

What is the impact of unfair access to finance on SMEs?

SMEs are crucial to the UK economy

- At the start of 2011 there were around 4.5 million SMEs in the UK representing 99.9 per cent of British businesses. These accounted for over half of private sector employment and nearly half of all private sector turnover.¹
- SMEs increase innovation and stimulate competition.² High growth SMEs, in particular, lead to an increase in private sector employment growth.³
- SMEs have the potential to contribute significantly to economic recovery of the UK and, in turn, the development of communities, driving enterprise, employment and stability.
- It has been estimated that *'if the UK can create the conditions that have enabled medium-sized businesses in other countries to flourish... that would enable them to play a vital role in transforming the UK's economic growth over the next ten years, contributing as much as £50 billion to the economy by 2020, and creating job opportunities across all regions of the UK.'*⁴

SMEs are suffering in the wake of the financial crisis and finding it harder to access finance

- Bank lending to SMEs peaked in 2009 and has been declining.⁵ In 2010, 21% of SMEs that sought finance in the UK were unable to obtain it from any source. This is a significant increase from the 8% of businesses in the same situation in 2007/2008.⁶
- Access to finance is important for funding investment, growth and for facilitating new business start-ups.⁷

- A survey conducted by the British Chambers of Commerce in June 2012 found that 42% of businesses believed access to finance issues would have either 'a strong influence' or 'a significant influence' on their business during 2012.⁸
- Bank lending to SMEs has not yet shown any recovery and the decline in lending has been even greater for smaller SMEs with less than £1 million turnover.⁹

SMEs in deprived areas are finding it even harder to get fair access to finance

- Only 3.5 – 4.5% of total lending to SMEs goes to businesses in the most deprived communities. This proportion has not changed for a decade.¹⁰
- Some firms are identified as 'high risk' because the borrowers may live and/or work in deprived areas where banks will not lend money. *'In effect, the recent changes to mainstream finance lending practices have created greater uneven geographies of finance and deeper levels of financial exclusion.'*¹¹
- A recent study investigated whether firms in deprived areas perceived different barriers to success than other firms. They found that the only perceived barrier related to location of the firm was that of access to finance. Other factors such as demand, cash flow and recruitment were not different in deprived areas compared to others.¹²

The Government is providing a number of schemes to support SME access to finance

- A number of schemes have been introduced by the Government to improve access to finance for SMEs:
 - **Enterprise Finance Guarantee (EFG)** was launched in January 2009 and *'is a loan guarantee scheme to facilitate additional lending to viable small and*

medium size enterprises lacking adequate security or proven track record for a normal commercial loan'¹³

- **Enterprise Capital Funds.** Launched in 2006, these are commercially managed venture capital funds providing equity finance to high growth potential SMEs. Around two thirds of the capital is provided by the Government, with the remainder being raised from private sector sources.¹⁴
- **National Loans Guarantee Scheme (NLGS),** Launched in March 2012, this scheme, *'uses government guarantees on unsecured borrowing by banks, enabling them to borrow at a cheaper rate. Participating banks pass on the entire benefit that they receive from the guarantees to businesses across the UK through cheaper loans'*¹⁵
- **Funding for Lending** was launched in July 2012 and replaced the NLGS. *'It works by allowing banks and building societies to borrow from the Bank of England for up to 4 years. As security against that lending, banks will provide assets, such as business or mortgage loans, to the Bank of England.'*¹⁶
- **Project Merlin,** announced in February 2011 saw the main UK high street banks sign up to an agreement to increased lending, especially to small businesses.¹⁷
- **Business Bank** was announced in September 2012 and full details will not be available until December. It is believed that the Business Bank will focus on supporting long-term lending to small businesses.¹⁸

There are limitations on the extent to which these Government initiatives and the current banking system can support SME access to finance

- The Government initiatives outlined in the previous section have limited impact with criticisms including:
 - Inefficient processes and unclear information¹⁹
 - Lack of awareness – A 2012 report suggested that only 22% of SMEs were aware of the EFG and only 20% of SMEs were aware of the commitment made by banks as part of Project Merlin to increase small business lending²⁰
 - The short-term focus of some of the initiatives, for example EFG is only in place until April 2015²¹
 - Over-reliance on the current banking system²²
- This over-reliance on the current banking system is potentially flawed for the following reasons:
 - As a result of the economic crisis, banks are now more cautious when assessing risk.²³
 - There are fewer banks the high street, reducing the service provided to small businesses.²⁴
 - Banks have replaced investment decisions based on local judgement with decisions based on credit scoring software.²⁵
- These issues have hindered the success of the Government initiatives described in the previous section, for example:
 - The lending agreed under Project Merlin in March 2011 was £1 billion behind by the end of September of the same year²⁶
 - Demand for EFG has been declining²⁷
 - Not all banks agreed to participate in NLGS, negotiations with lenders were slow and little progress was made²⁸

It is too early to see the impact of more recently introduced schemes such as Funding for Lending and the Business Bank.

CDFIs provide an alternative to traditional banking but are currently limited in their scope

- *'Community Development Finance Institutions (CDFIs) lend money to businesses, social enterprises and individuals who struggle to get finance from high street banks and loan companies. They help deprived communities by offering loans and support at an affordable rate to people who cannot access credit elsewhere.'*²⁹
- Since 2004, CDFIs have loaned to 11,400 businesses³⁰
- In 2010/11 nearly half of the business loans were to start ups³¹
- Loan amounts varied but an average loan to a micro business was £11,300 and to an SME was £37,000³²
- APR on business loans ranged but on average was 14% on a micro business loan and 13% on an SME loan.³³
- In the UK, CDFIs are 'lenders of last resort' as borrowers usually have to demonstrate lack of available funds from more traditional sources meaning this type of funding is not available to all SMEs
- Some sectors and locations are not currently covered by CDFIs in the UK³⁴

¹ <http://www.bis.gov.uk/assets/biscore/enterprise/docs/s/12-539-sme-access-external-finance.pdf>

² <http://www.bis.gov.uk/assets/biscore/enterprise/docs/s/12-539-sme-access-external-finance.pdf>

³ <http://newsroom.axa.co.uk/media/76579/axa-international-small-business-report-2011.pdf>

⁴ http://www.cbi.org.uk/media/1196347/cbi_future_champs_a5summary.pdf

⁵ http://www.civitas.org.uk/economy/Hatton_USUKSMEs.pdf

⁶ <http://www.bis.gov.uk/assets/biscore/enterprise/docs/s/12-539-sme-access-external-finance.pdf>

⁷ <http://www.bis.gov.uk/assets/biscore/enterprise/docs/s/12-539-sme-access-external-finance.pdf>

⁸ http://www.britishchambers.org.uk/assets/downloads/policy_reports_2012/12-09-03%20State%20Backed%20Business%20Bank%20Report.pdf

⁹ <http://www.bis.gov.uk/assets/BISCore/enterprise/docs/S/12-539-sme-access-external-finance.pdf>

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- ¹⁰ <http://www.cdf.org.uk/wp-content/uploads/2012/05/Responding-to-the-financial-crisis-in-our-communities.pdf>
- ¹¹ Appleyard, L. (2011). Community Development Finance Institutions (CDFIs): Geographies of financial inclusion in the US and UK. *Geoforum*, 42, 250-258
- ¹² <http://www.theworkfoundation.com/blog/831/Enterprise-in-deprived-areas-Different-problems-or-different-firms>
- ¹³ <http://www.bis.gov.uk/efg>
- ¹⁴ <http://www.bis.gov.uk/assets/biscore/enterprise/docs/s/12-539-sme-access-external-finance.pdf>
- ¹⁵ <http://www.hm-treasury.gov.uk/nlgs>
- ¹⁶ http://www.hm-treasury.gov.uk/ukecon_fundingforlending_index.htm
- ¹⁷ <http://www.bbc.co.uk/news/business-12406495>
- ¹⁸ <http://www.bbc.co.uk/news/uk-politics-19691162>
- ¹⁹ http://www.britishchambers.org.uk/assets/downloads/policy_reports_2012/12-09-03%20State%20Backed%20Business%20Bank%20Report.pdf
- ²⁰ http://www.cbi.org.uk/media/1314437/breedon_review_submission_feb_2012.pdf
- ²¹ http://www.civitas.org.uk/economy/Hatton_USUKSMEs.pdf
- ²² http://www.neweconomics.org/sites/neweconomics.org/files/A_local_banking_system.pdf
- ²³ <http://www.bis.gov.uk/assets/biscore/enterprise/docs/s/12-539-sme-access-external-finance.pdf>
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- ²⁶ http://www.neweconomics.org/sites/neweconomics.org/files/A_local_banking_system.pdf
- ²⁷ http://www.civitas.org.uk/economy/Hatton_USUKSMEs.pdf
- ²⁸ <http://www.guardian.co.uk/business/2012/sep/16/vince-cable-new-bank-truth-lending-failing>
- ²⁹ <http://www.cdfa.org.uk/about-cdfis/what-is-a-cdfi/>
- ³⁰ <http://www.cdfa.org.uk/wp-content/uploads/2012/07/Inside-Community-Finance-June-2012.pdf>
- ³¹ <http://www.cdfa.org.uk/wp-content/uploads/2012/07/Inside-Community-Finance-June-2012.pdf>
- ³² <http://www.cdfa.org.uk/wp-content/uploads/2012/07/Inside-Community-Finance-June-2012.pdf>
- ³³ <http://www.cdfa.org.uk/wp-content/uploads/2012/07/Inside-Community-Finance-June-2012.pdf>
- ³⁴ <http://www.birmingham.ac.uk/Documents/college-social-sciences/social-policy/CHASM/briefing-papers/2012/briefing-paper-cra-march2012.pdf>