

Twelve percent had sought venture capital equity investment; although this figure seems extremely high it may be explained by the bias towards large organisations in the sample. Nobody had sought crowdfunding investment. (See table 2.9)

Table 2.9 Type of finance sought in last five years

Type	Percentage of firms
Bank loan	39.8
Bank overdraft	33.7
Supplier credit	16.9
Retained earnings	27.7
Hire purchase	24.1
Equity from family	22.9
Loans from family	20.5
Factoring	16.9
Grants	16.9
Credit card	15.7
None	12.0
Equity from venture capital	12.0
Peer to peer	2.4
Crowdfunding	0.0

Note: Six firms did not respond.

Table 2.10 outlines why organisations sought funding. The most common reason for seeking funding was working capital (51%), followed by entering new markets (25%), investment in new capital equipment (23%), employing new staff (23%) and to develop new products or processes (22%).

Table 2.10 Purpose of funding sought

Purpose	Percentage of firms
Working capital	50.7
Entering new markets	24.6
Investment in new capital equipment	23.2
Employing new staff	23.2
Develop new products/processes	21.7
Acquisitions	13.0
Other	13.0
Property	11.6
Skills	7.2
Leadership development	1.4

Note: 32 firms did not respond.

Table 2.11 shows evidence on whether firms were discouraged from applying for finance. There was some evidence of discouragement, with 21% of firms feeling they would be likely to be turned down if they made an application.

Table 2.11 Discouragement

Did you feel you would be turned down for finance if you apply?	Number of firms	Percentage of firms
No	31	41.3
Not applicable	28	37.3
Yes - I have	16	21.3
Total responses	75	100.0

The question on levels of trust SMEs have in their banks elicited interesting responses. This question adopted a Likert scale (with 1 being low levels of trust and 5 being high). As shown in Table 2.12, the vast majority of SMEs have relatively strong levels of trust in their banks. However, there is a pocket of approximately 17% of firms who demonstrate low levels of trust in their banks. Revealingly, it is also clear from Figure 1 below that the smallest of firms are the ones least likely to view banks as being trustworthy.

Table 2.12 Trust in the banks

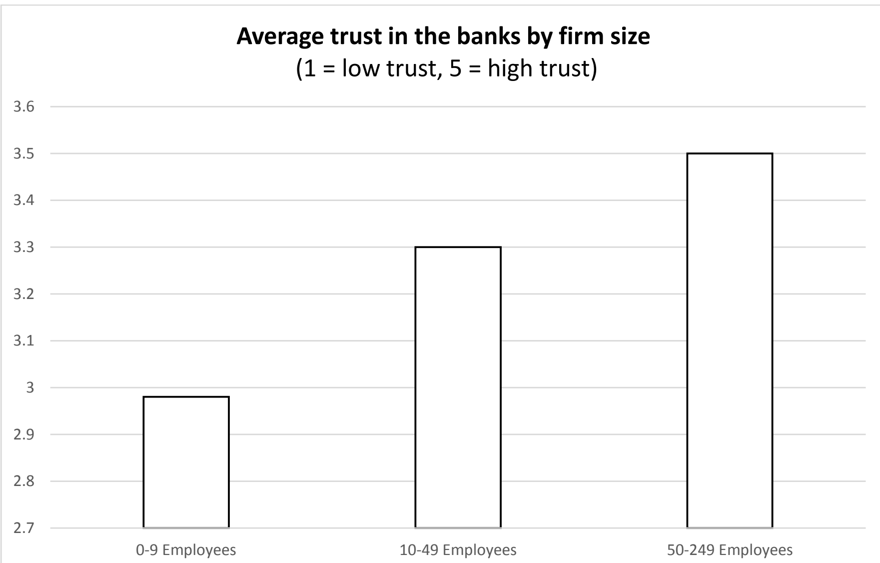
How much do you trust your main bank?	Number of firms	Percentage of firms
1	3	4.0
2	10	13.3
3	30	40.0
4	25	33.3
5	7	9.3
Total responses	75	100.0

Notes:

31 firms did not respond.

This question adopted a Likert scale (with 1 being low levels of trust and 5 being high).

Figure 2.1 Trust in the banks by firm size



Firms were very clear that personal guarantees were important for them when seeking external finance. Table 2.13 presents results on this point. Seventy-one percent felt it was very or extremely important. Twenty percent felt the nature of loan covenants was important. As with the issue of trust on the whole the smaller firms were typically those who found loan guarantees and loan covenants very important[2].

Table 2.13 Importance of loan guarantees and covenants

Importance	How important is the issue of personal guarantees when seeking external finance?		How important is the nature of loan covenants when seeking external finance?	
	Number	Percentage	Number	Percentage
Very unimportant	4	7.2	11	20
Neither important nor unimportant	12	21.0	33	60
Very important or extremely important	39	70.8	11	20
Number of responses	55	100.0	55	100.0

Finally, the consequences of either discouragement or inability to obtain finance are considered. Table 2.14 gives results on this point. Only 41 firms responded to this question, so the results need to be interpreted cautiously. For around a third of firms either discouraged from or unable to seek finance this would have no impact. However, for around 10% it would likely lead to a clear reduction in growth. For a small minority (7%) of firms, reluctance to seek finance would lead to the potential closure of the company.

Table 2.14 Impact of reluctance to seek/inability to obtain finance

Impact	Number of persons	Percentage of firms
No likely discernible impact	15	36.6
Continued growth but at a more modest rate	19	46.3
Clear reduction in growth	4	9.8
Potential closure	3	7.3
Total responses	41	100.0

Summary

In summary, in terms of the survey analysis one of the notable findings was the strong demand for external finance within our sample of SMEs. Over 60% of firms were looking to raise external finance over the next three years. This shows a strong appetite for external funding despite some of the perceived difficulties obtaining it. Indeed, just under half of all the firms encountered difficulties obtaining external funding.

Another important finding was the relatively high number of 'discouraged borrowers' – i.e. firms who do not seek external finance for fear of rejection. In total 20% of all the firms surveyed classified themselves as discouraged borrowers. Related to the above point, concerns remain within firms about their levels of trust in the banks. It appears from the survey results that a considerable number of SMEs continue to have quite deep-seated concerns about their banks. Interestingly, this lack of trust appears to be correlated to the size of the SMEs.

Underpinning this lack of trust seems to be the conditions attached to bank lending especially in terms of personal guarantees and the nature of bank covenants. The former issue in particular was identified by over 70% of the sample. Some 20% of respondents also highlighted the issue of bank covenants as a barrier to lending.

One final interesting finding from the survey results concerns the impact of SMEs being either reluctant or unable to borrow. While over a third of firms detected no discernible impact from this situation, nearly half of all firms said that it would incur more modest levels of growth within the firms. Perhaps, of even greater significance, is the fact that nearly one in five firms (i.e. 17.3%) said that these circumstances would either result in a clear reduction in their growth or closure of the business.

3. ANALYSIS OF INTERVIEWS

Nature of interview sample

In order to fully explore the nature of funding issues within SMEs, two different cohorts of SMEs were interviewed. The first cohort was a random sample of eight SMEs with varying levels of growth. The second cohort was a targeted sample of eight firms who qualify as 'high growth' under the OECD definition. By constructing these two groups it is possible to make some meaningful comparisons across the two types of firms.

The sample for the firm level interviewees was identified using the Financial Analysis Made Easy (FAME) database. The FAME database allows firms to be identified by their growth rates.

In order to qualify for both cohorts, firms had to be SMEs corresponding to the EU definition, employing less than 250 employees. The nature of the two cohorts was very similar in terms of age, size and sectoral background. The firms interviewed came from a wide range of sectors and geographies from across the UK economy. Considerable effort was made to ensure there was a mixture of young and older and small and larger SMEs within the cohorts, so that age/size related factors could be explored.

The interviews with the first cohort were conducted in 2015 and the interviews with the second cohort were conducted in 2016. This differentiation is not likely to have a significant bearing on the results reported. However, the results from the EU referendum may have a significant bearing on credit availability for firms of all sizes given the expected turbulence this has and will cause in the UK financial markets. Clearly, any resultant period of recession is likely to make it much tougher for SMEs to obtain suitable forms of credit.

In around half the cases, interviews were conducted with financial directors in the firms and the other half involved interviews with either the owner manager or managing director. The interviews were conducted by telephone and lasted approximately 30-45 minutes in length.

The interviews were semi-structured, using various thematic headings to probe the interviewees on various themes identified from the literature. Care was taken to ensure that both the non-high growth firms and the high growth firms were asked similar types of questions. All the participants were informed about the nature of the research and were guaranteed anonymity by the researchers. Owing to the sensitive nature of the work the interviews were not taped but direct quotations were manually transcribed by the researchers.

Interviews with policy makers and banks were also conducted to help triangulate the data collected from the firm interviews. In total, two banks and three providers of alternative sources of finance were also interviewed. Five policy makers were interviewed during the research. All the interviews were conducted by telephone with the exception of one face-to-face meeting with a policy maker.

Owing to the divergence across the different groups of interviewees, the analysis of the interview data has been broken down into two main headings: firm perspectives and supply-side perspectives (including banks, alternative financial providers and policy maker perspectives). All the findings reported below emanated directly from the interviews undertaken.

1. Firm perspectives

Interviewing two equal numbers of high growth and non-high growth SMEs, enables differentation between the funding issues confronting both sets of firms. The nature of funding issues within each cohorts is discussed in turn.

Attitudes of non-high growth SMEs

Despite their diversity in terms of sectoral orientation and size, the SMEs interviewed seemed to have a number of factors in common which marked them out from the high growth cohort. First, many of these non-high growth SMEs were quite risk averse when it comes to external borrowing. This was particularly the case for newer start-ups who had formed in the last three to five years. For these start-ups access to finance was effectively off the table owing to the unwillingness of these firms to give personal guarantees as security against bank borrowing. Indeed, the high costs associated with borrowing facilities had even seen start-ups avoid the use of overdraft facilities.

Start-ups, by their very nature, face a strong liability of newness owing to the lack of legitimacy from customers, suppliers and banks. This is a core reason lenders traditionally require these firms to offer personal guarantees or collateral. In many cases new start-ups are reluctant (or unable) to undertake these assurances so many eschew bank debt. As a result, the start-ups interviewed were often run 'cautiously and very risk averse'. Indeed, growth was not seen as an option owing to their missing 'track record' with the banks. Therefore, these businesses viewed organic growth and the generation of revenue as the only way in which they would be able to fund future growth as accessing external finance was seen as a 'no-go'. In contrast, the levels of risk adverseness and attitudes towards banks was different in well established, larger SMEs. In these instances, often the SMEs had well established relationships with a main lender, typically one of the big four UK banks. In contrast to the situation with start-ups some felt there was quite healthy competition for their business with one interviewee claiming they had the 'four banks chasing us for our business'. Indeed, the majority of these firms were positive about their relationship with their banks and had a 'relationship manager' who they dealt with to negotiate any new lending.

Owing to these positive relationships with their banks these firms had been able to undertake modest growth within their businesses. A notable feature of this group of companies was that most were asset rich who often utilised 'asset-based' lending when undertaking new rounds of funding. This obviously contrasts with the start-ups who had very little in the way of tangible assets to use as security for raising external funding.

In terms of their attitudes towards their main bank lender these were fairly mixed. While some had considered other forms of funding 'the ease and speed of correspondence made bank finance more easy'. Many felt their relationship with banks was pretty positive, especially those with a dedicated relationship manager. However, a common complaint was that some felt there was a 'lack of people who are interested in actually understanding the business – they just want to sell products'. Again, this feeling was most acutely felt by smaller firms who are only getting 'call centre services' from their banks.

The insistence on personal guarantees was perhaps the single biggest bone of contention for these firms in terms of the conditions attached to the use of external finance. In some cases, this was making firms more debt averse. One interviewee claimed that he was asked for a personal guarantee of £150,000 for a loan and now just 'wants to reduce debt as fast as possible'. This experience has 'scared off funding the business through debt'. While formerly quite growth-oriented some entrepreneurs were becoming much more risk averse as a consequence of these stricter lending conditions. The nature of bank covenants was also mentioned, but less frequently. One interviewee noted that 'banks use covenants to manipulate businesses as they want, and have used them to their own good [as opposed to that of the company]'.

Attitudes of high growth SMEs

As with the above cohort of less rapidly growing SMEs, the high growth-SMEs were a very heterogeneous collection of firms from a diverse range of sectors such as oil and gas, plant hire, recruitment and mechanical engineering. They certainly do not correspond with the high-tech firms typically associated with high growth such as software, digital media and so on. There was a diversity in terms of the age and size of these high growth SMEs – while around half were de novo starts some others were between 10-40 years old. Again, this is reflective of the overall population of high growth firms as a whole (Mason *et al.*, 2015).

In contrast to the previous cohort, the group of high growth SMEs interviewed were much more risk oriented (i.e. willing to take risks), especially in terms of their projected growth, and much more inclined to seek external sources of finance from a wide variety of sources. The strength of growth in these firms was impressive. In nearly all the cases, these SMEs had grown by more than the official OECD high growth threshold over the last two or three years. In one case, a data analysis company was growing at a rate of 15% month on month growth. In all but one instance, the firms were planning on continued strong growth. A recruitment company had increased its turnover by 40% in the last year and decided it would resume growth at a much lower rate to help 'catch their breath'.

In the main the high growth SMEs seemed to be quite split in terms of their financial providers. Of those who were relatively well established and mature, many used conventional banks as their main sources of external funding. None of these firms reported any major problems obtaining funding from their banks. Some stated that since the financial crisis 'both sides are a bit more sceptical than they used to be'. However, in all cases the established SMEs claimed they had a good relationship with their main bank with most 'fairly happy with them in that respect'. Indeed, one rapidly growing engineering company based in the Midlands noted they have a 'very strong relationship with their bank'.

By contrast, the newer and smaller firms interviewed seemed much less focused on banks for external finance. For most of them, banks were not seen as particularly relevant in terms of the provision of funding their growth. Many had instead turned to equity investors such as venture capital, business angels and equity crowdfunding to help fund their growth. None of the high growth SMEs had used peer-to-peer lending. Traditional sources of bank finance were seen as 'too static and not suitable for this kind of business'. In many cases, the entrepreneurs running these smaller equity-funded businesses had quite short time horizons in terms of their 'exit strategies' (e.g. build for 3-4 years then sell).

In this group of younger smaller businesses there seemed strong levels of so-called 'discouraged' borrowers (Kon and Storey, 2003). In one start-up the entrepreneur claimed bank funding was not even considered: 'we didn't even look into it, we felt banks would not fund us for the amount needed and the limited experiences we had under our belt'. Interestingly, in one case the banks told one of the start-ups that they would match any equity investment they received but would not lend otherwise.

In terms of their perceptions of loan conditions again the issue of personal guarantees was raised as a major stumbling block by a number of the firms. Many owners refuse to countenance personal guarantees. However, attitudes towards the terms and conditions of loan agreements within high growth SMEs was generally more favourable than lower growing SMEs. One firm noted they are 'fairly happy with them in that regard'. A common perception was that despite lending increasing markedly their 'T&Cs didn't move'. Some observed that the fine print within detailed bank covenants tended to be overlooked as long the business is 'doing well'.

One final issue raised by one of the internationally focused firms was that their bank needed a high level of working capital to be available before being willing to fund an overseas expansion. The bank perceived this negatively and offered very unfavourable terms to the firm. Given that international expansion is crucial for this firm they may 'need to put business through the UK artificially to be able to gain finance'.

2. Supply side perspectives: Attitudes of banks, alternative finance providers and policy makers

In order to examine the main factors within the supply-side of funding for rapidly growing SMEs, a number of interviews were performed with UK banks, alternative finance providers and policy makers in the UK, such as BIS, the Financial Conduct Authority, the British Business Bank and the Scottish Investment Bank. Again, to protect the anonymity of the interviewees none of the issues highlighted will be attributed to any particular organisation or person.

Turning to the views from UK policy makers, there seems a strong feeling within the policy making community that access to finance remains a problem for some SMEs (see also British Business Bank, 2016). Policy maker interviewees acknowledge that the issue of access to credit continues to remain problematic for a number of SMEs. This is evident in the large number of public sector interventions designed to facilitate access to funding in the UK.

In particular, policy makers are concerned about access to growth finance for a small proportion of firms with the potential to achieve rapid growth. While there are ample products available for small and large firms, policy makers identified a gap related to provision of finance for growth oriented firms seeking mid-range funding. The British Business Bank was aiming to address this concern through a new fund, the 'Help to Grow' fund, which was aimed at incentivising banks to lend to these firms.

A number of observations can be made in relation to recent trends within the approaches taken towards policy making in this area. From the interviews conducted there seems a vague acknowledgement that high growth SMEs are vital for economic growth. However, these firms are often seen as specialist firms requiring different types of funding, especially sources of equity finance in spite of the continued importance of debt finance for many high growth SMEs.

What also seems evident from these conversations with policy makers is that the move towards the promotion of increased competition is crucial. While previously market failure arguments were used to undertake loan guarantee schemes, such as the Enterprise Finance Guarantee Scheme (Cowling and Siepel, 2013), nowadays a stronger focus within UK public policy is on efforts designed to increase competition within the banking sector UK small business marketplace. This is evident in the manner in which the UK has actively enacted a number of policy initiatives designed to rebuild the banking sector to assist SME lending.

During this time, and despite these difficulties, the funding landscape for SMEs is beginning to alter which appears to be increasing the levels of competition within the SME funding marketplace. For example, the Bank of England introduced new regulations aimed at easing entry into the UK's banking sector. The Bank of England introduced a simplified two stage process with lower capital requirements for setting up banks in 2013. This was specifically designed to increase competition within the UK's banking sector and since this time new so-called 'challenger banks' have entered the UK banking sector such as Atom, Virgin, Mondo and Metro. Metro bank was issued with the first new banking license for over 100 years.
Many of these banks have specifically targeted the SME lending market which is heavily dominated by the big main UK banks - Barclays, HSBC, RBS and Lloyds.

Many of the larger incumbent banks interviewed did not perceive there to be insufficient competition. Given that the four largest UK banks still have a combined market share of 80% for general purpose loans for SMEs (British Business Bank, 2016), the so-called 'challenger banks' have as yet to make substantive in-roads into the market for small business lending. Despite these positive developments there appears to be a tacit acknowledgement that measures to increase competition are unlikely to have a major impact in the short-to-medium term.

In parallel with the introduction of these new operating guidelines aimed at increasing competition within the banking sector has been the rapid emergence of alternative sources of finance. Again, a key driver behind the growth of these new forms of finance has been the heavily deregulated nature of the UK's finance sector which has given rise to the massive growth of the so-called fin-tech sector. These 'alternative' sources of finance have proliferated in the UK in recent years (British Business Bank, 2014), with market research suggesting approximately 20,000 SMEs in 2015 raised alternative finance through online channels (Nesta, 2016). Many growth-oriented SMEs are now increasingly turning to new internet-enabled financial providers to fulfil their external financing requirements.

So what are alternative forms of finance? These are new forms of funding such as crowdfunding, peer-to-peer lending and invoice trading. Recent market research shows that the market for these new forms of funding grew to £3.2bn in 2015 (Nesta, 2016). These forms of funding appear to play a pivotal role in enabling SMEs to obtain credit. For example, debt-based crowdfunding (also known as peer-to-peer lending) supplied the equivalent of 13.9% of new bank loans to UK SMEs in 2015, suggesting it can no longer be considered a marginal actor in terms of SME funding (Atz and Bholat, 2016; Nesta, 2016).

Equity crowdfunding is now the second fastest growing source of alternative finance in the UK, providing SMEs with £245m in funding in 2015 and acting as a critical funding source for innovative UK start-ups (Brown *et al*., 2015). Prima facie, these newer forms of funding appear to appeal to high growth firms who make a disproportionate impact to the economy but who sometimes encounter restrictions when accessing credit on suitable terms (Rostamkalaei and Freel, 2016).

Alternative funding such as peer-to-peer lending and equity crowdfunding appear to offer a significant challenge to the operational models of traditional bank and equity funding. Indeed, some claim that they herald the 'disintermediation of the finance market', enabling small firms to directly connect with new investors

(Harrison, 2016, p.4). Although both fall under the umbrella term of alternative finance, the dynamics of these two forms of crowdfunding are quite distinctive. Debt crowdfunding, also known as peer-to-peer lending or marketplace funding, consists of secured and unsecured debt-based transactions between institutions, retail actors and businesses conducted via internet-based platforms.

In many respects, this is a natural progression from mainstream banking with several layers of bureaucracy removed. Unlike banks, these platforms are not subject to capital requirements and do not run branches, thus they can offer competitive rates to both borrowers and lenders. Equity crowdfunding, on the other hand, involves the sale of registered securities, mostly by early stage firms, to both retail and professional investors via internet-based platforms. These platforms are in essence mini 'stock markets' for start-ups and enable professional and retail investors to invest directly in start-ups rather than going through regulated stock markets. Unlike traditional forms of funding, this potentially provides growth-oriented start-ups with capital very quickly.

While debt and equity crowdfunding are undoubtedly enhancing the supply of funding to credit-constrained UK SMEs, they clearly have potentially wide-ranging implications for the firms that obtain funding through these mechanisms and for the customers who invest in them. In terms of the former, little is known about the types of firms receiving these forms of funding, their reasons for seeking such funding, or the impact of this funding on firm development and growth. This raises important questions concerning the longevity and benefits of crowdfunding. Similarly, in terms of the latter, very little is known about the types of investors who invest through crowdfunding platforms, their rationale for doing so, or their expectations about their likely return on investment. Again, this raises questions concerning the rationality of investors and issues of investor protection.

Apart from the market research and scoping undertaken by Nesta (2016), the lack of knowledge of the market for alternative finance generally means that very little is known about these issues at present. What is known is that these developments are likely to have a strong influence on the way firms in future structure their levels of external finance. Table 3.1 below illustrates the manner in which these new forms of funding are offering greater levels of choice to SMEs in the UK. It is also likely that greater levels of new entrants within the funding marketplace for SMEs will increase competition and conceivably reduce the costs of borrowing for some. From the interviews undertaken, it appears that providers of alternative finance are attracting a number of 'discouraged' borrowers from the banks. New equity crowdfunding platforms view themselves as offering a crucial source of finance particularly to innovative new start-ups which banks would typically view unfavourably owing to their lack of collateral or track record. Peer to peer lenders, on the other hand, tend to target and deal with larger more established SMEs with a lending 'track record'. They feel their greatest advantage is the speed in which they can offer a firm finance. This was corroborated by one of the firms interviewed who utilised this form of finance.

Table 3.1: Transition from traditional to newer forms of SME funding

Type of firm	Traditional types of finance (pre-crisis)	Newer sources of finance (post-crisis)
Start-ups and micro firms (less than 10 employees)	Friends, family, founders, credit cards, business angels, VCs	Seed funding from accelerators, rewards and equity crowdfunding
Small firms (between 10 and 49 employees)	Banks, business angels, VCs	Equity crowdfunding, peer-to-peer lenders
Medium-sized firms (between 50-249)	Banks, VCs, private equity, IPOs	Challenger banks, peer-to-peer lenders, equity crowdfunding

Source: Authors' illustration

Summary

In summary, our company interviews identified quite distinctive patterns in terms of their perceptions of access to finance. For example, many non-high growth SMEs were quite risk averse when it comes to external borrowing. This cohort seemed willing to sacrifice their levels of growth in order to avoid becoming too strongly reliant on external borrowings. The high growth cohort seemed much more receptive to external finance. This cohort was split between larger SMEs, who tended to use conventional debt-based lending such as asset-based finance, and smaller newer firms who were much more likely to be 'discouraged borrowers'. The latter cohort was much more likely to use either equity forms of funding or seek recourse to new financial instruments such as peer-to-peer lending or crowdfunding.

The supply-side interviews indicate that policy makers continue to acknowledge that funding remains problematic for some firms. The view persists, however, that supply-side measures seem the best solution to increase access to funding in SMEs. Meanwhile, the interviews with alternative providers of finance revealed their attractiveness to 'discouraged' bank borrowers. These new forms of funding seem to be filling part of the funding gap left by reluctant bank borrowers. It needs to be acknowledged that only a small number of SMEs either know about, or use these forms of funding.

4. DISCUSSION OF FINDINGS

This report has examined the nature of funding issues within different types of SMEs with a particular focus on the nature of the funding environment surrounding high growth SMEs. The intention at the outset of this research project was to shed further light on the multi-faceted and multi-layered nature of the complex and inter-related processes shaping funding for high growth SMEs. In doing so, the aim of this work is to help inform policy makers and to make a contribution to the literature on small business finance and high growth entrepreneurship. The main findings uncovered during this research are discussed below.

First, in terms of the survey analysis, one of the notable findings from the survey was the strong demand for external finance within our sample of SMEs. Despite the attention given to newer forms of finance, mainstream bank debt continues to dominate the SME funding marketplace. Over 60% of firms were looking to raise external finance over the next three years. This shows a strong appetite for external funding despite some of the perceived difficulties obtaining it. Indeed, just under half of all the firms encountered difficulties obtaining external funding.

Another important finding was the relatively high number of 'discouraged borrowers' – i.e. firms who do not seek external finance for fear of rejection. In total 20% of all the firms surveyed classified themselves as discouraged borrowers. Clearly this represents a sizeable number of firms who could potentially be forfeiting their levels of growth for fear of rejection from lenders. Therefore, despite increased competition within the banking sector coupled with renewed interest in lending to SMEs in some of the 'big four' UK banks the issue of perception remains a stumbling block to SME lending.

Related to the above point is the overall levels of trust in the banks. It appears from the survey results that a considerable number of SMEs continue to have quite deep-seated concerns about their banks. Interestingly, it also appears this lack of trust seems to be correlated to the size of the SMEs. The smaller firms in particular seem to be highly reticent about engaging with banks to finance their growth. This is fairly consistent with the so-called 'growth cycle theory' of small business finance which finds that smaller firms typically encounter greater difficulties when seeking debt finance than larger ones (Gregory, 2005).

Underpinning this lack of trust seems to be the conditions attached to bank lending. An important finding from the survey in this respect was the strong concerns exhibited in relation to personal guarantees and the nature of bank covenants. The former issue in particular was identified by over 70% of the sample as a major issue inhibiting access to external funding. Some 20% of respondents also highlighted the issue of bank covenants as a barrier[3]. This may be a strong factor preventing SMEs accessing funding especially if entrepreneurs either have limited personal wealth or tend to be more risk averse.

One final interesting finding from the survey results concerns the impact of SMEs being either reluctant or unable to borrow. While over a third of firms detected no discernible impact from this situation, nearly half of all firms said that it would incur more modest levels of growth within the firms. Perhaps of even greater significance is the fact that 17.3% of firms said that these circumstances would either result in a clear reduction in their growth or closure of the business. This is perhaps the starkest of all the observable findings from the survey of SMEs. The key findings from the interviews of both high growth and non-high growth SMEs are considered next. In many ways the interviews back-up and reinforce a number of the findings from the survey questionnaire. For example, the interviews found a strong appetite for external borrowing from the majority of the larger SMEs interviewed. This was evident in both the cohorts and shows that some of the reluctance to undertake external borrowing may have eased since the authors last undertook interviews with SMEs in 2013 (Brown and Lee, 2014).

In line with the findings from the survey, the interviews detected a strong reluctance by some SMEs to engage with banks. While this was evident in some of the larger SMEs interviewed it was very marked in smaller firms and start-ups. In many ways, some of these firms have almost effectively written off banks as a source of funding for these types of SMEs. It appears that an increasing amount of start-ups are now turning to other forms of equity-based and/or alternative finance to help mitigate funding from banks.

Firms unsuited to equity based forms of funding on the other hand seem to be almost entirely reliant on internal resources for their funding. This may owe either to the unwillingness of the entrepreneur to cede control of the business to a third party or being a type of firm with low levels of financial return and/or growth potential which are unattractive to the vast majority of equity investors.

Another finding which corroborated the survey evidence concerned the issue of trust. It is fair to say that trust between firms and their banks has gradually improved since the financial crisis. However, in some aspects this continues to be fragile and problematic, especially in relation to the need for personal guarantees to secure loans. Across both cohorts of SMEs, this appeared to one of the major obstacles preventing firms from re-engaging with banks. This was particularly acute for less risk-oriented lower growth SMEs.

Finally, turning to the examination of the changing supply-side and policy context a number of tentative observations can be drawn. It appears that the funding landscape for SMEs in the UK is undertaking considerable change. Increased competition from new entrants coupled with the rapid emergence of new sources of alternative finance is enhancing the funding situation for some SMEs. These developments seem to be particularly beneficial for SMEs with a strong propensity for growth who are willing to engage with new providers of finance. However, users of these new sources of finance are very much in the minority. It is likely that greater levels of new entrants within the funding marketplace for SMEs will increase competition and conceivably reduce the costs of borrowing for some. However, it is too early to tell what longer-term impact this will have on incumbent banks. Further work will be needed before this contention can be verified.

5. CONCLUSIONS AND POLICY RECOMMENDATIONS

This report sheds important light on some crucial but overlooked aspects of research on small business funding. The survey results show a strong appetite for external finance in SMEs but also highlight continuing problems facing some firms in this regard. However, it is important to state that not all firms deserve the finance they apply for, nor is there definitive evidence of the existence of a funding gap for SMEs (Hughes, 1997; Freel, 2007; Rostamkalaei and Freel, 2016). The challenge for policy makers is to ensure that finance goes to firms likely to help the national economy, without providing excess capital to firms which are not creditworthy.

The findings in this respect are important and endorse others who have found that high growth SMEs do not face any particular problems accessing funding (Vos, 2007; Brown and Lee, 2014). Overall, high growth SMEs seem much more positive about the relationship they have with their banks, especially those with relational banking arrangements with their main banks. However, this statement only tells part of the picture as revealed by both the survey and interview data. For those firms who are newer and smaller there is much less trust in banks as sources of finance for growing firms. It seems that these 'reluctant borrowers' are negatively affected by their bad impression of the banks and that this could be impeding growth within the economy.[4] A key factor shaping levels of trust seems to be the conditions attached to bank loans, especially in terms of personal guarantees. These findings clearly have implications for public policy makers. In some respects, it would appear to contradict the special focus on high growth SMEs. Given they appear to be able to obtain access to finance equally well, and in some cases better than typical SMEs, would potentially discount the need for special interventions aimed particularly at these firms. The fact that these firms encounter higher borrowing costs (Rostamkalaei and Freel, 2016) may simply reflect the riskier nature of these operations in terms of their greater innovative and international orientation. The fact that banks particularly discriminate against smaller more informationally opaque growing firms with more stringent requirements for personal guarantees and loan covenants may also be rational behaviour on their part. Emerging evidence suggests that small informationally opaque firms are particularly disadvantaged by the decline in relationship banking whereby business owners have strong personal interaction with potential borrowers (Beck, forthcoming). The move towards more transactional lending based on credit scores and "hard" information is punitive towards these types of SMEs.

In certain other respects, the work endorses the broad direction of travel in terms of public policy. For example, the recurring issue of personal guarantees makes it difficult for firms with insufficient security to obtain credit. In 2009, the UK government introduced the Enterprise Finance Guarantee (EFG) (formerly the Small Firms Loan Guarantee Scheme), now operated by the British Business Bank. This scheme underwrites the lending for viable firms with insufficient security to receive funding. The scheme provides a 75% guarantee on loans of up to £1m to firms perceived to banks as high risk. Given the perceived effectiveness of these kind of programmes (Cowling and Siepel, 2013), perhaps the government could help to promote this programme more widely. Given the expected funding problems likely to face SMEs post the EU referendum (Financial Times, 2016), the UK government may wish to increase their default rate (perhaps even temporarily) for the EFG to mitigate the likely effects of the expected credit squeeze post-Brexit. Similarly, the new Scottish Business Development Bank may wish to investigate a similar initiative targeted at Scottish firms.

While academic evidence has shown the EFG to be a very effective means of improving access to finance in SMEs (Cowling and Siepel (2013), the manner in which it is operated by the UK's main banks may be undermining its effectiveness. First, banks appear to be using the scheme inconsistently. Indeed, some anecdotal evidence suggests that some of the banks still require personal guarantees in addition to the guarantees provided under the scheme. These mixed messages will clearly put off many SMEs from using the scheme. Second, it appears that the level of default rates (i.e. those firms who do not repay their loans) within the portfolio of SMEs supported by the scheme is being under-utilized by the banks. In other words, banks are being conservative in their decision making about funding firms despite the fact that the scheme allows 15% of supported firms to default. This seems a very useful and cost-effective policy instrument so more research is urgently needed to examine how the scheme functions in practice with a view to improving its operational effectiveness.

Given the dominance of the UK's major four banks within the lending market for SME finance in the UK, greater competition is urgently needed. Encouraging new entrants, especially relationship lenders, to enter the market would seem particularly advantageous to help increase competition within the market. In one aspect of the lending marketplace, alternative finance, competition has improved the funding situation for SMEs. An important caveat in this regard concerns geography. Given that innovative SMEs encounter greater difficulties obtaining finance in some peripheral parts of the UK (see Lee and Brown, 2016), greater consideration should be given to how these areas can be helped to alleviate these constraints. Indeed, it is starkly evident that the vast majority of new financial providers and alternative sources of finance have emerged and benefited firms located in the south-east (Atz and Bholat, 2016; Brown *et al*., 2015; Nesta, 2016). Given this situation, consideration should be given to how awareness levels of these new financial providers can be directed towards firms in more geographically remote parts of the UK.

This research clearly has limitations which require highlighting. First, the survey was conducted on a relatively small sample of UK SMEs (n = 113). Plus, the sample was skewed towards larger more resourceful SMEs who tend to be more growth-oriented. Another slight concern, is the fact that the number of responses for some questions dropped below half the overall sample. Readers should therefore exact caution when making inferences from the survey findings to the wider population of 5.4 million SMEs. Second, the interview component of the work involved interviews with two cohorts of different types of SMEs. While great care was taken to ensure these were a diverse group of firms, the findings from these limited observations must be viewed as exploratory rather than definitive. Further qualitative evidence on a much larger sample of SMEs is needed to help corroborate the findings within this study.

ENDNOTES

1. In line with the EU definition, SMEs are defined in this study using the employment threshold criteria as firms employing less than 250 employees.
2. However, due to the small sample for this question we do not break this down by company size.
3. Given just over 50% of respondents answered this question care should be taken when interpreting this finding. Likewise, a similarly low response occurred in relation to the issue surrounding personal guarantees.
4. Reluctant borrowers are firms who are similar to discouraged borrowers but who forgo borrowing through choice and not through fear of rejection by banks.

REFERENCES

Acs, Z. J., Morck, R., Shaver, J. M., & Yeung, B. (1997), 'The internationalization of small and medium-sized enterprises: A policy perspective', *Small business economics*, 9(1), 7-20.

Atz, U. & Bholat, D. (2016), *Peer-to-peer lending and financial innovation in the United Kingdom*, Bank of England Staff Working Paper No. 598.

Autio, E., & Rannikko, H. (2016), 'Retaining winners: Can policy boost high-growth entrepreneurship?'. *Research Policy*, 45(1), 42-55.

Baeck, P., Collins, L., & Zhang, B. (2014), *Understanding Alternative Finance: The UK Alternative Finance Industry Report 2014*, London: Nesta.

Baruch, Y., & Holtom, B. C. (2008), 'Survey response rate levels and trends in organizational research', *Human Relations*, 61(8), 1139-1160.

Beck, T. Degryse, H., De Haas, R., van Horen, N. (forthcoming) When Arm's Length is Too Far: Relationship Banking over the Credit Cycle", Journal of Financial Economics.

British Business Bank (2014), *Equity Crowdfunding in the UK: Evidence from the Equity Tracker,* Sheffield: British Business Bank.

British Business Bank (2016), *Small Business Finance Markets*, 2015/16, British Business Bank, Sheffield.

Brown, R., & Lee, N. (2014), *Funding issues confronting high growth SMEs in the UK*, Institute of Chartered Accountants of Scotland, Edinburgh.

Brown, R., Mason, C., & Mawson, S. (2014), *Increasing 'the Vital 6 Percent': Designing effective public policy to support high growth firms*, Nesta, London.

Brown, R., & Mawson, S. (2015). 'The geography of job creation in high growth firms: the implications of 'growing abroad', *Environment and Planning C: Government and Policy*, 0263774X15614152.

Brown, R., Mawson, S., Rowe, A., & Mason, C. (2015), *Harnessing the Crowd: The Demand-Side Dynamics of Equity Crowdfunding in Nascent Entrepreneurial Ventures*, Centre for Responsible Banking & Finance, University of St Andrews WP 15-009, available at: http://www.st-andrews.ac.uk/business/rbf/workingpapers/RBF15_009.pdf

Butters, J. K., & Lintner, J. V. (1945), *Effect of federal taxes on growing enterprises*, Division of Research, Graduate School of Business Administration, Harvard University.

Cassar, G. (2004), 'The financing of business start-ups', *Journal of Business Venturing*, 19(2), 261-283.

Coad, A., Daunfeldt, S. O., Hölzl, W., Johansson, D., & Nightingale, P. (2014), 'High-growth firms: introduction to the special section', *Industrial and Corporate Change*, 23(1), 91-112.

Cowling, M., Liu, W., & Ledger, A. (2012), 'Small business financing in the UK before and during the current financial crisis', *International Small Business Journal*, 30(7), 778-800.

Cowling, M., & Siepel, J. (2013), 'Public intervention in UK small firm credit markets: Value-for-money or waste of scarce resources?', *Technovation*, 33(8), 265-275.

Dobbs, M., & Hamilton, R. T. (2007), 'Small business growth: recent evidence and new directions', *International journal of entrepreneurial behavior & research*, 13(5), 296-322.

Du, J., & Temouri, Y. (2015), 'High-growth firms and productivity: evidence from the United Kingdom', *Small business economics*, 44(1), 123-143.

Freel, M. S. (2007). Are small innovators credit rationed?. *Small Business Economics*, 28(1), 23-35.

Freel, M., Carter, S., Tagg, S., & Mason, C. (2012), 'The latent demand for bank debt: characterizing 'discouraged borrowers'', *Small business economics*, 38(4), 399-418.

Gregory, B. T., Rutherford, M. W., Oswald, S., & Gardiner, L. (2005), 'An empirical investigation of the growth cycle theory of small firm financing', *Journal of Small Business Management*, 43(4), 382-392.

Goedhuys, M., & Sleuwaegen, L. (2016), 'High-growth versus declining firms: the differential impact of human capital and R&D', *Applied Economics Letters*, 23(5), 369-372.

Harrison, R. (2016), ' Crowdfunding and the revitalisation of the early stage risk capital market: catalyst or chimera?' in (ed) Harrison, R. *Crowdfunding and Entrepreneurial Finance*, Routledge: London.

Henrekson, M., & Johansson, D. (2010), 'Gazelles as job creators: a survey and interpretation of the evidence', *Small Business Economics*, 35(2), 227-244.

Hughes, A. (1997), 'Finance for SMEs: A UK perspective', *Small Business Economics*, 9(2), 151-168.

Kon, Y., & Storey, D. J. (2003), 'A theory of discouraged borrowers', *Small Business Economics*, 21(1), 37-49.

Lee, N. (2014), 'What holds back high-growth firms? Evidence from UK SMEs', *Small Business Economics*, 43(1), 183-195.

Lee, N., Sameen, H., & Cowling, M. (2015), 'Access to finance for innovative SMEs since the financial crisis', *Research policy*, 44(2), 370-380.

Lee, N., Brown, R,. & Schluter, T. (2016), *Modes of Firm Growth*, Research Paper No 46, Enterprise Research Centre, available at: http://www.enterpriseresearch.ac.uk/our-work/publications/

Lee, N., & Brown, R. (2016), 'Innovation, SMEs and the liability of distance: The demand and supply of bank funding in peripheral UK regions', *Journal of Economic Geography,* doi:10.1093/jeg/lbw011.

Lerner, J. (2010), 'The future of public efforts to boost entrepreneurship and venture capital', *Small Business Economics*, 35(3), 255-264.

Li, M., Goetz, S. J., Partridge, M., & Fleming, D. A. (2016), 'Location determinants of high-growth firms', *Entrepreneurship & Regional Development*, 28(1-2), 97-125.

Manolova, T. S., Manev, I. M., & Gyoshev, B. S. (2014). Friends with money? Owner's financial network and new venture internationalization in a transition economy. *International Small Business Journal*, 32(8), 944-966.

Mason, C., & Brown, R. (2013), 'Creating good public policy to support high-growth firms', *Small Business Economics*, 40(2), 211-225.

Mason, C., Brown, R., Hart, M., & Anyadike-Danes, M. (2015), 'High growth firms, jobs and peripheral regions: the case of Scotland', *Cambridge Journal of Regions, Economy and Society*, 8(2) 343-358.

Nesta (2016), *Pushing Boundaries: The 2015 UK Alternative Finance Industry Report, National Endowment* for Technology, Science and Arts: London.

North, D., Baldock, R., & Ullah, F. (2013), 'Funding the growth of UK technology-based small firms since the financial crash: are there breakages in the finance escalator?', *Venture Capital*, 15(3), 237-260.

Rajan, R., & Winton, A. (1995), 'Covenants and collateral as incentives to monitor', *The Journal of Finance*, 50(4), 1113-1146.

Rostamkalaei, A., & Freel, M. (2016), 'The cost of growth: small firms and the pricing of bank loans', *Small Business Economics*, 46(2), 255-272.

Satterthwaite, S., & Hamilton, R. T. (2016), 'High-growth firms in New Zealand: Superstars or shooting stars?', *International Small Business Journal*, 0266242616659913.

Schneider, C., & Veugelers, R. (2010), 'On young highly innovative companies: why they matter and how (not) to policy support them', *Industrial and Corporate change*, 19(4), 969-1007.

Seghers, A., Manigart, S., & Vanacker, T. (2012), 'The impact of human and social capital on entrepreneurs' knowledge of finance alternatives', *Journal of Small Business Management*, 50(1), 63-86.

Udell, G. F. (2015), *SME Access to Intermediated Credit: What Do We Know, and What Don't We Know?*, Reserve Bank of Australia, Conference Volume.

Vanacker, T. R., & Manigart, S. (2010), 'Pecking order and debt capacity considerations for high-growth companies seeking financing', *Small Business Economics*, 35(1), 53-69.

Vos, E., Yeh, A. J. Y., Carter, S., & Tagg, S. (2007), 'The happy story of small business financing', *Journal of Banking & Finance*, 31(9), 2648-2672.

APPENDIX 1

ICAS Members Survey

Q1 Information and consent

Thank you for choosing to participate in this survey which is being conducted for ICAS. This survey considers perceptions within small businesses towards external sources of finance. Typically, those making use of external finance, grow more rapidly. Therefore, the focus of the study is on examining the factors shaping the decision-making process behind the 'demand' for external sources of funding in SMEs. Participation in the project is voluntary and you may withdraw at any time throughout the process. All data collected will remain anonymous. If you have any questions in connection with the project, please contact the lead researcher Dr Ross Brown at Ross.Brown@st-andrews.ac.uk.

Q2 For statistical purposes, please give the first set of digits of your postcode.

Q3 What size of business do you work for?

- ❍ Less than 5 employees
- ❍ 6-9 employees
- ❍ 10-49 employees
- ❍ 50-249 employees
- ❍ 250+ employees

Q4 What is the structure of your business?

Please select the most appropriate option

- ❍ Sole trader
- ❍ Limited partnership
- ❍ Limited liability partnership (LLP)
- ❍ Private limited company
- ❍ Public limited company
- ❍ Charity
- ❍ Employee owned

Q5 What is the core nature of your business?

Please select the most appropriate option

- ❍ Accommodation and food service activities
- ❍ Activities of extraterritorial organisations and bodies
- ❍ Activities of households as employers; undifferentiated goods- and services-producing activities of households for own use
- ❍ Administrative and support service activities
- ❍ Agriculture, forestry and fishing
- ❍ Arts, entertainment and recreation
- ❍ Construction Education
- ❍ Electricity, gas, steam and air conditioning supply
- ❍ Financial and insurance activities
- ❍ Human health and social work activities
- ❍ Information and communication
- ❍ Mining and quarrying
- ❍ Manufacturing
- ❍ Public administration and defence; compulsory social security
- ❍ Professional, scientific and technical activities
- ❍ Real estate activities
- ❍ Transportation and storage
- ❍ Water supply, sewerage, waste management and remediation activities
- ❍ Wholesale and retail trade; repair of motor vehicles and motorcycles
- ❍ Other service activities

Q6 How many years has the business been trading?

- ❍ Less than 1 year
- ❍ 1-2 years
- ❍ 3-5 years
- ❍ 6-10 years
- ❍ More than 10 years

Q7 What was the approximate annual turnover at the end of your last accounting period?

- ❍ Less than £100k
- ❍ Up to £1m
- ❍ Up to £5m
- ❍ Up to £10m
- ❍ Up to £20m
- ❍ More than £20m

Q8 What percentage level of growth in turnover did your business experience during the last financial year?

- ❍ Negative growth
- ❍ 0-9%
- ❍ 10-19%
- ❍ 20-29%
- ❍ 30% or above

Q9 What percentage level of growth do you predict for the coming financial year?

- ❍ Negative growth
- ❍ 0-9%
- ❍ 10-19%
- ❍ 20-29%
- ❍ 30% or above

Q10 Approximately how much money are you looking to raise over the next three years?

- ❍ Don't know
- ❍ None
- ❍ Less than £10k
- ❍ Up to £25k
- ❍ Up to £50k
- ❍ Up to £100k
- ❍ Up to £250k
- ❍ Up to £500k
- ❍ Up to £1m

❍ Up to £5m
❍ More than £5m

Q11 How is your business funded? (a value of 0 would indicate a business funded completely by debt, a value of 100 would indicate a business completely funded by equity)

______ Percentage of debt to equity

Q12 How important are the following factors for growing your business?

	Extremely unimportant (16)	Very unimportant (17)	Neither important nor unimportant (18)	Very important (19)	Extremely important (20)
New capital investment	❍	❍	❍	❍	❍
New property or premises	❍	❍	❍	❍	❍
Investment in R&D and new product development	❍	❍	❍	❍	❍
Acquisition of other firms	❍	❍	❍	❍	❍
Internationalisation	❍	❍	❍	❍	❍
Establishing joint ventures	❍	❍	❍	❍	❍
Establishing links with universities	❍	❍	❍	❍	❍
Other (please specify):	❍	❍	❍	❍	❍

Q13 How would you describe your current borrowing situation?

❍ Current borrower
❍ Currently not borrowing

Answer if 'How would you describe your current borrowing situation?' – 'Currently not borrowing' is selected

Q14 Why are you currently not borrowing?

- ❍ No money needed
- ❍ Tried to access funding, but was unsuccessful
- ❍ Discouraged (you have an interest in obtaining funding but feel you would be rejected)
- ❍ Reluctant (you know that you could gain external funding but have chosen not to - please state why) ____________________
- ❍ Other (please specify) ____________________

Q15 Where do you go for business advice, and support? (please tick all that apply)

- ❍ Company board
- ❍ Chamber of Commerce
- ❍ Professional or trade representative body
- ❍ Institute of Directors
- ❍ Bank
- ❍ My own network
- ❍ Professional advisers (e.g. accountant, lawyer)
- ❍ Mentor
- ❍ Local authority
- ❍ Business gateway
- ❍ Peers

Q16 What type of funding has been sought by your business in the last five years? (Please include irrespective of success of funding application)

- ❍ None
- ❍ Bank loan
- ❍ Bank overdraft
- ❍ Supplier credit
- ❍ Retained earnings
- ❍ Credit card finance
- ❍ Equity from friends, family, business partners or directors
- ❍ Equity investment from a business angel
- ❍ Equity investment from a venture capitalist

- ❍ Factoring/invoice discounting
- ❍ Government grants
- ❍ Loans from family/business partners/directors
- ❍ Leasing or hire purchase
- ❍ Peer-to-peer networks
- ❍ Crowdfunding
- ❍ Other (please specify) ______________________

If none of the above is selected, then skip to – 'If no external finance has been sought ...'

Q17 Of the selected funding sought in the last five years, approximately what percentage was successfully obtained?

Q18 Did you have any difficulties in obtaining external finance from the first source you approached?

- ❍ Unable to obtain any finance
- ❍ Obtained some but not all of the finance sought
- ❍ Obtained all the finance but with some problems
- ❍ Obtained the finance sought but on poor terms
- ❍ No difficulties in obtaining finance

Q19 What was the purpose of the funding sought?

- ❍ Invest in new capital equipment
- ❍ To use for working capital
- ❍ Develop new products or processes
- ❍ Enter new markets
- ❍ Increase the skills of the workforces
- ❍ Increase the leadership capability of managers
- ❍ Employ more staff
- ❍ Buy new property or premises
- ❍ Acquire another business
- ❍ Other (please specify)______________________

Q20 Was external advice sought before making an application (either for a loan or overdraft facility)?

- ❍ Yes (please specify) ____________________
- ❍ No

Q21 How important was this advice in making your application?

- ❍ Extremely unimportant
- ❍ Very unimportant
- ❍ Neither important nor unimportant
- ❍ Very important
- ❍ Extremely important

Answer if 'What types funding has been sought by your business in the last five years?' – 'None of the above' is selected

Q22 You indicated that no external finance was sought by your firm. What was the main reason for this?

- ❍ No money needed
- ❍ You thought you would be rejected
- ❍ You thought it would be too expensive
- ❍ You don't want to take on additional risk
- ❍ You did not know where to find the appropriate type of finance

Q23 Over the last five years, have you felt that you would be turned down by your bank if applying for funding?

- ❍ Yes - I have felt that I would be turned down
- ❍ No - I have not felt that I would be turned down
- ❍ This is not applicable to me, I have not wanted/needed funding from my bank

Answer if 'Over the last five years, have you felt that you would be turned down by your bank if applying ...' – 'Yes, I have felt that I would be turned down' is selected

Q24 As a result, have you been put off seeking external funding because you thought your application would be refused?

- Yes - I have been put off applying for funding because of this
- No - I have not been put off applying for funding

Q25 Over the last five years have you made any informal enquiries about obtaining finance to a lending institution such as a bank?

- Yes
- No

Answer if 'Over the last five years have you made any informal enquiries about obtaining finance to a lending institution such as a bank?' – 'Yes' is selected

Q26 Following these enquiries, did you feel encouraged to apply for funding or not?

- Yes - I felt encouraged to apply for funding
- No - I felt discouraged to apply for funding

Q27 How much do you trust your main bank? (On a scale of 1-5 please rank how much you trust your main bank, with 1 indicating low levels of trust and 5 indicating high levels of trust)

- 1 - low
- 2
- 3
- 4
- 5 - high

Answer if 'How much do you trust your main bank? (On a scale of 1-5 please rank how much you trust your main bank; with 1 indicating low levels of trust and 5 indicating high levels of trust)' – '5- High' is not selected

Q28 Does a lack of trust in your bank make you less likely to access finance from them?

- Yes
- No

Q29a Please say whether you agree or disagree with the following statements regarding applying for bank funding

	Strongly disagree	Disagree	Agree	Strongly agree	Not applicable
Banks do not understand my business	❍	❍	❍	❍	❍
Previous loan rejections make me less likely to apply for bank funding	❍	❍	❍	❍	❍
I do not want to lose autonomy with my business by applying for funding	❍	❍	❍	❍	❍
The nature of personal guarantees put me off applying for funding	❍	❍	❍	❍	❍
I am concerned about the terms and conditions of bank finance (e.g. that they are too punitive)	❍	❍	❍	❍	❍
I prefer using retained earnings	❍	❍	❍	❍	❍

Q29b Please say whether you agree or disagree with the following statements regarding applying for bank funding (continued)

	Strongly disagree	Disagree	Agree	Strongly agree	Not applicable
Informal enquiries to the bank were off-putting	❍	❍	❍	❍	❍
Switching to a new bank is too much of a hassle	❍	❍	❍	❍	❍
The cost of switching to a new bank would be too high	❍	❍	❍	❍	❍
I fear that facilities would be withdrawn if conditions deteriorate	❍	❍	❍	❍	❍
The cost of borrowing from the bank would be too high	❍	❍	❍	❍	❍
Conditions of covenants are unfavourable	❍	❍	❍	❍	❍
The response time to my application is important to me	❍	❍	❍	❍	❍

Q30 Have the previously mentioned factors made you more reluctant to undertake external borrowing in the last five years?

❍ Yes
❍ No

Q31 How important is the issue of personal guarantees for you when seeking external finance?

❍ Not at all important
❍ Very unimportant
❍ Neither important nor unimportant
❍ Very important
❍ Extremely important
❍ Not applicable (I do not use external finance)

Answer if 'How important is the issue of personal guarantees for you when seeking external finance?' – 'Not applicable (I do not use external finance)' is not selected

Q32 How important is the nature of loan covenants (the terms and conditions of the loan as stipulated by the lender) for you when seeking external finance?

- ❍ Not at all important
- ❍ Very unimportant
- ❍ Neither important nor unimportant
- ❍ Very important
- ❍ Extremely important

Q33 What impact does your reluctance to seek, or inability to obtain, external credit have on the growth of your business?

- ❍ This is not applicable to me - I have not been reluctant/unable to seek finance
- ❍ No likely discernible impact
- ❍ Continued growth but at a more modest level
- ❍ Clear reduction in growth
- ❍ Potential for business closure
- ❍ Don't know/difficult to predict
- ❍ Other ____________________

Q37 Could you tell us about your experiences trying to access funding?

Q34 Would you be willing to participate in a short telephone interview on this topic?

- ❍ Yes
- ❍ No

Answer if 'As part of our research we would like to conduct a number of interviews in order to gain a better...' – 'Yes' is selected

Q35 Thank you for agreeing to participate in a follow up interview. Please provide your contact details so that one of our researchers can get in contact with you once the survey has closed.

Name
Company
Telephone
E-Mail
Other

ABOUT THE AUTHORS

Dr Ross Brown is a lecturer in the School of Management, University of St Andrews. Ross is a member of the University's Centre for Responsible Banking and Finance. He is an expert in entrepreneurship, innovation and SME funding. Ross worked for over a decade as a research manager for the economic development agency, Scottish Enterprise. He recently advised the LEED programme within the OECD and the South African government on policies to support high growth entrepreneurship. He has published extensively in these areas in journals such as *Small Business Economics, Regional Studies* and the *Journal of Economic Geography*.

Dr Neil Lee is an Assistant Professor of Economic Geography, London School of Economics and an Academic Fellow of the Centre for Responsible Banking and Finance, University of St Andrews. The former Head of Research at the Work Foundation, Neil is a leading authority on innovation, high growth firms and funding issues facing SMEs. He is currently advising the Northern Irish Government on supporting high-growth entrepreneurship. He has worked on a number of externally funded research projects on innovation, economic disparities and high growth entrepreneurship, publishing extensively in these research areas in prestigious academic journals such as the *Journal of Economic Geography, Economic Geography and Research Policy*.

Alexander Stanley is a PhD research student and research assistant at the University of St Andrews School of Management. His current research interests focus on high growth firms, leadership and business sustainability.

High growth small and medium-sized entities (SMEs) are an important contributor to the economy and job creator in the UK. But is the demand and supply of finance to this section of the economy impeding growth? And if so, what can be done to improve access to finance and growth. Should funding initiatives be specifically targeted at high growth SMEs?

This report addresses these important questions by analysing the borrowing requirements of SMEs (high growth and non-high growth) and the factors that may deter or discourage such firms from borrowing. The research is based on a survey and interviews with high growth and non-high growth SMEs and interviews with banks, alternative financial providers and UK policy makers.

The research finds that there is strong demand from SMEs for external finance but that there is also a high number of discouraged borrowers with trust of banks a continuing issue. The impact on growth of being either reluctant or unable to borrow is significant – with 63% expressing the view that the absence of funding would lead to either more modest levels of growth, a clear reduction in growth or closure of the business.

The report concludes with policy recommendations, suggesting that focusing purely on supply side measures will not be sufficient to address ongoing external funding issues for SMEs.

ISBN 978-1-909883-37-6
EAN 9781909883376

Price: £10.00

ICAS

CA House 21 Haymarket Yards Edinburgh EH12 5BH
research@icas.com +44 (0)131 347 0237 icas.com/research