Finance for Small and Medium-Sized Enterprises

A Report on the 2004 UK Survey of SME Finances

Dr Stuart Fraser
Centre for Small and Medium-Sized Enterprises
Warwick Business School
University of Warwick

EXECUTIVE SUMMARY

Background to the research

In January 2004, a consortium of 19 public and private sector organizations, led by the Bank of England (see Appendix 2), commissioned Warwick Business School to carry out the UK Survey of SME Finances (SMEF). This is the first representative survey of SMEs in the UK to offer a close analysis of businesses (with fewer than 250 employees), their main owners and access to external finance.

The aims of the study were to:

- Provide benchmarking data on the availability of credit to SMEs and the types of finance used.
- Collect information on the relationship between SMEs and their providers of finance.
- Develop a general purpose micro database for quantitative research on business finance (offering, for example, scope for comparisons with US business finances).

The survey was conducted among a representative sample of 2,500 SMEs, in the private sector, in the UK. The survey fieldwork was carried out by Computer Assisted Telephone Interview (CATI). This was conducted by IFF Research, an independent market research company, at IFF's CATI centre, between 5 August and 18 October 2004.

Structure of the Report

This report constitutes a summary analysis of the results of the survey. The report is divided into three parts. In the first part, we set out some background for the analysis. Specifically, this background is in the form of: a discussion of some key issues affecting SME finances (Section 1); and, an analysis of contextual data, relating to the characteristics of the businesses in the survey and the range of problems experienced in running them (Section 2).

In Section 1, the issues discussed are:

- Potential sources of market failure in SME finance markets – in particular, information asymmetries between lenders and borrowers.
- Underinvestment in financial skills and the impact on access to finance.
- The desire for independence/ high internal locus of control as an internal constraint on access to external finance.
- The lack of competition in markets for SME financial services (principally money transmission and bank debt).

The analysis in Section 2 allows a perspective to be gained on businesses' perceptions of their financing problems relative to other operational issues.

The second part of the report provides a general overview of the data relating to the demand and supply of SME financial products. On the demand-side, we look at:

- The range of financial products currently used by SMEs (Section 3)
- New finances sought in the last 3 years (Section 4).

In Section 5, we look at the extent of *unsatisfied* demand among businesses needing new finance. In this context, we look at the extent of:

- Outright rejection.
- Partial Rejection (i.e., the businesses were offered less than they wanted).
- Discouragement (i.e., the businesses did not apply for new finance because they *believed* they would be rejected).

The second part concludes by examining issues relating to the supply of SME financial services (Section 6). The policy setting for this analysis is public concern about a lack of competition in the supply of financial services to SMEs. These concerns have led the Competition Commission to make a number of recommendations to make it easier for businesses: to compare the prices of banking services; to purchase these services from different suppliers; and to switch banks if desired (Competition Commission, 2002). In this context we look at:

- The market shares of the main providers of financial services to SMEs.
- The number of different providers used.
- The nature of relationships with the main providers, principally
  - The breadth of relationships (number of financial services supplied by the main provider)
  - The length of relationships.
  - The cost of banking.
  - Levels of customer satisfaction.
  - The propensity to switch banks.

This analysis allows us to:

- Examine the extent to which the supply of financial services is concentrated in a single supplier.
- The degree of variation in charges across different providers.
- The willingness of businesses to seek another provider.
- The factors which motivate switching – e.g., dissatisfaction with price or service.

The third part of the report presents analysis of the average and total amounts used of the different forms of finance. The analysis concludes by looking at the relationships between finances to determine which finances could be considered to be in competition with one another. In particular, this analysis gives some indication of which types of finance are potential alternatives to traditional bank debt. Appendices are used throughout to present more extensive tabulations.

Summary of the Results

Section 2: Contextual Data Analysis

The analysis in Section 2 relates to:

- Business and principal owner characteristics.
- Use of external financial advice.
- Self-assessed skills in different aspects of running the business.
- Extent to which financially qualified individuals are running SME finances.
- Extent of problems in different aspects of business operations.

Regarding business characteristics the data show that by size:

- 2,200,000 businesses have no employees (about 61% of SMEs).
- 1,450,000 businesses have an annual turnover of less than £50,000 (about 40% of SMEs).
- 1,350,000 businesses have less than £10,000 worth of assets.

By sector:

- More than a third of SMEs are in Real Estate, Renting and Business Activities (some 1.3 million businesses)
- Only 5% are in manufacturing (around 180,000 businesses).

By region:

- 38% of SMEs are located in London and the South East (1,400,000 businesses).
- 87% of SMEs are located in England (3,150,000 businesses).
- 5% are located in Scotland.
- 5% are located in Wales.
- 3% are located in Northern Ireland.

By legal form:

- Almost 2 in 3 businesses are sole traders (2,400,000 businesses)
- Less than 1 in 4 businesses are limited liability companies (870,000 businesses)
- About 1 in 10 businesses are partnerships (including limited liability partnerships).

By age:

- The majority of businesses (51%) are aged more than 15 years (1,900,000 businesses).
- About 7% of SMEs are start-ups (aged less than 2 years) (250,000 businesses).

By growth rate:

- About 11% of businesses (320,000 businesses) are high growth businesses, having an average turnover growth of 30%, or more, per annum over a period going back up to 3 years.

By ethnicity:

- 93% of businesses are majority white owned (3,400,000 businesses).
- About 7% of businesses are majority owned by individuals from ethnic minority backgrounds (220,000 businesses).

By gender:

- 75% of businesses are majority owned by males (about 2,700,000 businesses).
- 25% of businesses are majority owned by females (just over 900,000 businesses).

Regarding the characteristics of the *principal* owner:

- A woman is the principal owner in 1 in every 5 SMEs.
- 79% of principal owners are aged between 40 and 65.
- In addition, 61% of principal owners have more than 15 years business experience.
- 29% of principal owners have no or, at most, basic (O-levels/GCSE), academic qualifications.
- 23% have a University degree.

Comparing business and principal owner characteristics with those in the US:

- US businesses tend to be larger, on average, than UK businesses.
- US businesses tend to be younger, on average, than UK businesses.
- The proportions of female and ethnic minority businesses, in their respective populations, are similar between the UK and US.
- Owner managers in the US are more likely to have a university degree than their UK counterparts.

Looking at the use of external financial advice in the UK:

- Accountants are used as the main source of financial advice in almost one-third of the SME population.
- Bank managers are the main source of advice for 16% of SMEs.
- Over a third of SMEs use no external advisers.

Also, majority female owned businesses are:
- More likely to use an accountant than majority male-owned businesses.
- Less likely to use no external advice than majority male-owned businesses.

Regarding self-assessed skills in different areas of the business's operations:
- Production is the area of operation in which owner managers have the *highest* degree of self-confidence in their abilities.
- Coping with red-tape is the area with the *lowest* self-confidence.
- Self-confidence in financial operations is intermediate along with sales and staffing issues.

Further analysis in this area shows that:
- The self-confidence levels, in majority female owned businesses, are similar to the average levels, across all aspects of business operations.
- 25% of ethnic minority owned businesses report a lack of self-confidence with finance, which is above the average level (16%).
- 28% of ethnic minority owned businesses report a lack of self-confidence in dealing with red-tape, again above average (22%).
- 16% of start-ups report a lack of self-confidence with sales (versus 10% on average).
- Only 1% of high growth businesses report a lack of self-confidence with sales (versus 10% on average).

Regarding formal financial qualifications:
- Only 16% of sole traders and partnerships have their finances managed by someone with a financial qualification.
- There are *no* significant differences, in the incidence of financially qualified management, comparing: female versus male-owned businesses; ethnic minority versus white-owned businesses; start-ups versus established businesses; or high growth versus non-high growth businesses.

Turning to self-reported business problems:

- Production is the area of business operations with the least reported problems.
- Finance is the second least problem area.
- Staffing and red-tape represent the highest problem areas.

A closer inspection of business problems for different types of business suggests that:

- The problem levels, in majority female owned businesses, are similar to the average levels across all aspects of business operations.
- 20% of ethnic minority owned businesses report problems with production, which is above the average level (9%).
- 23% of ethnic minority owned businesses report problems with finance, again above average (11%).

- However, only 10% of ethnic minority owned businesses report problems in dealing with red-tape, which is below the average level (20%).
- 16% of start-ups report problems with production (versus 9% on average).
- The problem levels, in high growth businesses, are similar to the average levels across all aspects of business operations.

Section 3: Use of External Finance

The analysis in Section 3 relates to the types of financial products used by SMEs in the last 3 years. This analysis indicates that:

- 80% of SMEs have used one or more external sources of finance in the last 3 years.
- Use of external finance increases with the number of employees and turnover. It varies from 75% (no employees) to 98% (50-249 employees).
- There are no significant differences in the likelihood of using external finance between male and female owned businesses or between white and ethnic minority owned businesses.

Regarding the types, and amounts, of finance used:

- Just under 2 million businesses (53% of SMEs) use an overdraft
  - The total amount owed in overdrafts is estimated to be £12 billion.
- A similar number use personal or business credit cards (55%)
  - Businesses spend £450 million per month through personal credit cards
  - Expenditure, through business credit cards, is about £1.4 billion per month.
- Approximately 900,000 businesses use term loans (24%)
  - The total amount outstanding on term loans is about £64 billion.
- A similar number use leasing and/or hire-purchase (asset finance) (27%)
  - Total monthly repayments on leasing/hire-purchase agreements are estimated to be £2 billion.
- Grants are used by just under a quarter of a million businesses (6%)
  - The total amount of grants accessed in the last 3 years is about £7.6 billion.
- Invoice finance is used by about 100,000 businesses (3%)
  - This represents an estimated £8 billion in monthly advances.
- About the same number use equity finance (3%: 100,000 businesses)
  - This represents an estimated £14.3 billion in total investment in the last 3 years.

Estimates of the use of friends and family finance show that:

- About 6% of SMEs report using loans or equity finance from friends and family.
- There are no discernible differences, in the use of friends and family finance, by: gender; ethnicity; business age; or growth rate.

Analysis of current and deposit accounts indicates that:

- 97% of SMEs use a current account.
- 41% of SMEs hold funds on deposit.
  - In value terms, this represents an estimated £92 billion in total deposits.
- Start-ups are significantly less likely to hold funds on deposit compared to established businesses (27% versus 43%).

Comparisons of the use of some basic financial products, between the UK and US, reveal the following:

Table ES.1: Comparisons of Financial Products Used in the UK and US

	US SSBF (1998)[1]	UK SMEF (2004)
Any loan [2]	55%	65%
Personal Credit Card	45%	28%
Business Credit Card	33%	34%
Current Account	94%	97%
Deposit Account	22%	41%

Notes:
1. US Survey of Small Business Finance (see e.g., Bitler et al, 2001).
2. For the US, any loan denotes using any of the following: credit lines; mortgages; vehicle loans; equipment loans; or capital leases. For the UK any loan denotes using any one of: overdrafts; term loans; asset finance; or asset-based finance.

- The patterns of usage of financial products are quite similar between the UK and US.
- However, there is some evidence that use of personal credit cards is lower, and use of deposit accounts is higher, in the UK than the US.

Section 4: New Finance Sought in the last 3 years

The analysis in Section 4 relates to *new* finances sought in the last 3 years (not including friends and family finance). This analysis shows that:

- 44% of SMEs (1.6 million businesses) sought new finance in the last 3 years. This percentage varies from 36% (no employees) to 76% (50-249 employees)
- Sole traders are significantly less likely to have sought new finance than either partnerships or companies (37% versus 57%).
- Majority female owned businesses are *no* less likely than majority male owned businesses to have sought new finance.
- However, there is some evidence that ethnic minority owned businesses are *more* likely to have sought new finance than white-owned businesses (61% versus 43%).
- Start-ups are more likely to have sought new finance than established businesses (69% versus 42%).

- Also, 62% of high growth businesses sought new finance versus 41% of slower growing businesses.

Among businesses, which did not seek new finance, 95% report that they did not need new finance. This suggests that a lack of demand, rather than supply side constraints, is the main reason for not seeking new finance.

The amounts of new finance sought are as follows:

- The average amount is just under £82,000 (median=£20,000).
- This amount increases from £29,000 (businesses with no employees) to just over £1 million (50-249 employees).
- Limited companies sought just under £200,000. This amount is significantly higher than the amounts sought by other legal forms of business.
- There are no statistically significant differences in the amounts sought by female-owned versus male-owned businesses.
- However, ethnic-minority owned businesses sought just over £28,000 on average. This is significantly less than the amount sought by white-owned businesses (£85,000).
- There are no significant differences in the amounts of finance sought by age of business or growth rates.

The types of new finance sought are:

- Overdrafts: 32%
- Grants: 15%
- Term loans: 40%
- Asset finance: 39%
- Asset-based finance: 2%
- Equity finance: 7%.

Looking at start-up finance (businesses aged less than 2 years):

- Well over 2 in 3 start-ups used personal savings
- 1 in 8 used a friend or family loan as part of their start-up finance.
- The use of equity finance is very small (1.6%) with investors being mainly family and friends.
- Over 1 in 20 start-ups claimed to have used no finance to establish their business.

As for the *main* source of start-up finance:

- Personal savings were the principal source of finance for 2 in every 3 start-ups.
- 1 in 10 relied mainly on a bank loan.
- Less than 1 in 20 entrepreneurs relied mainly on a mortgage on their home.

The average amount of finance used at start-up is estimated at £71,000; the median amount is just over £15,000.

Section 5: Rejection and Discouragement

In Section 5 we look at experiences of rejection and discouragement in applying for external finances (not including friends and family finance) in the last 3 years. This analysis estimates that:

- 11% were rejected outright (180,000 businesses)
- 19% received less than they wanted (300,000 businesses)
- 8% felt discouraged from applying because they believed they would be rejected (130,000 businesses).

Further analysis shows:

- Businesses with greater assets tend to experience fewer rejections and less discouragement. This is, perhaps, unsurprising since these businesses have more collateral to offer lenders.
- Sole traders are more likely to experience discouragement than partnerships (10% versus 2%).
- Businesses in Northern Ireland have the lowest outright rejection rate (1%) but the second highest discouragement rate (14%).
- Start-ups are less likely to experience outright rejection than established businesses (4% versus 12%). However, this figure does not take into account businesses which did not get started as a result of rejection (since these businesses are not observed in the sample).
- There are *no* significant differences in rejection or discouragement rates by gender, ethnicity or growth rate.
- Similarly, there is *no* evidence that switching banks, or using more than one provider of financial services, increases the likelihood of rejection or discouragement.

Among businesses needing a new overdraft:

- 16% were rejected outright
- Greater than 1 in 3 received less than they wanted
- 7% felt discouraged from applying.

Among businesses needing a new loan:

- 9% were rejected outright
- 6% received less than they wanted
- 9% felt discouraged from applying.

Among businesses needing a new lease/hire-purchase:

- 5% were rejected outright
- 3% received less than they wanted
- 7% felt discouraged from applying.

Looking at businesses' views of the reasons for rejection, denial rates due to no, or insufficient, security are:

- 22% for overdrafts.
- 12% for term loans.

Rejection rates due to a lack of track record (no credit history) are:
- 8% for overdrafts.
- 7% for bank loans.

On the other hand, rejection rates due to a poor credit history are:
- 5% (personal history) and 11% (business history) for overdrafts.
- 4% (personal history) and 4% (business history) for term loans.

A further:
- 5% of overdraft rejections are due to the business having too much existing debt.
- 15% of loan rejections are due to an inadequate business plan.

These results suggest that a sizeable proportion of businesses are rejected due to having no security or track record (30% overdrafts; 19% term loans). These businesses are *potential* candidates for assistance through the Small Firms Loan Guarantee Scheme (although further analysis would be required to establish their eligibility for the scheme).

Analysis of the impact of (term loan) rejections showed that:
- The project went ahead, with other funding, in 3 out of 5 rejections.
- The plans had to be shelved, for a short time, in just under 30% of rejections.
- The business had to drop its plans completely, or found itself in dire financial straits, in less than 1 in 20 cases of rejection.

We conclude Section 5 by estimating an econometric model relating incidences of rejection to levels of financial skills and other business characteristics (for sole traders and partnerships only). The key findings from this model are:
- Businesses, with qualified financial managers, are 3 percentage points *less* likely to experience rejection, holding other business characteristics constant.
- Low self-confidence in dealing with finances has *no* impact on the likelihood of rejection.
- Also, using no external advice *does not* increase the likelihood of rejection.

Section 6: Providers of Finance

In this section we look at SMEs relationships with providers of finance. In the first analysis we look at the market shares of the main providers of financial services to SMEs. Here we find that:
- The largest four providers account for almost 80% of the market.
- The largest provider is the main provider to 1 in 4 SMEs.
- The two largest providers account for 42% of the market.

Market shares by geographical region are as follows:

- In England and Wales the top four providers supply just over 80% of the market.
- In Scotland the top four providers supply 95% of the market.
- In Northern Ireland the top four providers supply almost 90% of the market.

Analysis of the number of different providers of finance used indicates that:

- The majority of SMEs have only one main provider (59%).
- Less than 1 in 10 businesses have used three or more providers.
- Only 1 in 50 have used four or more providers.
- 71% of businesses, with term loans, have these loans supplied by the same bank which supplies their current account.

Longer financial relationships may help lenders to assess the creditworthiness of businesses and improve businesses' access to finance. In this context, our analysis finds that:

- On average, SMEs have been with their main provider for almost 15 years.
- Larger businesses tend to have had a longer relationship than smaller businesses.
- Majority male-owned businesses have longer financial relationships than majority female owned businesses (15 years versus 12 years).
- Majority white-owned businesses have longer financial relationships than majority ethnic-minority owned businesses (15 years versus 10 years).
- High growth businesses have only half the average relationship of lower growth businesses (8 years versus 16 years).

Looking at bank charges (not including loan interest payments) the survey indicates that:

- SMEs pay, on average, £51 in total monthly bank charges.
- This figure ranges from £25 for businesses with no employees, up to £430 for businesses with 50-249 employees.
- By turnover, charges range from under £15 per month up to £430 per month.
- The amount charged, by bank, varies from £26 to £85 per month.
- There is little variation in the charges of the largest four banks.

The four major clearing groups, Royal Bank of Scotland Group, Barclays; Lloyds TSB and HSBC, were identified, by the Competition Commission (2002), as making excess profits from their SME banking. In order to remove these profits, the 'big four' have undertaken, with the Office of Fair Trading, to pay interest on current accounts or waive charges on money transmission services (since 1st January 2003). Relating to this issue the survey finds that:

- More businesses report receiving interest on their account than free transactions.
- 2 in every 3 SMEs report receiving free transactions and/or interest on their current account.
- This figure rises to 4 in every 5 SMEs for accounts opened since 2003.

Regarding satisfaction with bank charges:

- The majority of SMEs (61%) are satisfied, to some degree, with their bank charges.
- However a sizeable minority of businesses, almost 1 in 3, report some dissatisfaction with their bank charges.

In respect of other aspects of the services provided by banks:

- Just under two-thirds of businesses are either very, or fairly, satisfied with the availability of finance at their bank.
- However 1 in 4 businesses are unable to say whether they are satisfied or dissatisfied with the availability of finance. This could be because the business has not sought any finance from its bank.
- Almost 90% of businesses are satisfied with the competence of bank staff.
- More than two-thirds are satisfied with their bank's level of understanding of their business.
- However about 15% are unable to say whether they are satisfied or dissatisfied with their bank's level of understanding of their business.

In a competitive environment, one means for businesses to express dissatisfaction with their current bank is to move to another bank. In this context, we look at (ex-post) switching rates and the propensity to switch banks in the future. Here we find that:

- The annual rate of bank switching is just above 2% over all types of business.
- This figure rises to 5% among businesses with a turnover in the range £250,000-£499,999.
- Over 7% of SMEs are currently considering switching to a new provider from their current bank.
- A further 29% of SMEs would consider switching if approached by another bank.

In addition:

- Businesses with qualified financial managers are more likely to switch than businesses without qualified financial managers. This suggests that a lack of financial acumen could be a barrier to switching.
- Start-ups are 3 times less likely to have switched than established businesses (most likely, because they have not been around long enough to make a switch). However, start-ups are twice as likely, as established firms, to be considering switching.
- High growth businesses are 3 times more likely to have switched than slow growing businesses.

Among switchers, the reasons for switching are because:

- The business was attracted by better borrowing terms and/or charges at their current bank (1 in 4 switches).
- The business felt compelled to change banks because they had been refused finance at their previous bank (fewer than 1 in 20 switches).

- The business was offered better services/facilities at their current bank and/or were generally dissatisfied with the service at their previous bank (more than 1 in 2 switches).
- The business was offered lower charges at their current bank (1 in 7 switches).
- The business was offered lower borrowing rates at their current bank (1 in 10 switches).

Switching, it appears, is more sensitive to dissatisfaction with service than charges or borrowing rates.

Regarding the ease of switching, the majority of switchers rate the process as being easy (the median score is 8, on a scale of 1 – extremely difficult – to 10 – extremely easy)

A potentially significant barrier to new suppliers of banking services is if they need to offer customers a local branch network. In this context, we look at the most frequently used method of doing business with the main bank. The results here show that:

- Visiting a branch is the most frequent method of banking among all SMEs, and businesses with fewer than 10 employees.
- Telephone banking is the most frequent method of banking among businesses with 10-249 employees
- Internet banking is used by around 1 in 7 SMEs.
- This figure is higher than 1 in 4 for larger SMEs (50-249 employees) and is more popular than visiting a branch.

Overall these results suggest that technology, facilitating distance banking, could have a beneficial impact on competition for larger SMEs (by circumventing the need for new entrants to provide customers with a local branch network). However, having access to a local branch remains important for smaller businesses.

The key results from the analyses of specific finances (Sections 7-15) are as follows:

Section 7: Deposit Accounts

- The average amount held on deposit by SMEs is £61,000 (±£14,000).

The following motives for holding deposits are reported:

- A *transactions* motive (e.g., 'to meet day to day requirements' or to 'fund a specific project') is reported by more than 1 in 3 businesses holding deposits.
- A *precautionary* motive is reported by almost 1 in 3 businesses holding deposits ('buffer against a rainy day').
- An *asset* motive ('to earn extra interest') is reported by more than 1 in 4 businesses holding deposits.

Section 8: Term Loans and Overdrafts

- The average amount outstanding on *all* term loans is £88,000 (±£20,000).

- The average size, of the largest individual term loan, is just under £100,000.
- Only 38% of largest term loans are secured. These loans have an average size of £148,000.
- 60% of largest term loans are unsecured. These loans have an average size of just under £70,000.
- Start-ups have smaller term loans than established businesses (£61,000 versus £103,000). This result is robust when controlling for other business characteristics.
- There are no significant differences in the size of term loans by gender, ethnicity or growth rate.

The main purposes of the largest term loan are to fund:
- Premises (28% of businesses).
- Working capital (16% of businesses).
- Motor vehicles (15% of businesses).
- Equipment (9% of businesses).

Looking at the analysis of overdrafts:
- The average amount overdrawn is just over £21,000 (±£9,000).
- The average secured overdraft limit is £83,000. These overdrafts account for 27% of all overdrafts.
- The average unsecured overdraft limit is just under £20,000. These overdrafts account for 70% of all overdrafts.
- Ethnic minority owned businesses have significantly lower overdraft limits than white owned businesses (£18,000 versus £35,000).
- Start ups have significantly lower overdraft limits than established firms (£7,000 versus £35,000).

The main purposes of having an overdraft facility are:
- To fund working capital (50% of businesses)
- As a safety net (34% of businesses)
- To ease pressure on cash-flow (4% of businesses).

Looking at margins on bank debt, for term loans:
- The median margin is about 2 points over Base.
- The bulk of margins for businesses with no employees lie between 0 and 3 points over Base.
- For businesses with 10-49 employees, most margins lie between 1.5 and 2.5 points over Base.
- There are very few instances of margins exceeding 5 points over Base.

The margin data for overdrafts indicates that:
- The median margin is about 2 points over (Bank of England) Base.
- This figure is closer to 1 point over Base for medium-sized firms (50-249 employees).

- The bulk of margins lie between 0 and 2 points over Base.
- There are very few instances of margins exceeding 5 points over Base.

Comparing margins for different types of business we find that:

- Very long financial relationships tend to reduce margins relative to intermediate relationships.
- Majority female-owned businesses pay significantly *higher* margins on term loans than male-owned businesses (2.9 versus 1.9 percentage points over Base). This result is robust when controlling for business and loan characteristics.
- Ethnic-minority owned businesses pay significantly *lower* margins on term loans than white-owned businesses (1.2 versus 2.3 percentage points over Base). Again, this result is robust when controlling for business and loan characteristics.
- There are no significant differences, in either overdraft or term loan margins, by business age or growth rate.
- Also, switching banks, or using multiple providers, does not appear to increase the cost of borrowing.

An estimated 5% of businesses failed to make one or more of the payments due on their loan in the last 12 months.

Section 9: Asset Finance (Leasing and Hire-Purchase)

Analysis of the types of asset finance used indicates that:

- About 1 in 3 use leasing only.
- 3 in 5 use hire-purchase only.
- Less than 1 in 10 use both leasing and hire-purchase.
- The incidence of using both forms of asset finance increases with firm size: almost 1 in 4 medium-sized firms (50-249 employees), using asset finance, have both forms.

Regarding the amounts of these finances used

- The average monthly repayment on leasing and/or hire-purchase is just over £3,000.
- This represents total monthly repayments of £2 billion.
- Ethnic minority owned businesses make significantly lower monthly repayments than white owned businesses (£709 versus £3,123). This result is robust when controlling for other business characteristics.

Looking at the purposes of asset finance:

- 72% of businesses use it to pay for vehicles.
- 11% of businesses use it to pay for computer equipment.
- 9% of businesses use it to pay for machinery.

About 1.5% of asset finance users failed to make at least one re-payment in the last year.

Section 10: Asset Based Finance (Factoring, Invoice Discounting and Stock Finance)

Analysis of the types of asset based finance used indicates that:

- More than a half use invoice discounting.
- 2 in 5 use factoring.
- 1 in 20 use stock finance.
- Large numbers of businesses 'don't know' the type of asset-based finance being used.

Looking specifically at invoice finance (invoice discounting and factoring):

- The average amount advanced per month is estimated to be £146,000.
- The estimated total advanced is just under £8 billion.

The main purposes of using invoice finance are to:

- Fund working capital (2 in 3 businesses).
- Fund business expansion and acquisition (1 in 4 businesses).

Section 11: Credit Cards

- The average amount charged to personal credit cards is estimated to be £433 per month.
- This represents a total monthly expenditure of £450 million.
- Business credit cards accrue estimated monthly expenditures of over £1,100.
- This amounts to a total of £1.4 billion per month.

Regarding the purposes of credit card expenditures:

- The reasons for using credit cards are very similar across personal and business credit cards.
- In particular, the majority of these expenditures are to fund day to day expenses such as: paying for raw materials (39%); motor (39%) and travel expenses (39%); and sundry expenses (25%).
- However significant numbers use credit cards to pay for fixed capital: about 12% use them to pay for equipment and vehicles; and 5% purchase other fixed assets.

Further analysis of credit card data shows that:

- 21% of business owners never re-imburse themselves for business expenditures on personal credit cards.
- 19% are occasionally re-imbursed for these expenditures.
- 58% are always re-imbursed in full for these expenditures.
- 79% pay-off business expenditures, on *personal* credit cards, *in full* at the end of each month – implying, that 1 in every 5 owners borrow for business purposes on their personal credit cards.
- 95% pay-off business expenditures, on *business* credit cards, in full at the end of each month – about 1 in 20 borrow on business credit cards.

Section 12: Equity Finance

- The average equity investment, in the last 3 years, is estimated at just under £135,000.
- The total raised from all equity investors, in the last 3 years, is just over £14 billion.
- However there is a large degree of uncertainty in these estimates, reflecting the small sample size of equity users.

Regarding the types of investor used (among businesses with equity investments):

- Directors are the most popular, named, source accounting for 1 in 4 equity investments.
- About 1 in 10 of these businesses has received funds from existing shareholders or friends.
- 1 in 50 obtained funding from a venture-capitalist.

Looking at the reasons for using equity supplied by friends, family or directors as opposed to other sources:

- 1 in 5 business-owners cited the following reasons: 'to maintain control of the business'; or 'no need for another source'.
- Less than 1 in 20 cited supply-side constraints ('unable to raise equity from other sources').

These findings do not appear to support the notion of an 'equity gap' in the supply of formal venture capital to SMEs. However, the interpretation of these results requires caution since the sample of equity users is small.

Section 13: Grant Finance

- The value of the average grant awarded, in the last 3 years, is about £33,000.
- The total value of grants awarded to SMEs in the last 3 years is estimated at £7.6 billion.
- The total value of assistance to businesses, with less than 10 employees, is estimated at £6.3 billion, representing over 80% of the total awarded to all SMEs.

The main sources of grant finance reported are:

- Regional Grants (20%).
- Enterprise Grants (12%).
- Agricultural Grants (11%).
- Business Support Scheme (7%)

Section 14: Relationships between Finances

We conclude the report by looking at the relationships between the different forms of finance analyzed individually in previous sections. In particular, the aim here is to investigate:

- The types of finance which are more likely to be used as *alternatives* to each other (substitute finances). These are finances which are in competition with each other, since a rise in the demand for one implies a fall in the demand for the other.
- The types of finances which are more likely to be used in *conjunction* with each other (complementary finances). These finances are not in competition since a rise in the demand for one also implies a rise in the demand for the other.

To achieve this analysis, models are estimated relating the probability of using one source of finance to other sources (controlling for owner, business, regional and industry characteristics).

These results show that:

- There is a strong degree of substitutability between traditional bank debt finances (term loans and overdrafts). In particular, using a term loan reduces the likelihood of having an overdraft facility by almost 80 percentage points (holding firm characteristics constant).
- Asset finance is a potential substitute for term loans. Businesses which use asset finance are 25 percentage points less likely to use term loans, other things being equal.
- Asset-based finance, credit cards, equity finance and grants are also potential substitutes for term loans.
- Interestingly, term loans, asset finance and asset-based finance are strong substitutes for credit cards. Businesses would, most likely, get cheaper finance by replacing credit card borrowing with some other form of debt.
- There is no relationship between overdrafts and asset-based finance. This is, perhaps, surprising since asset-based finance is often viewed as a substitute for overdraft finance.
- Businesses with term loans are more likely to have a grant than those without term loans, suggesting these finances are complements.

These results imply that most finances are in potential competition with each other: most notably, term loans, overdrafts and asset finance. The exception to this finding is the relationship between grants and term loans. Specifically, businesses are more likely to have a grant, *given* they have term loan. This result is unsurprising, since many grants are awarded conditionally on the business matching the grant funding with other sources of finance.

Conclusions

The report concludes by drawing together the various themes which emerge from the analysis. In particular, the general availability of finance is contrasted with specific issues for access to, and the cost of, finance for ethnic minority and female-owned businesses respectively. Further research is planned to enable firmer conclusions, for ethnic minority businesses, to be reached. The low incidence of financially qualified management in SMEs is highlighted as another possible obstacle to obtaining finance.

In the context of competition, the relationship between firm characteristics and bank switching is noted. Specifically, businesses with financially qualified management, and high growth businesses, are more likely to switch banks. This suggests that, on the demand-side, a lack of financial acumen, or absence of dynamism, may contribute to the high level of inertia observed in SME banking relationships. There is no evidence that switching banks is either difficult, hinders access to finance, or raises the cost of borrowing.