04 AWARENESS – NOT YET COMPREHENSIVE

Awareness amongst smaller businesses of the full range of external finance options available is limited

Most smaller businesses are not aware of the full range of external finance options available to them, and are instead reliant on finance provided by banks. For instance, 93% of smaller businesses are aware of credit cards and 85% are aware of leasing or hire purchase as types of finance available. The figures are much lower for alternative funding sources, with 32% aware of crowdfunding and 35% aware of peer-to-peer lending, but they are increasing over time.

Discouragement is still an issue for a significant number of smaller businesses

While businesses are beginning to view finance as less difficult to obtain (26% viewed it as very difficult in 2014 compared to 43% in 2012), there remains a gap between perceptions of the chances of obtaining finance, versus true approval rates. In addition, the proportion of businesses discouraged from applying for finance remains significant.

Furthermore, evidence also suggests that smaller businesses do not tend to shop around, and many do not plan ahead when seeking finance – potentially limiting their chances of obtaining finance.

Taken together, this demonstrates serious deficiencies on the demand side, providing compelling evidence that the British Business Bank must also focus on demand side factors in parallel with improving supply, in order to improve the overall functioning of SME finance markets.

The following chapter presents new data on how aware smaller businesses are of their finance options, and how they go about seeking finance.

4.1 AWARENESS OF FINANCE OPTIONS

- Awareness of alternative sources of debt finance outside banks is not yet comprehensive enough, however in 2014 there was an increased awareness of new platforms

- Awareness issues and business investment readiness also impact on demand for equity finance

For finance markets to work, both the supply and demand side need to interact efficiently. Awareness of the finance options available, and how to access them, is essential for smaller businesses to be able to effectively signal their demand to suppliers of finance.

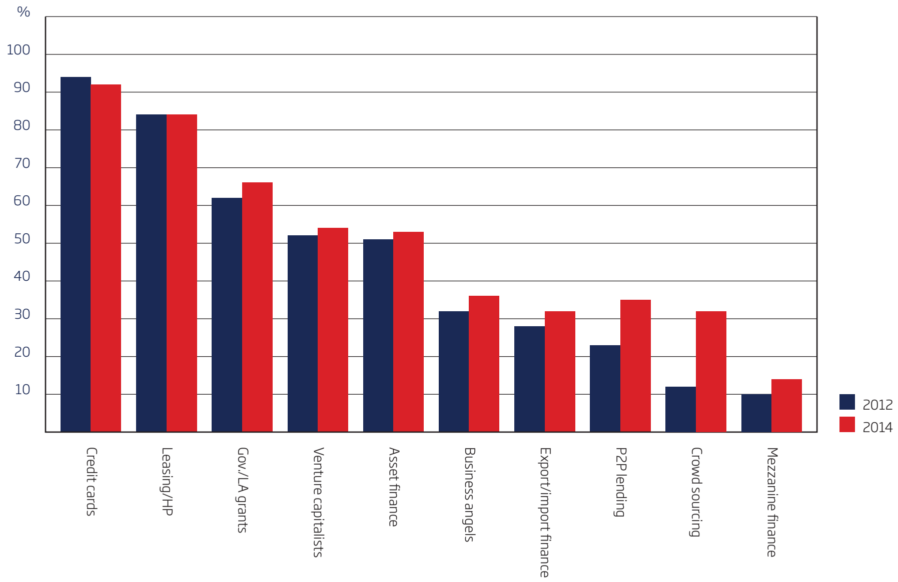
Awareness of alternative sources of debt finance outside banks is not yet comprehensive enough, however in 2014 there was an increased awareness of new platforms

Although awareness of bank finance is high, awareness of other forms of finance from non-bank sources is lower. The vast majority of small businesses were aware of credit card finance (93%), and leasing/hire purchase is known by 85% of small business. Only around a third of SMEs were aware of business angels, peer-to-peer lending, and crowdfunding, but the data suggests a significant increase from 2012. This has not translated into higher usage of these types of finance, which remains low compared to other sources. Between 2012 and 2014 there has also been an increase in the proportion of businesses aware of mezzanine finance.

Awareness of which suppliers to approach for different forms of finance was much lower than awareness of the existence of the types of finance (between 10 and 35 percentage points lower). That said, awareness of who to approach for peer-to-peer and crowdfunding platforms have shown significant rises compared to 2012.

FIG 33 *Source: BMG, SME Journey Survey*

AWARENESS OF DIFFERENT FORMS OF EXTERNAL FINANCE



Awareness issues and business investment readiness also impact on demand for equity finance

Demand side issues appear more acute in businesses seeking equity finance. For instance, Mason et al. (2010) acknowledge that the high rejection rates of applications to business angels and venture capital funds "clearly indicates that most businesses that seek external finance do not meet the requirements of external investors".[106] However, this also reflects the model equity finance providers use of looking for high growth potential businesses in order to generate a financial return.

Smaller business owners are often unwilling to seek external equity finance as they do not want to give up control of their businesses to third parties.[107] For viable high-growth businesses this can prevent their full growth potential from being reached, in some cases resulting in lower long-run returns for the business owner compared to their share of the returns, had they obtained equity finance.

The SME Journey survey also suggests that many smaller business owners lack information on how equity finance works and where to obtain such finance – 55% of smaller businesses are aware of venture capital but only 20% are aware of a specific supplier to approach.

Many smaller business owners are unaware of what equity investors are looking for in investment propositions and therefore do not sufficiently promote themselves and their businesses to potential investors, for example because of poorly written business plans.[108]

Supply and demand side factors for SMEs raising external equity finance can interact, leading to a 'thin market,' where a limited number of investors and high growth firms have difficulty finding and contacting each other at reasonable cost.[109] This friction in the market can lead to inefficient matching and consequently, an economically inefficient allocation of equity finance.

4.2 BUSINESS CONFIDENCE IN OBTAINING FUNDING

- Businesses underestimate the likelihood of obtaining finance. In addition, a small but significant proportion are discouraged from seeking finance

- Most smaller businesses (66% of those seeking finance) only approach one finance provider. Many smaller businesses do not plan more than a week ahead and do not spend much time on their application, which may impede their chances of obtaining finance

- Increased information available to businesses could help to make SME finance markets work more efficiently

A lack of accurate information can act as a barrier to the market working efficiently. Given that there are costs (both time and money) associated with applying for finance, misconceptions of the likelihood of success can lead to viable businesses not seeking finance when they need it. Furthermore, business finance applicants not supplying the right information or presenting it in a poor way can lead to finance providers miscalculating the risks, and potentially denying finance to viable businesses.

Businesses underestimate the likelihood of obtaining finance. In addition, a small but significant proportion of businesses are discouraged from seeking finance

There remains a general perception amongst smaller businesses that banks are not lending. 58% of businesses perceive that it is fairly, or very difficult to obtain funding. However, attitudes towards obtaining finance have improved since 2012. In 2014 smaller businesses perceived that (on average) 42% of those that apply for bank finance were successful in getting it, up from the 32% reported in 2012. This is despite the majority (around three quarters) of smaller businesses that actually applied for finance in the three years prior to 2014 getting the full amount requested from the first provider they approached.

These conclusions are broadly supported by other survey data. According to SME Finance Monitor, 43% of smaller businesses planning to seek finance were very, or fairly confident that a bank would lend to them in Q2 2014. Confidence of success was higher for renewals than for new money.[110] However, this data also shows a gap between confidence levels and actual approval rates for loan and overdraft finance from a bank – the 'confidence gap' was around 34 percentage points for new money from banks and 37 percentage points from renewals.

The improvements in attitudes are a positive development. However, a mismatch in perception remains and is likely to be a barrier holding some businesses back from applying for finance.

There is a range of potential reasons why smaller businesses may not apply for finance when they need or want to. SME Finance Monitor survey data estimates that around 5% of all SMEs are 'would-be seekers'.[111]

A small but significant proportion of these smaller businesses are discouraged from applying for finance. SME Finance Monitor estimates this to be around 3% of all SMEs, or around 160,000 thousand if we apply this to the estimated 5.2m businesses population. This estimate is based on those that either made informal enquiries to the financial institution, or were put off or because they thought they would be turned down by the financial institution so did not ask. Fraser (2014) [112] estimated that 63% of discouraged borrowers might have actually obtained bank finance if they had applied, which shows a potential missed opportunity for business growth.

Most smaller businesses (66% of those seeking finance) only approach one finance provider. Many smaller businesses do not plan more than a week ahead and do not spend much time on their application, which may impede their chances of obtaining finance

The latest SME Journey survey shows 66% of businesses seeking finance contacted just one provider on the last occasion finance was sought, usually because they had a longstanding relationship with them. Furthermore, in their last finance application just under half of businesses (49%) only contacted one of the four largest banks (i.e. Barclays, HSBC, Lloyds or RBS) when seeking finance. Some businesses did not need to go elsewhere because the first provider they approached gave them what they wanted. Others felt it was too much hassle to shop around, or did not have time to shop around because they needed the finance quickly.

This is broadly supported by evidence from SME Finance Monitor: Over half (57%) of businesses that sought finance in the past 3 years went directly to their main bank as soon as they identified that they had a need for external finance, rather than investigating their finance options.

The limited shopping around when seeking finance is a concern raised by the recent CMA study. [113] The CMA acknowledges there is currently a relatively weak demand side, with SME customers not obtaining, assessing and acting on information to ensure that they get the best possible deal.

Not only do many businesses not shop around for external finance, some may not be maximising their chances of being approved. Many businesses do not plan ahead and instead, seek finance as soon as they need it. For instance;

- 40% of SMEs apply for finance a week before needing it or after it is needed.
- The median time spent completing application forms or otherwise preparing to apply for finance remains at about one hour.

Although it declines with the size of the business, in most cases (82%) it is the business owner themselves, who is responsible for seeking finance on behalf of the business rather than a dedicated finance manager. Whilst it is not surprising that business owners will have competing demands on their time, it is also important to recognise some finance applications, particular for smaller amounts are completely credit scored, with minimal amounts of information required from the applicant.

Increased information available to businesses could help to make SME finance markets work more efficiently

Information is needed for SME finance markets to work effectively. Only a minority of SMEs (18%) seek external advice when applying for finance, but of those that do, the vast majority (95%) of SMEs find the advice they receive to be useful. Accountants and financial advisors are the most common sources of advice used, with accountants in particular being viewed as a trusted source of information.

The majority of those not seeking advice (75%) say that they do not need it. However:

- 45% of SMEs perceive finance providers do not give sufficient information on products to be able to effectively judge them.
- Fewer SME owners report that they are confident in their own capabilities in raising external finance compared to other aspects of running a business, like people management and introducing new products and services.

Whilst 58% of SMEs report that they know what providers look for when assessing finance applications, 19% do not.

EXPERT VIEW

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IMPROVED INFORMATION WILL HELP BUSINESSES ACCESS THE FINANCE THEY NEED

We are now seeing a far greater variety of finance options available for businesses than in the period immediately after the financial crisis.

Still, it should not be forgotten that the vast proportion of support for small business funding comes from the High Street banks although there are signs that the banks are becoming keener to lend as the economy improves.

Conventional bank lending is increasingly being supported by forms of finance that have been around for a very long time. In the past a business might have sought to increase its overdraft, now they are much more likely to consider a switch to asset finance. The third quarter of 2014 was the biggest on record for the use of asset based finance, with £19.3bn of funding in use, up 12% on the £17.2bn in use a year earlier, according to the Asset Based Finance Association (ABFA), the body representing the asset based finance industry in the UK and Republic of Ireland.

The ICAEW has found that an increasingly popular option is equity finance, a good means of funding additional growth within a business, made more attractive by the tax benefits offered via the Enterprise Investment Scheme and Seed Enterprise Investment Scheme.

As more options become available for smaller businesses, it becomes increasingly important that the right information is available. The Corporate Finance faculty at the ICAEW has worked with the British Business Bank and 17 of the UK's leading financial and business institutions to create and distribute the Business Finance Guide, a free publication that sets out the range of possible routes for businesses seeking to raise funding. Copies can be downloaded from www.icaew.com/bfg or www.british-business-bank.co.uk/bfg

It was unprecedented to have so many industry bodies working together on the same initiative and engagement has been very high. The Guide certainly allows businesses to consider a wider variety of forms of finance and we also want to encourage businesses to get in touch with chartered accountants and finance providers, look for more information and understand how the different options will work for them.

Greater availability of information plays a vitally important role in helping businesses access the finance they need to grow and create jobs. So the role of professional advice cannot be underestimated. There is no real substitute for getting the right advice and figures from the SME Finance Monitor show that only 22% of companies seek advice before applying for a loan, although this is up on prior years where the percentage had been as low as 18%. The British Business Bank data also shows that companies who do so are more successful in their applications for bank finance, most often because they have provided more information.

People can be reluctant to take advice, which is why the ICAEW has introduced the Business Advice Scheme, providing free consultation to micro and small businesses not yet supported by a chartered accountant via 4,136 offices throughout the UK.