Policy Briefing

Exploring the success and barriers to SME access to finance and its potential role in achieving growth

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What are the potential growth impacts of external finance on UK SMEs? Who seeks it, who gets it, and who is discouraged? Drawing on analysis of the 2015 UK Longitudinal Small Business Survey of 15,502 SMEs and interviews with six senior staff from Oxford Innovation who provide finance support to high growth firms, we provide robust contemporary evidence and key policy implications.

Key findings

Widespread consensus exists between the analytical evidence from the LSBS 2015 and the business finance support provider interviews that obtaining external finance is strongly and significantly associated with SME growth.

Almost one fifth (19%) of SMEs sought external finance last year, mostly from banks (43% loans and 42% overdrafts), credit cards (51%) and leasing (36%). Demand for equity (6.5%) and Peer to Peer (4%) appears to be rising in substitution for bank finance for younger, smaller SMEs. Finance was mainly required for working capital (51%) and equipment (42%). Only 7% mentioned growth finance and just 3% R&D.

The majority (62%) of firms only applied once, but one fifth applied three or more times. Persistence pays; the vast majority of applicants (83%) obtain at least some external financing, 11% were still in transaction and only 6% received nothing.

Almost one in ten (9%) SMEs had financing needs, but were discouraged from applying. One third of these had applied for finance, but then gave up and revised down their growth aims, indicating that some growth oriented SMEs may grow faster if they could gain timely access to sufficient external funding.

Who applies, receives or is discouraged?

Regression analysis reveals distinctive and significant (at beyond .05 level) patterns, suggesting that larger SMEs with better management capabilities to access external finance were more likely to apply, be more successful and receive larger amounts of funding. Younger SMEs, established less than five years ago, were also more likely to apply for funding, but were less likely to be successful. SMEs in capital intensive sectors such as manufacturing and primary agriculture were more likely to seek finance, whilst those in accommodation and catering were least likely to receive finance. Smaller SMEs with less than 10 employees were more likely to be discouraged from applying along with those with poor access to finance capabilities and women and ethnic minority-led SMEs.

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The key factors associated with whether firms applied for, received and were discouraged from seeking finance in the future are outlined in the table below.

Applied	**Received at least some external funding**	**Discouraged from applying**
• Larger SMEs, 3+ partners/ directors, perceived finance capabilities • SMEs established <5 years • Primary and Manufacturing • Ethnic minority owned • Less deprived areas	*Most successful:* • Larger SMEs, larger amounts, 3+ partner/directors perceived finance capabilities *Least successful:* • Self employed, younger SMEs, hotel and catering	• Smaller SMEs (notably under 10 employees) and younger SMEs <5 years • Perceived poor finance capabilities and <3 partner/directors • Women and Ethnic minority-led SMEs

Overall, there is a clear indication that firms' management resource base and prior experience in accessing external finance is crucial to success. There were also strong indications that finding and utilizing the right kind of external finance assistance is important to younger, smaller and distressed SMEs, in improving their financial models and success rates.

Policy implications

Government ought to complement its efforts on the external financing supply side by stimulating the demand-side for finance to ensure that quality propositions are put in front of investors. This will require support to improve capacity development amongst business advisors, a better join-up in the business support landscape, and enhanced provision and take-up of investor readiness support (SQW, 2016; Baldock et al. 2015).

- Better education for entrepreneurs on understanding their risk profile, the variety of finance available and identifying finance that suits their risk profile.
- Provision of investment readiness support which targets those that need it most – younger, smaller potential high growth businesses with particular attention to ethnic-minority, women-led and rural businesses.
- Guidance and tools to smaller/younger businesses to improve their financial management and business development.
- Improvement to the all round financing ecosystem integrating entrepreneurial support with a full range of suitable financing along the finance escalator.
- Enhancing existing SME datasets to provide more granular analysis of key factors in the future.

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