SME Access to Finance 2009

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SME Access to Finance Survey Report 2009

This report presents the findings of a Scottish Government survey on access to finance in the Scottish SME sector during the early part of 2009. In particular, the report focuses on how credit conditions (demand and supply) have changed for Scottish SMEs during this period, and the current constraints faced by businesses as a result of the credit crunch and current economic downturn.

The Scottish Government

Introduction

1. There is limited data on credit conditions for businesses in Scotland. The SME Access to Finance survey was commissioned in 2009 to provide an assessment of the demand for private sector debt finance in the SME sector in Scotland. The report findings are based on a comparison of results from two surveys on access to finance carried out by CBR (2007)[1] and the Scottish Government (2009), the latter of which looked specifically at the change in credit conditions and financial markets following the economic downturn towards the end of last year.

2. The analysis in this report attempts to draw out the existing strengths and weaknesses in the market for financial resources to the SME sector by looking at the finance constraints faced by different types of business, and across different sectors. Its intended purpose is to identify whether a financing gap exists and where the evidence suggests a clear market failure, how policy might be taken forward to assist viable firms in accessing the finance they need.

3. The sections of the report are set out as follows;

[1] Financing UK Small and Medium-sized Enterprises, The 2007 Survey. The results for this paper are based on the Scottish-only sample extracted from this survey.

Executive Summary

i. This summary is an extract of the report on 'SME Access to Finance'. The findings are based on the results of two recent surveys of Scottish SMEs undertaken by CBR (2007) and the Scottish Government survey in 2009, the latter of which looked specifically at the change in credit conditions and financial markets following the economic downturn towards the end of last year.

Main forms of finance used

ii. The main forms of finance currently used by SMEs in Scotland are credit cards (46%) and overdrafts (36%). High-growth firms are less likely to use overdrafts and leasing and Hire Purchase (HP) than non-high growth firms, but more likely to use credit cards to finance their business.

Applications (Demand)

iii. There has been an increase in applications for finance across all firms. The proportion of firms applying for credit irrespective of whether it was granted or not, has increased from 39% of all firms in 2007 to 53% in 2009. Applications for finance tend to increase with size of firm, age of firm and growth.

iv. The increase in demand for finance appears to be driven largely by an increase in applications for overdrafts (ranging from 10 percentage points to 17 percentage points for micro to medium firms) and leasing or HP facilities. The exception to this is for high-growth firms[2] who appear to have switched away from overdrafts and loans/mortgages towards credit cards, leasing and HP.

v. The average amount of finance sought by Scottish SMEs over the past three years has increased by 12 per cent - from £104,574 in 2007 to £118,522 in 2009[3].

Approvals (Supply)

vi. There is evidence to show that the supply of finance to SMEs in Scotland has reduced. The approval rate for applications has fallen, particularly for micro firms where only 60% of firms have been able to secure any amount of finance sought compared to 82% in 2007. The likelihood of applications being approved increases with firm size.

vii. The supply of finance to high-growth firms appears to have reduced fairly dramatically with only 44% of applications being approved in 2009, compared to an approvals rate of 79% in 2007. This compares to approvals for non-high growth firms being 68% in 2009, a reduction of 18 percentage points since 2007.

viii. There are notable changes in the types of finance that firms are being rejected for. The biggest change in 2009 for micro firms is the increase in rejections for credit

[2] High-growth firms have been defined as those with 30% or more growth in each of the last 3 years. The analysis of high-growth vs. non-high growth excludes firms that are less than 3 years old, and those who did not respond to questions on turnover.
[3] Figures are in nominal terms, unadjusted for inflation.

card finance, compared to 2007. For medium sized enterprises, many more are being rejected for asset-based finance than they were in 2007.

ix. For all those who were unsuccessful at obtaining 100% of finance sought, around 62% of micro firms *did not* manage to secure the funding needed elsewhere - and of those who did, the majority sourced this from 'family and friends' or other unspecified sources. A greater proportion of small and medium firms are more likely to secure funding from an alternative bank or a different financial product offered by the same bank.

Reasons for not lending

x. The biggest change in the reasons given by banks since 2007 for not lending is 'economic climate' or 'industry too risky'. Issues of security/not enough security are also increasingly becoming reasons for unsuccessful applications particularly for high-growth firms.

New lending

xi. 18% of firms took out new lending or had to re-finance some sort of credit facility in the last 12 months – overdrafts accounted for over 80% of these applications. There has been a significant shift towards using this new finance for working capital requirements than previously.

xii. The main reason for the majority of firms (86%) who did not take out new lending in the past 12 months was simply that they 'did not need to borrow'. A significant proportion of micro firms (around 42%), expressed a 'reluctance' to borrow, based on reasons such as economic climate or thinking they would be turned down.

xiii. A much higher proportion of high-growth firms (95%) did not need to borrow, compared to non-high growth firms (84%). However, a greater number of non-growth firms showed a greater reluctance to borrow or re-financing in the last 12 months, with 11% expressing the current climate as a reasons for not doing so.

Equity finance

xiv. The survey identified a very small proportion of firms who used equity finance. The most common reason for not applying for equity finance relate to views that 'business doesn't need the finance', they 'have finance from other sources', and that enterprises are reluctant to 'give up control of the business'. 10-15% of micro and small firms stated that they did not know how to go about applying for it.

xv. Comparing to 2007, there has been a 10 percentage point increase in the proportion of firms who would '*consider'* raising equity finance in the future – from 17% of firms to 28%. This increase is due to micro and medium sized firms. However, a much smaller proportion of firms state that they are actually 'planning' to use equity in the next 3 years.

Refinancing experience

xvi. The majority of enterprises felt that the ease of obtaining credit compared to one year ago was largely 'unchanged'. However, where it had become harder, the most significant responses were for commercial loans/mortgages and overdrafts, with around 40% of those responding stating that these forms of finance had become harder to obtain.

xvii. For all firm sizes, the key change in accessing finance over the last 12 months relates to the increase in charges and interest rates. The amount of time taken to make a decision for lending is also a significant factor for small and medium firms.

xviii. The differences in the re-financing experience is rather more pronounced between high-growth firms and non-high growth firms. For high-growth firms, in addition to the changes in the cost of credit, the key factors refer to a reduction in the supply of credit – either the facility has been taken away or reduced, or there is an increase in the time taken for lenders to make a decision.

Impact on business

xix. Firms were asked about the problems faced by their businesses in the current economic climate. In all cases, getting orders (i.e. demand for products) and finance (including cost, and obtaining sufficient finance) are showing the greatest increases in observed constraints since 2007. In line with what we would expect in a recession, staffing is less of an issue for firms in 2009 than it was in 2007.

xx. The survey also indicates a revision downward in business growth expectations due to the current economic conditions and the tightening of credit markets. The majority of micro firms have revised growth expectations towards 'getting smaller' though a significant number are also expecting to grow substantially over the next three years. For medium and small firms, there is a shift away from 'growing substantially' to either 'growing moderately' or 'staying the same'.

Unmet Need

xxi. The issue of 'unmet need' arises when *viable demand* for finance from businesses is not being met. The difficulty lies in entangling this element of demand from all other expectant demand from firms that seek finance but are not considered to be viable or credit-worthy businesses by finance providers.

xxii. It is estimated that in 2009, around 25% of all micro firms are unable to secure finance they require **from any source** compared to 11% of small firms and 3% of medium size firms. This gap in demand has increased since 2007, where only 7% of micro firms were unable to secure any form of finance, 2% of small firms and 0.1% of medium size firms.

Supply by Financial Institution

xxiii. There does not appear to be any significant differences in the supply of finance by any particular provider. However, in line with their implied market share from the survey results, the two main Scottish providers, RBS and HBOS accounted for around 69% of all rejection in applications for finance to Scottish firms (75% when including the newly formed Lloyds Banking Group).

xxiv. The concentration of market providers in Scotland implies that any change in the lending practices of these banks will have strong implications for the overall SME credit market.

Sector Analysis

xxv. The sector analysis presents data on nine sectors from the access to finance survey. These are Agriculture, Manufacturing, Construction, Wholesale/Retail, Hotels/Restaurants, Transport/Communication, Real Estate/Business Activities, Health/Social work and Other services.

Applications (Demand)

xxvi. There has been an increase in applications for all types of credit facility compared to 2007 across all sectors with the exception of equity financing which shows little change. Looking across all firms, the increase in demand is driven largely by overdrafts and from particular sectors – Hotels/Restaurants (37 percentage point increase) Construction (30 percentage points) and Wholesale/Retail (20 percentage points), and to a lesser degree Manufacturing (7 percentage point increase) and Agriculture (8 percentage point increase).

xxvii. The average amount of finance sought over the last three years by SMEs varies across the sectors. Manufacturing, Construction, Wholesale/Retail and Real Estate/Business Activities sectors have all increased the amount of finance they are seeking since 2007. On the other hand, the amount of finance applied for by the Hotel/Restaurant sector has fallen quite dramatically. The Agriculture, Health/Social Work services and ‘Other’ sectors have also reduced the amount of finance they are seeking.

Approvals (Supply)

xxviii. The reduction in supply of finance based on the approvals rate has impacted across all sectors. Zero-employee firms (i.e. self-employed) in each sector are facing the biggest restriction in supply, with approval rates showing a more pronounced decline between 2007 and 2009, compared to all other firms.

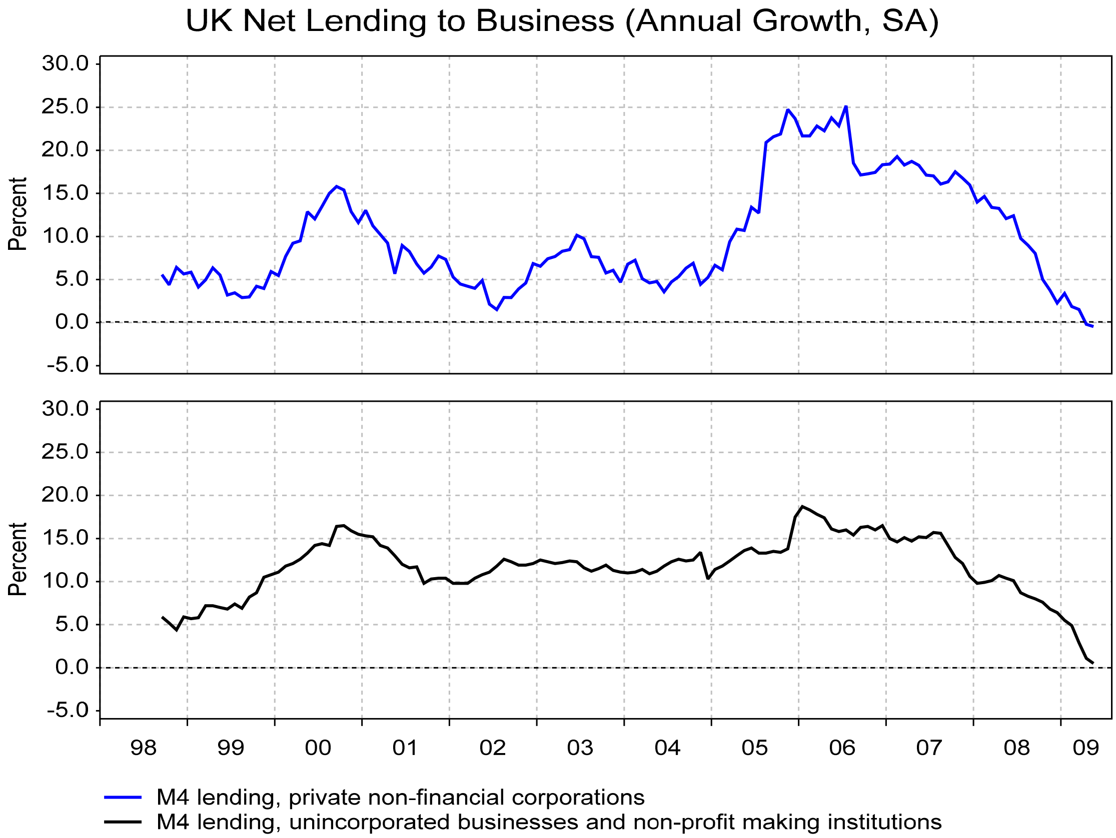
xxix. The sectors showing the largest decrease in approval rates (excluding zero employees) are Hotels/Restaurants (a drop of around 17 percentage points), Business Activities (12 percentage points), Wholesale/Retail (11 percentage point), Construction (7 percentage points), and Manufacturing (9 percentage points). When self-employed are included, the biggest decline in approvals is notably in the Construction industry, with a reduction of almost 42 percentage points.

New Lending

xxx. The predominant reason, other than not needing to, for not undertaking new lending across nearly all the sectors was that 'they did not want to borrow in the current climate'. Other significant reasons included that firms believed that they would be turned down, or that finance would to be 'too expensive'. For firms in Wholesale/Retail the belief that they would be turned down featured *more predominantly* than not wanting to borrow, and just as much of a reason for not borrowing in the economic climate for firms in Hotel/Restaurants sector.

Changes to Growth Aspirations

xxxi. The most pessimistic sectors appear to be Agriculture, Wholesale/Retail, Hotels/Restaurants and Real Estate/Business Activities sector which have all revised growth ambitions towards becoming smaller than staying the same or expanding. Manufacturing and Transport/Communications sector appear to be more cautious with the balance of firms who are reducing growth ambitions, stating that they will 'stay the same size' rather than becoming smaller. On the other hand, there is an increase in the number of firms by around 12 percentage points who are expecting to grow compared to 2007.



Source: Reuters EcoWin

Macro-economic Context

1.1. This survey was conducted during a time of great economic uncertainty across both Scotland and globally. Major advanced world economies suffered falls in their growth beginning in late 2007, with the pace of the slowdown accelerating towards the end of 2008 and into early 2009, with nearly all now confirmed to be in recession.

1.2. Scottish GDP decreased by 0.8% and 1.7% respectively in the third and forth quarters of 2008, and further falls in output are expected to continue through 2009.

1.3. The decline in Scottish GDP in the final quarter of 2008 was driven by the production sector, which experienced a sharp contraction of 4.7%. The construction sector also weakened over the past year, down 4.7% on the previous quarter. The service sector experienced a smaller decline in output, down 0.8% on the previous quarter.

1.4. The Scottish labour market has felt the impact of the recession, with significant reductions in the rate of employment, and increases in both unemployment and inactivity over the year to the first quarter of 2009. Working age employment fell by 47,000 over this period.

1.5. Evidence from the Bank of England shows that credit conditions in the UK have tightened, with the rate of lending to both small and large businesses falling since 2006, with this decline accelerating since the beginning of the credit crunch in mid-August 2007.

1.6. The decrease in lending to businesses can partially be attributed to the exit of foreign lenders from the UK market, who had contributed around half of the growth in lending to businesses in 2007. Growth in lending to businesses by the major UK banks has also slowed, but at a less rapid pace than that of foreign and smaller lenders.

1.7. The Bank of England has responded to the tightening credit conditions and falling output by carrying out aggressive cuts to its Base Rate, reducing it from 5.75% in November 2007 to a record low of 0.5% in March 2009 and also resorting to the unconventional monetary policy of 'quantitative easing', the purchasing of assets by the central bank to expand the money supply.

1.8. There is mixed evidence on how these cuts in the Base Rate have affected the overall cost of credit, with the decline in the interbank lending rates failing to match these falls.

1.9. A more detailed narrative on the state of the Scottish economy can be found on the Scottish Government website at; http://www.scotland.gov.uk/Topics/Economy/state-economy/latest.

Survey Design and Methodology

2.1. The survey interviewed 1,001 small and medium sized businesses in the private sector in Scotland. Fieldwork was conducted by telephone by Continental Research, an independent market research company, between 15th March and 10th April 2009.

2.2. The questionnaire was largely based on the UK 2007 SME Financing survey and was structured as follows: After demographic questions (both business and respondent) the survey asked questions regarding their current borrowings. They were then asked about all facilities they had applied for during the previous 3 years, and whether they were successful in obtaining these or not. Where less than the full amount applied for was obtained, respondents were asked in more detail about the product(s) this related to. A new section was added to the survey relating specifically to accessing finance since the onset of the ‘credit crunch’ and the consequential impacts of the changes in the cost of credit and the economic downturn on the business. The survey then ended with some general business questions.

2.3. The sample of SMEs was drawn from Dun & Bradstreet/Experian. Quotas, designed to reflect the 2007 survey, were set by size of firm (number of employees), by the sector (from the sample), for new start businesses and for those trading in deprived areas. Larger businesses and smaller sectors were over-sampled relative to the proportion in the market to ensure meaningful results for these groups could be obtained. The achieved sample is displayed below.

		Size			
		Micro (<10)	Small (10-49)	Medium (50-250)	Total
SECTORS	AB Agriculture	62	23	5	90
	D Manufacturing	65	56	26	147
	F Construction	83	49	13	145
	G Wholesale/Retail	62	38	16	116
	H Hotels/Restaurants	50	34	10	94
	I Transport/Communication	22	22	7	51
	K Business Activities	73	55	18	146
	N Health/Social Work	31	31	6	68
	O Other Services	97	32	15	144
	Total	545	340	116	1,001

2.4. For the following analysis - as in 2007 - weighting was applied by size and sector so as to reflect the true structure of the Scottish SME population. No sectors where excluded from the sampling in 2009, with the exception of the public sector and not for profit organisations. The 2007 survey also excluded Financial Services, Mining and Quarrying, Electricity, Gas and Water Supply sectors.

2.5. The size of the samples in both 2007 and 2009 mean that the findings can be reported with a relatively high degree of statistical reliability. For instance, a finding of 50% at the overall level (all firms included) in 2009 has a statistical error of ±3.1%, while the corresponding error for 2007 is ±4.4%.

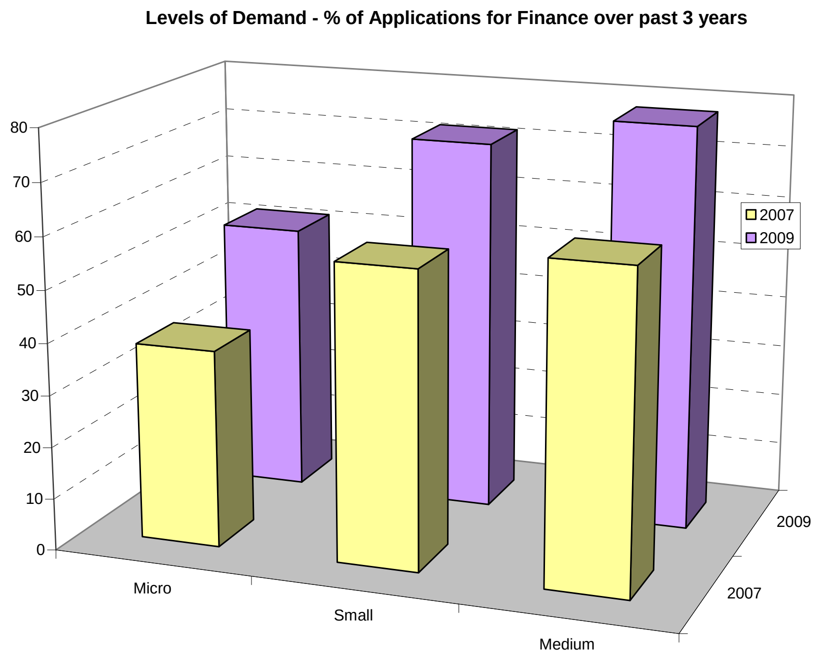
2.6. For the presentation of results, definitions for firm sizes and growth firms are given as follows; micro (0-9 employees), small (10-49 employees) and medium (50-249 employees). High growth firms are defined within this report as those firms that have stated a turnover of 30% or more in each year for the last three years. Non-high growth are all other firms in the sample that do not meet the high-growth criteria.

2.7. For the sector analysis in section 5, the report presents results for each sector across two broad firm sizes – (i) all firms, and (ii) all firms excluding zero employee firms. The analysis has been presented this way to reduce any tendency of zero employee firms to skew the results. Due to smaller sample sizes for sector analysis, a breakdown of firm by size category as in the main report has not been replicated.

2.8. There are approximately 280,000 SMEs in Scotland, employing around 1 million - representing 99% of all enterprises and 53% of all employment. Of total SMEs, 94% are micro businesses, 5% are small firms and 1% medium size firms.

2.9. Banks and other financial institutions play a key role in financing day-to-day business operations and expansion. Short-term forms of debt financing include overdrafts, credit cards, factoring and invoice discounting, while medium term debt financing can take the form of term loans, leasing and Hire Purchase agreements. Longer term debt finance options include business mortgages, and fixed asset loans. Debt financing is the most common source of finance sought by Scottish SMEs. The section below identifies the nature of demand for these products in a relatively ‘healthy’ Scottish economy[4] in 2007 compared to the economy in recession at the beginning of 2009.

[4] The results here are presented for the year 2007, prior to the downturn in the economy, highlighting the financing and behavior of firms seeking credit in a ‘good’ economic environment

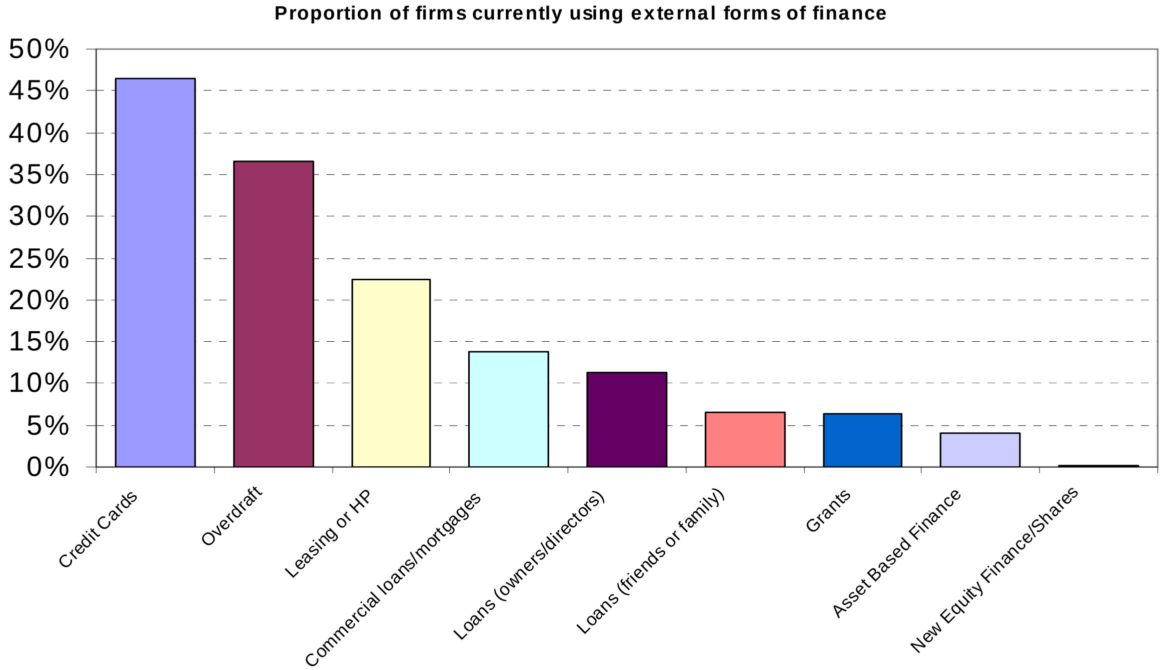


Base (2009): Micro: n=545; Small: n=340; Medium: n=116;
Base (2007): Micro: n=257 ; Small: n=151; Medium: n=93

Levels of Demand in Scotland

3.1. Access to finance is viewed as an important factor for the development of entrepreneurial economies. Businesses need to be able to access the right finance in order to invest, innovate and grow within an economy.

3.2. The demand for finance from SMEs tends to increase with firm size. Around 52% of micro enterprises in Scotland sought finance in 2009, 72% of small firms and 78% of medium size firms. The level of demand for finance has risen since 2007. This rise can be largely attributed to an increase in the requirement for working capital and cash flow at a time when demand for goods and services is falling during a recession.



Base: All businesses: n=1,001

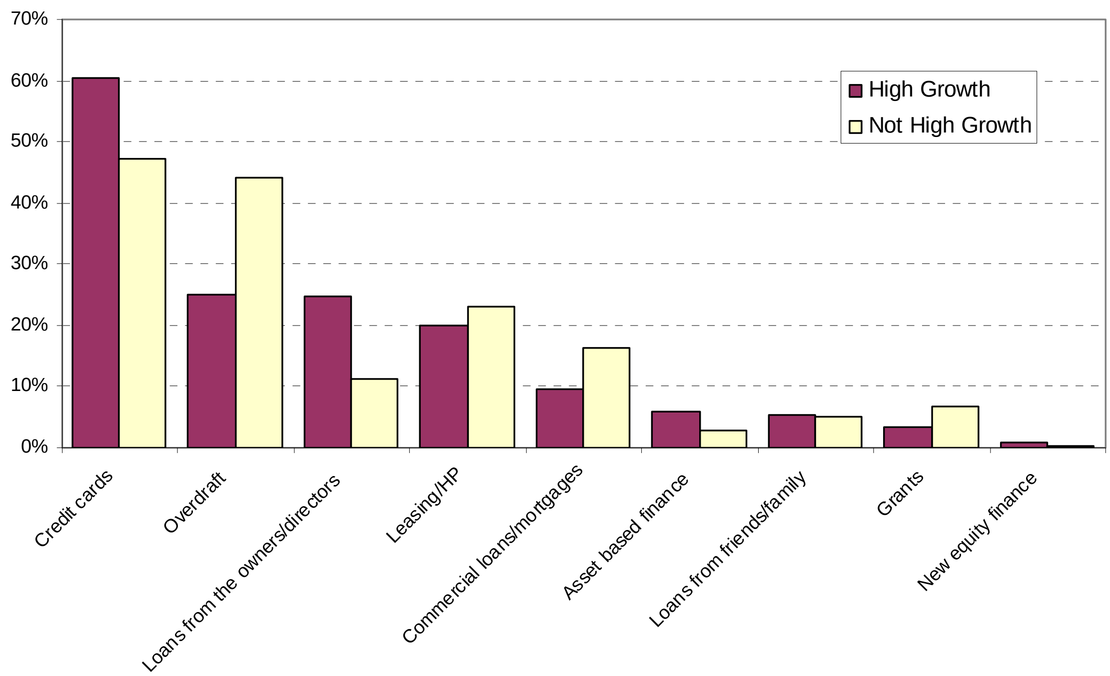
Demand - Current use of external finance

3.3. Credit cards and overdrafts are the most common form of finance currently used amongst all SMEs, followed by leasing/HP and commercial loans. New equity finance is the least used type of finance, with only 0.2 % of firms using it at the time of the survey.

3.4. The pattern of demand for the different types of credit is similar across the firm size bands, although the proportion using each increases with size. The exception to this is loans from friends or family which is used in roughly equal proportion across the three size bands.

3.5. There is a divergence between types of finance used in high growth and non-high growth firms. High growth firms use relatively less overdraft facilities compared to non-high growth firms but use relatively more credit cards finance and loans from owners and directors. Non-high growth firms are also more likely to use grant funding than high-growth firms.

Proportion of firms using external finance, split by growth (%)



Base: High growth businesses: n=118; Not high growth businesses: n=704

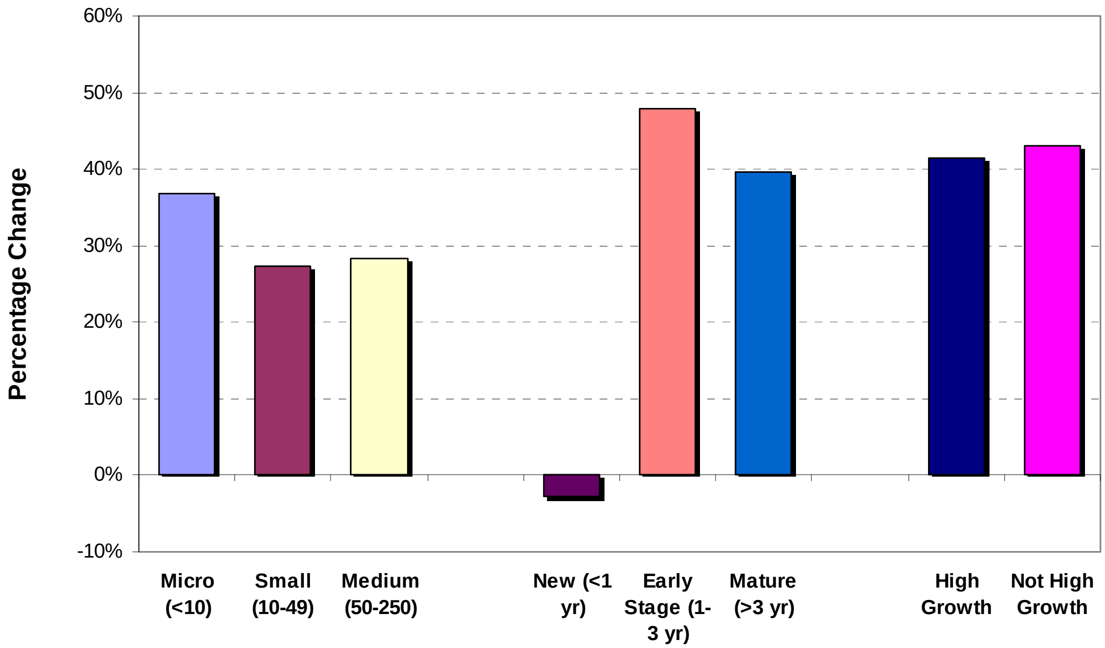
Applications for new finance

3.6. There has been an increase in applications (demand) for finance across all firms, and across all sizes and growth category. Overall the proportion of firms who had applied for finance over the previous 3 years irrespective of whether they were successful in obtaining it or not, had increased by 14 percentage points between August 2007 and March 2009, from 39% of all firms to 53%.

3.7. The chart below shows the increase in applications across all firm categories. Applications for finance tend to increase with size of firm. The proportion of medium size enterprises who applied for finance jumped from just over 60% in 2007 to nearly 80% in 2009. When analysing by age of the firm, both early-stage and mature firms[5] show increases of over 10 percentage points although the proportion of new firms (less than one year old) applying for finance has fallen marginally.

[5] Mature firms are described here as those aged 3 years plus. New firms are those which are less than 1 year old, and early-stage are those between 1 and 3 years.

Change in applications for finance over past 3 years, 2007 and 2009

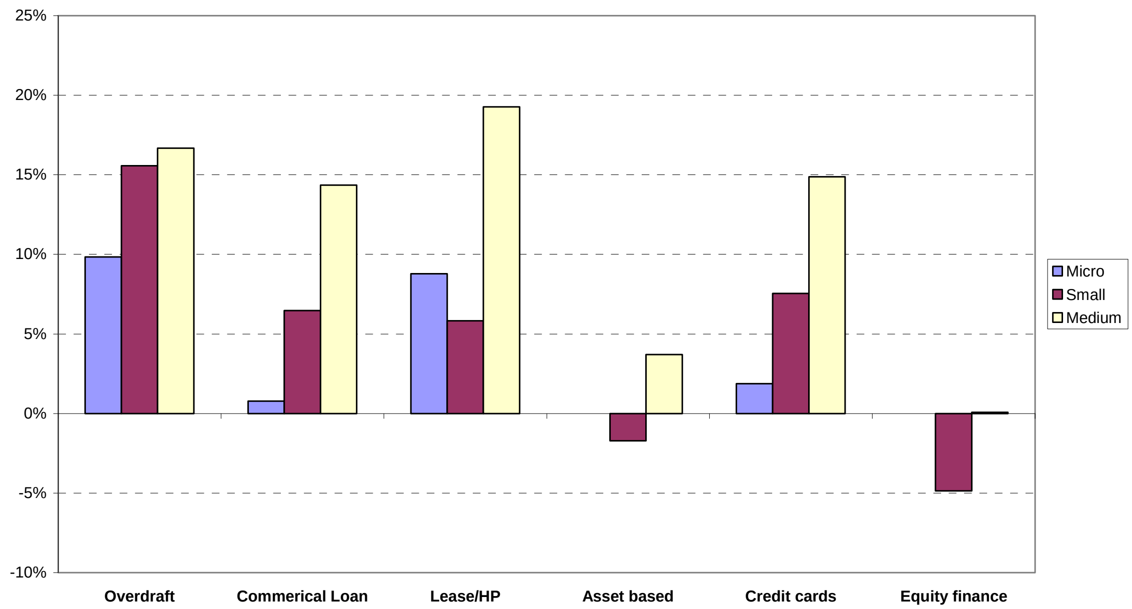


Base (2009): Micro: n=545; Small: n=340; Medium: n=116; New businesses: n=76; Early stage: n=100; Mature: n=825; High growth: n=118; Not high growth: n=704
Base (2007): Micro: n=257 ; Small: n=151; Medium: n=93 ;New businesses: n=17 ;Early stage: n=65; Mature: n=415; High growth: n=92; Not high growth: n=328

Forms of finance applied for

3.8. Demand for nearly all types of credit has increased, with the exception of equity funding. The increase in demand for finance appears to be driven largely by an increase in applications for overdrafts (ranging from 10 percentage points to 17 percentage points for micro to medium firms) and leasing or HP facilities. This picture is consistent across all firm sizes. Applications for credit cards have increased marginally for micro firms but by nearly 15 percentage points for medium firms. Furthermore, demand for equity appears to have fallen by around 5 percentage points since 2007 for small firms.

Change in types of application applied for, 2007 to 2009



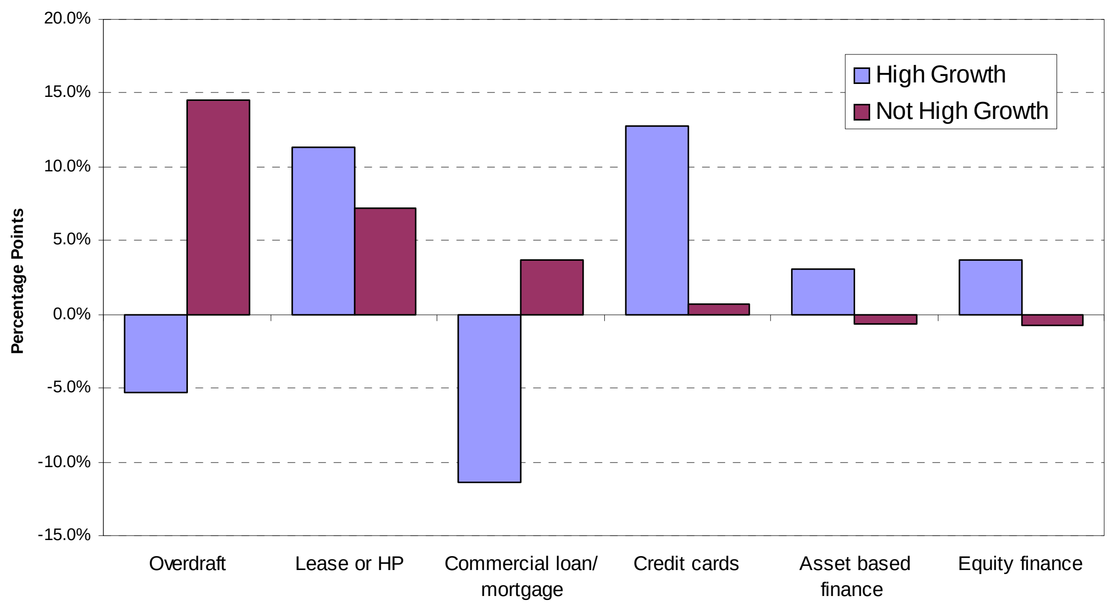
Base (2009): Overdraft: n=416; Lease or HP: n= 377; Credit Cards: n=299; Commercial Loan: n=196; Asset Based: n=60; Equity Finance: n=12
Base (2007): Overdraft: n=135; Lease or HP: n=141; Credit Cards: n=88; Commercial Loan: n=79; Asset Based: n=25; Equity Finance: n=8

3.9. The rise in applications for these particular forms of finance are not surprising given that many firms cite the main reason for using overdrafts and leasing/HP as being for working capital purposes. In an economic downturn where demand for goods and services is likely to decline, many businesses use these forms of credit as a source of cash-flow to cover short-term costs.

3.10. In terms of applications for finance by high-growth vs. non-high growth firms (shown in chart overleaf), there is a marked difference in the changes of the types of finance being applied for – most notably high growth firms show falls in applications for overdrafts and commercial loans and mortgages whereas non-high growth firms show a rise in applications for both.

3.11. The largest percentage point rise for high growth firms is in applications for credit cards, and unlike non-high growth firms which reported falls in applications for asset based finance and equity, high growth firms reported modest increases in applications for both (of 3 and 3.7 percentage points respectively).

Change in types of finance applied for between 2007 and 2009



Base (2009): Overdraft: n=354; Lease or HP: n= 329; Credit Cards: n=175; Commercial Loan: n=160; Asset Based: n=53; Equity Finance: n=10
Base (2007): Overdraft: n=113; Lease or HP: n=125; Credit Cards: n=69; Commercial Loan: n=64; Asset Based: n=25; Equity Finance: n=8

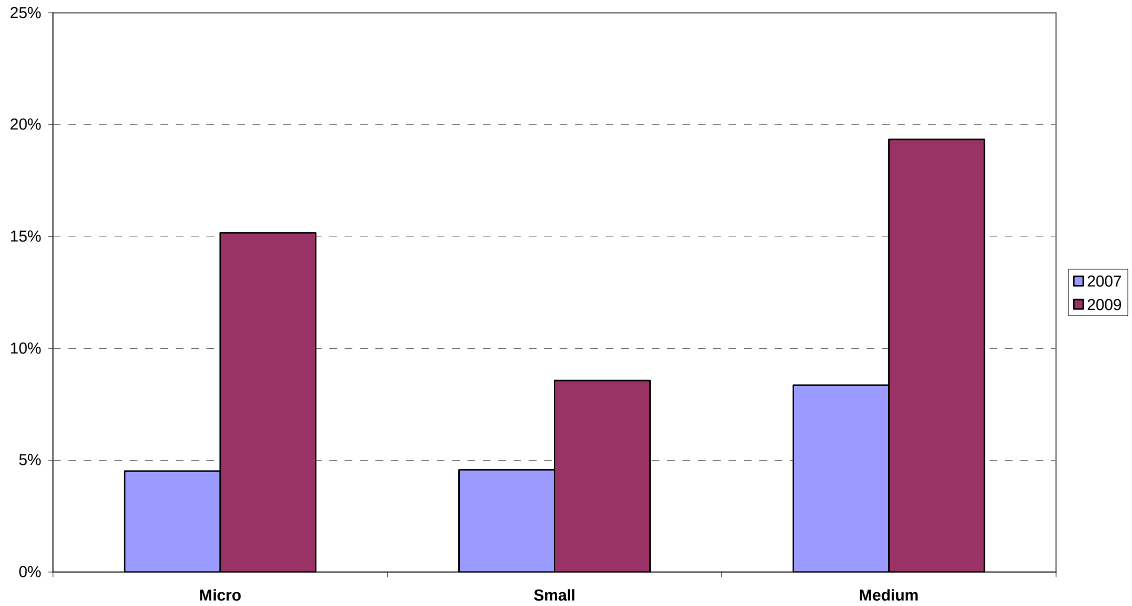
Amount of finance applied for

3.12. The average amount of finance applied for over the past three years has increased by 12% when looking at all SMEs - from £104,574 in 2007 to £118,522 in 2009. Both micro and small sized firms increased the average amount of finance sought by 19% and 5% respectively, although medium sized firms reported a slight decrease (of around 7%) in the average amount sought in 2009.

Average (mean) amount of finance sought over the past 3 years				
	Micro (<10)	Small (10-49)	Medium (50-250)	All Firms
2007	£67,223	£338,731	£1,199,008	£104,574
2009	£79,909	£355,178	£1,121,056	£118,522

These figures have not been adjusted for inflation.
Base (2009): Firms which had applied for finance: Micro: n=293; Small: n=247; Medium: n=91
Base (2007): Firms which had applied for finance: Micro: n=103; Small: n=89; Medium: n=59

Percentage (%) Applications Rejected, 2007 and 2009



Base (2009): Firms which had applied for finance: Micro: n=293; Small: n=247; Medium: n=91
Base (2007): Firms which had applied for finance: Micro: n=103; Small: n=89; Medium: n=59

Supply - Approval/Rejection rates

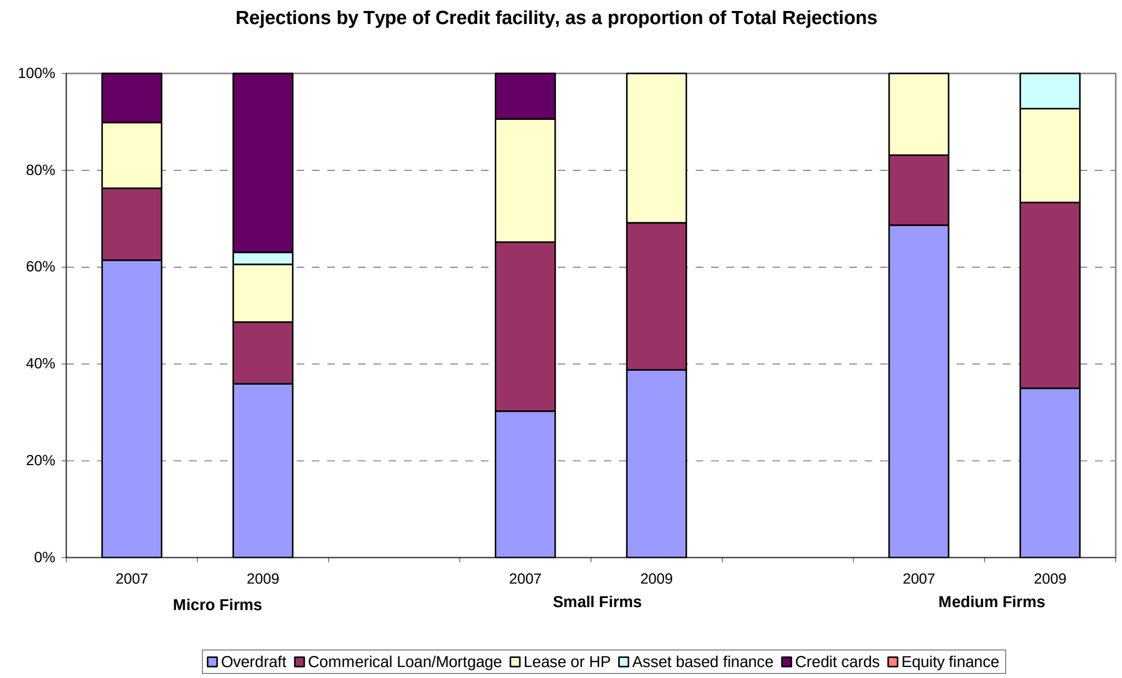
3.13. There is evidence to show that the supply of finance to SMEs in Scotland has reduced. The approval rate[6] for applications has fallen, particularly for micro firms where only 60% of firms have been able to secure any amount of finance sought compared to 82% in 2007. The likelihood of approvals in finance applications increases with size of firm. However, the supply of finance to high-growth firms in Table 2 appears to have reduced fairly dramatically with a reduction of 35 percentage points between 2007 and 2009.

	Approvals rate %	
	2009	**2007**
Micro	60.1%	81.6%
Small	78.6%	93.1%
Medium	89.1%	99.5%

	Approvals rate %	
	2009	**2007**
High Growth	43.9%	78.5%
Non high-growth	68.4%	86.5%

Base (2009): Firms which had applied for finance: Micro: n=293; Small: n=247; Medium: n=91; High growth: n=83; Not high growth n=446
Base (2007): Firms which had applied for finance: Micro: n=103; Small: n=89; Medium: n=59; High growth: n=50; Not high growth n=162

[6] Defined here as those firms securing more than 0% of finance sought over the last 3 years.

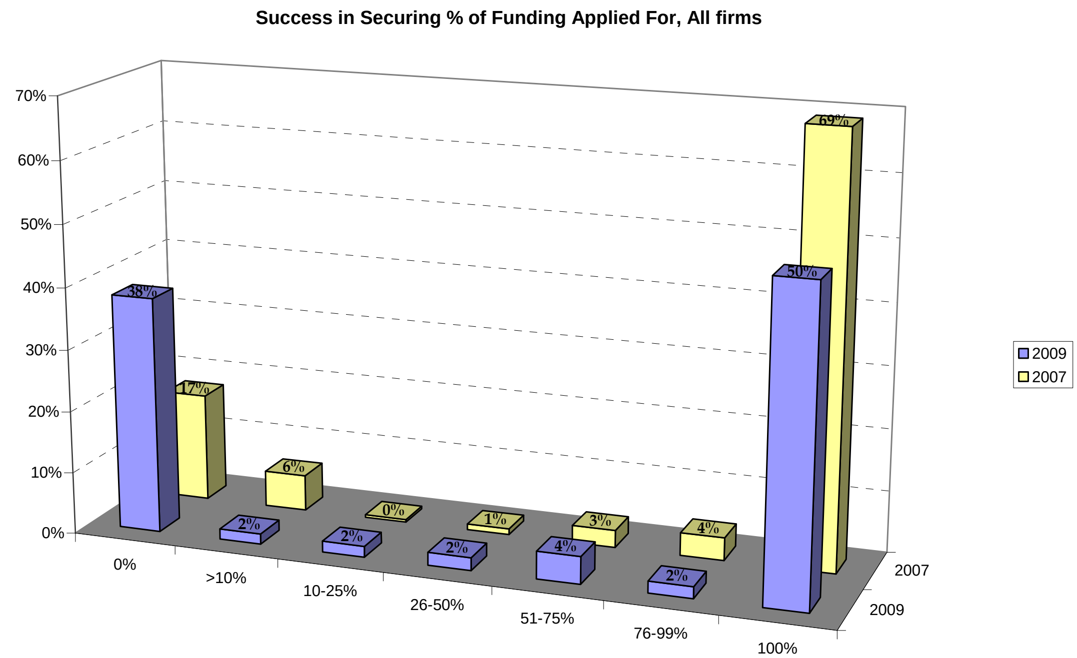


Base (2009): Micro: n=293; Small: n=247; Medium: n= 91
Base (2007): Micro: n=103; Small: n=89; Medium: n=59

3.14. The numbers of firms being *rejected outright* for finance has increased by as much as 10 percentage points for micro and medium size enterprises, and by 4 percentage points for small firms. In 2009, 15% of micro firms were turned down on application for finance, compared to only 5% of these firms being rejected in 2007. Similarly, the percentage of small and medium sized business rejected for any type of credit facility has increased to 9% and 19% - a rise in rejections of 5 and 11 percentage points respectively.

3.15. There are notable changes in the types of finance that firms are being rejected for. The largest reductions by type of credit facility are credit cards, commercial loans and overdrafts. Given that these types of credit facility are the most common forms of financing, the reduction in supply can be expected to have a fairly pronounced impact in access to finance.

3.16. The biggest change in 2009 for micro firms is the increase in rejections for credit card finance, compared to 2007. For medium sized enterprises, many more are being rejected for asset-based finance than they were in 2007. These results are not surprising in the current economic climate.

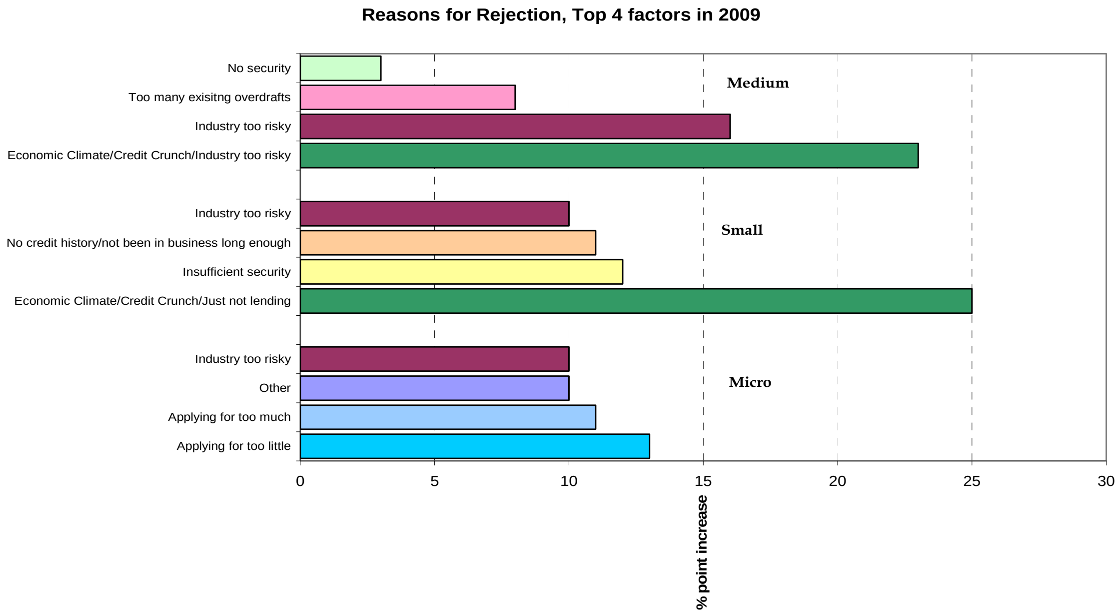


Base (2009): Firms which had applied for finance: n=631
Base (2007): Firms which had applied for finance: n=251

Success in obtaining 100% of finance sought

3.17. In terms of success in obtaining the full amount of finance sought, 50% of all firms managed to secure 100% of finance applied for compared to 69% in 2007. Micro firms are less successful than any other firm size in obtaining 100% of finance sought. In terms of lending, financial institutions are likely to provide either all, or none of the funding sought – fewer than 12% of firms are able to obtain partial funding. However, high-growth firms are more likely to secure partial funding than non-high growth firms.

3.18. The ability to secure funding elsewhere is positively correlated with size of firm. In 2009, of those enterprises who were rejected by their main bank/provider in the first instance, the majority of small (50%) and medium firms (71%) were able to source funding from other sources – namely from a different bank, or a different product with the same bank. For micro firms, however, around 62% did not manage to secure the funding needed elsewhere - and of those who did, the majority of micro firms sourced this from 'family and friends' or other unspecified sources.



Base (2009): Firms which had been rejected an overdraft: Micro: n=56; Small: n=29; Medium: n=12

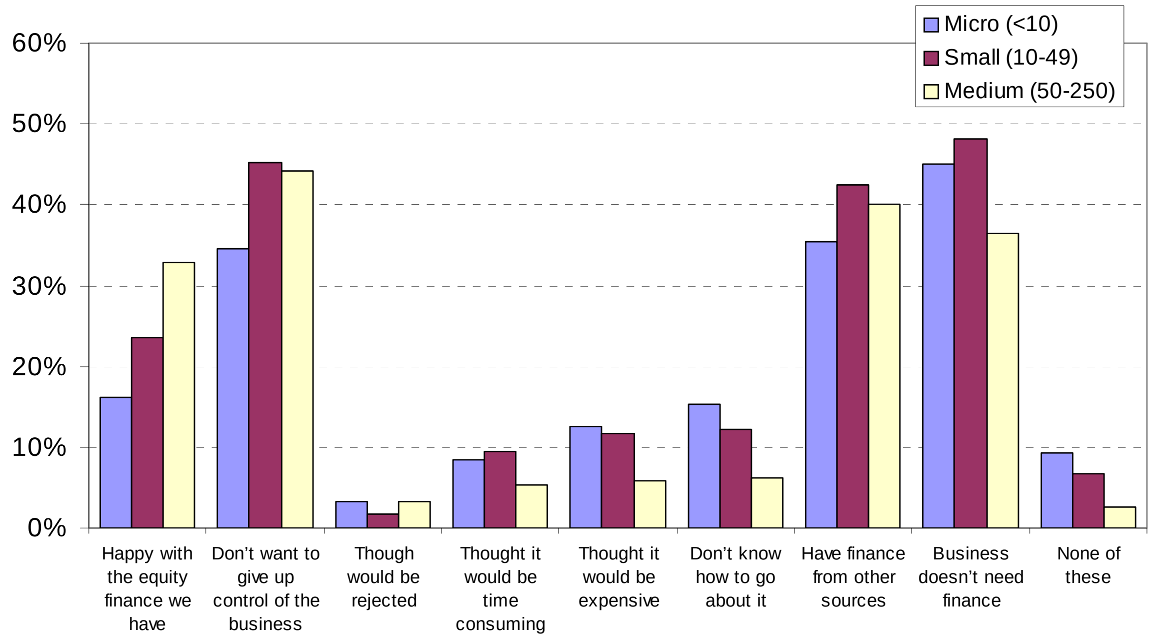
Reasons for Rejection

3.19. Enterprises were asked about the reasons given by financial institutions for being rejected in their applications for overdrafts. A broader range of reasons are cited for being unsuccessful in 2009 compared to 2007, where businesses were more likely to report 'don't know', 'no reason', or some 'other 'reason.

3.20. For micro enterprises, there was an increase in nearly all explanations given in 2009 for the rejection of application of finance for these firms. Interestingly, 'industry being too risky' features prominently across all firms in 2009, which was not considered as a factor at all in 2007. For small and medium size enterprises, 'economic climate/credit crunch/just not lending' featured as the most significant explanation given for not approving applications. Issues of security/not enough security are also increasingly becoming reasons for unsuccessful applications indicating that financial providers are becoming more risk-averse in the current economic climate.

3.21. There are a number of differences between high-growth firms versus all other firms, in the relative change in factors that contribute to the rejection of finance applications. In more detail, 'insufficient security' or 'no security' have become more pronounced reasons for rejection in applications from non-high growth firms, but less of an issue for high-growth firms compared to 2007. The main change in reasons for rejecting high-growth firms seems to be around issues of 'poor business credit history' or 'poor personal credit history'. There has been a prominent increase in the reason 'industry too risky' in 2009 for both types of firms but more so for non high-growth firms, increasing as a factor by 7 percentage points, and 13 percentage points for high-growth and non-high growth firms respectively.

Reasons for not applying for equity finance over the past 3 years



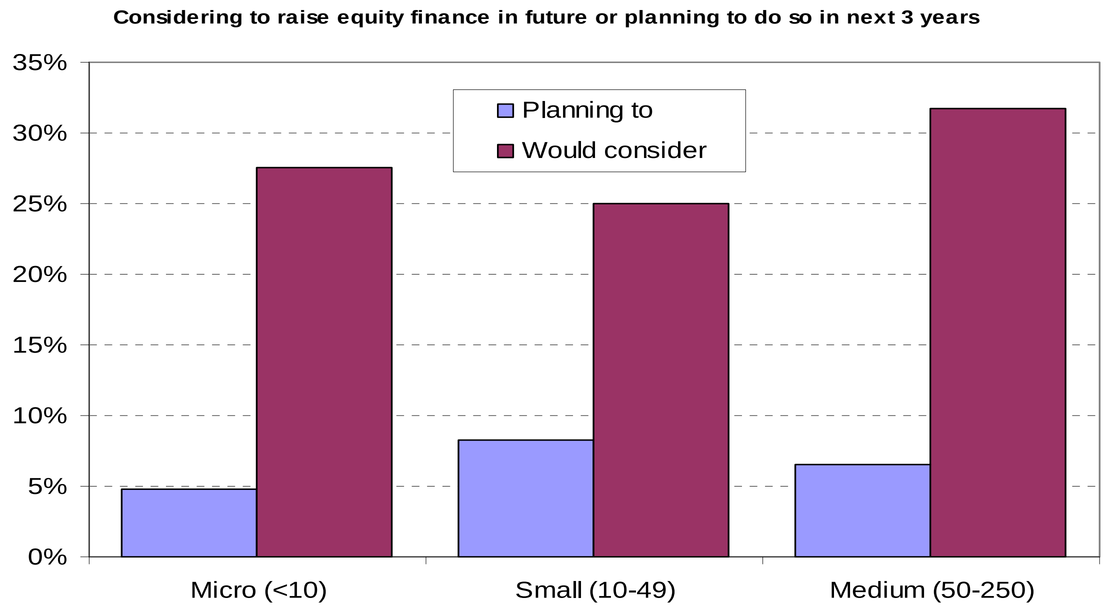
Base (2009): Firms which had not applied for equity: Micro: n=164; Small: n=238; Medium: n=97

Equity Finance

3.22. The two main types of equity financing are private capital, which is invested by the entrepreneur (or family and friends) establishing the business; or venture capital. Venture capital is usually a longer-term investment in a business with high growth potential. These investors often provide business support in addition to financial support to the firm. Other forms of equity finance can include business angels.

3.23. The access to finance survey provides limited data on equity financing, largely due to the fact that equity finance constitutes only 0.2% of all external finance used. Small base numbers, therefore, do not allow for a comprehensive or robust analysis of those who are currently using equity finance.

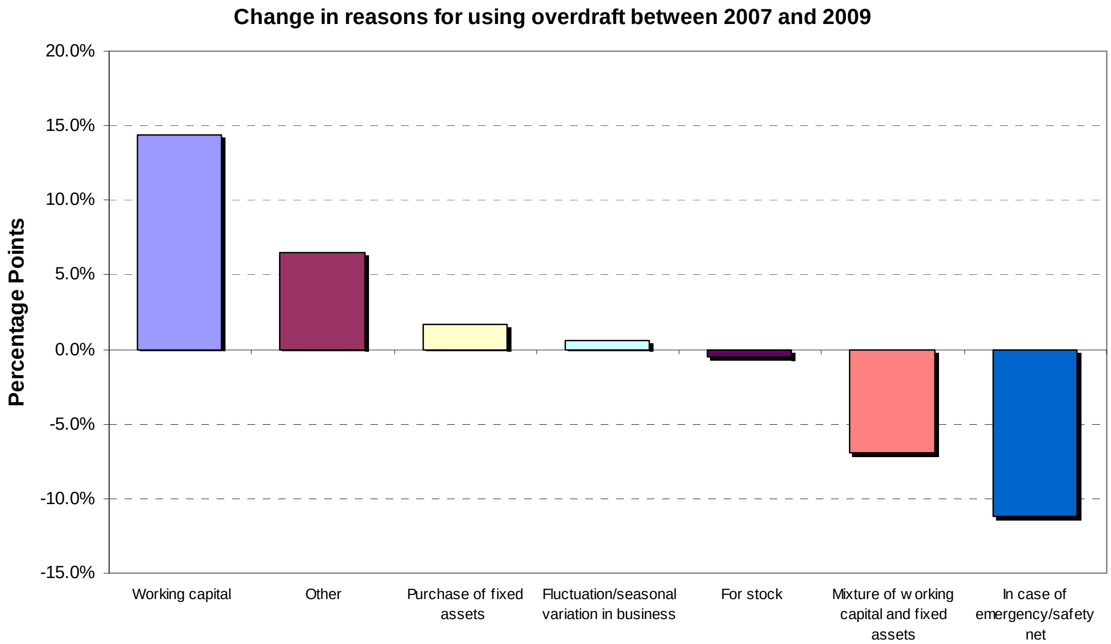
3.24. However, the survey does provide an indication of the reasons enterprises have not applied for equity finance over the last three years. The most common responses relate to 'business doesn't need the finance' and that enterprises are reluctant to 'give up control of the business'. A significant proportion of medium firms also state that they are happy with the equity finance they currently have. Interestingly, less than 5% of firms felt that they would be rejected, although 10-15% of micro and small firms stated that they did not know how to go about it.



Base (2009):Planning to?: Micro: n=545; Small: n=340; Medium: n=116
Base (2009):Would Consider?: Micro: n=164; Small: n=242; Medium: n=99

3.25. In terms of potential future demand for equity finance, there is a substantial difference between the proportion of firms actually *planning* to raise equity finance in the following three years and those that would *consider doing so at some point in the future.*

3.26. Comparing to 2007, there has been a 10 percentage point increase in the proportion of firms who would consider raising equity finance in the future – from 17.3% of firms to 27.5%. This increase is due to micro and medium sized firms, with the proportion of small firms reporting they would consider it remaining stable. This is perhaps suggestive of firms possibly seeking out alternative sources of finance at a time when traditional sources are being squeezed.



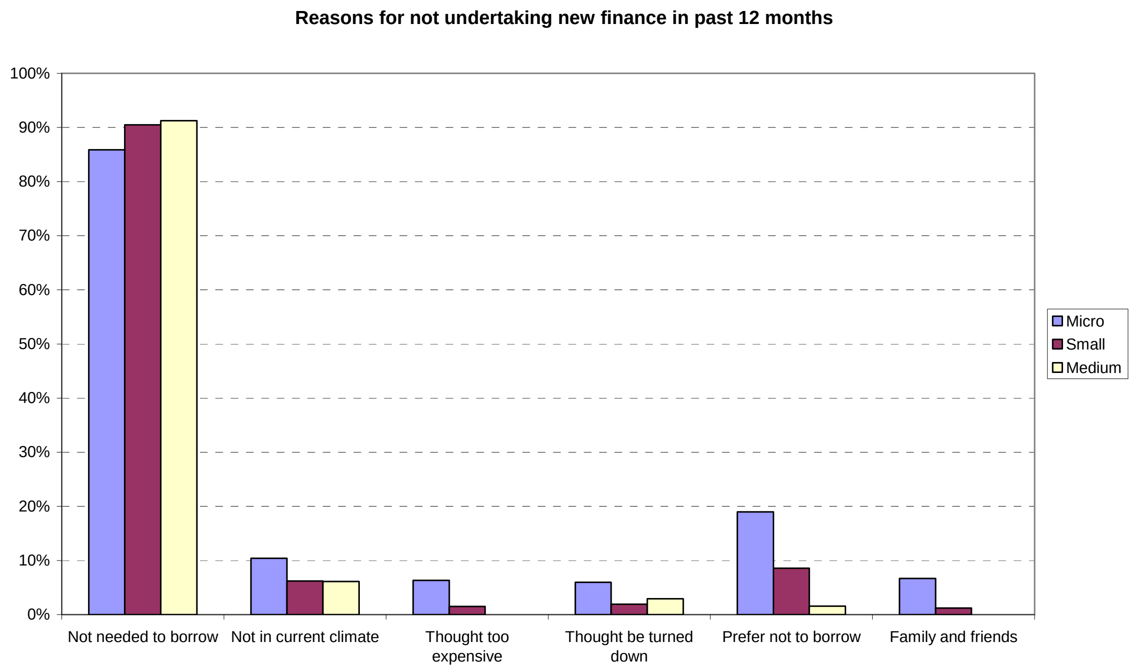
Base (2009): Firms currently using an overdraft: n=501
Base (2007): Firms currently using an overdraft: n=234

Impact of the Credit Crunch on Accessing SME Finance

4.1. The onset of the recession along with the financial crisis in the banking sector is likely to have impacted on the behavior of both businesses and the financial sector in terms of the response to increases in the costs of borrowing and on taking risks. The evidence from the Bank of England Credit Conditions Survey confirms this change. The sections below detail how the credit crunch is changing the behavior of borrowers and lenders.

Changes in the behaviour of firms and financial institutions

4.2. There is a notable change in the way enterprises are using external finance to meet business needs compared to 2007. The most dramatic change is the shift towards working capital requirements and away from retaining it as an emergency fund or safety net or as a mixture of working capital and fixed assets.



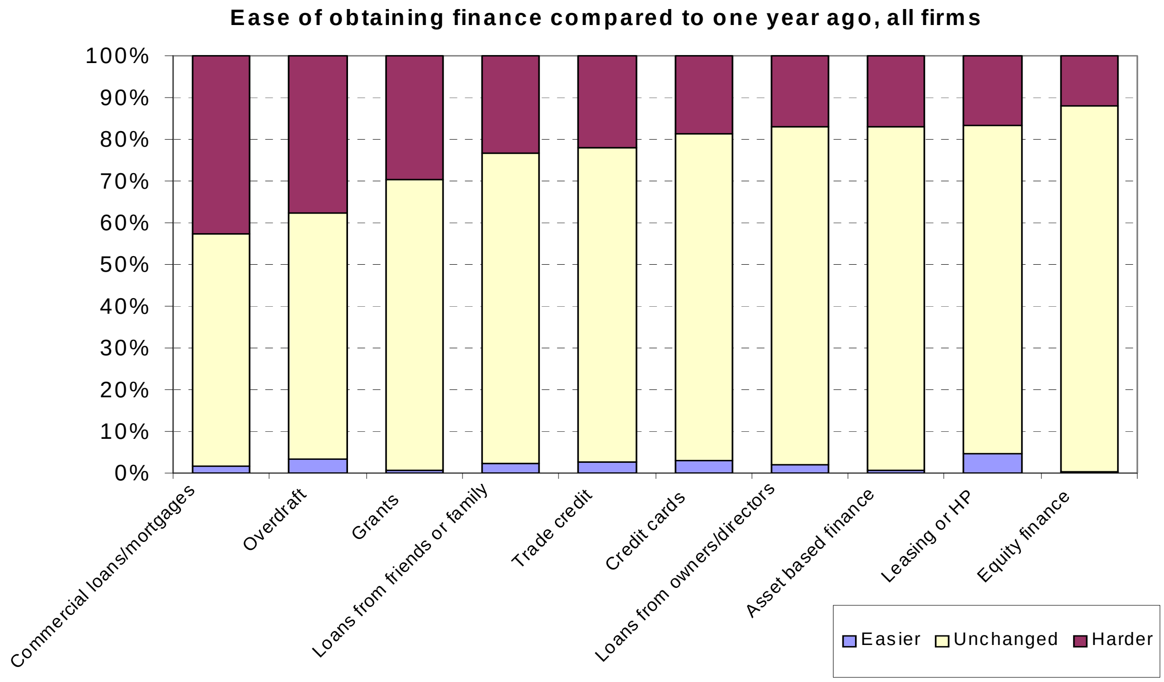
Base (2009): n=744

4.3. Around 18% of firms took out new lending or had to re-finance some sort of credit facility in the last 12 months[7] – overdrafts accounted for over 80% of these applications across all firm sizes, followed by loans (at around 19% for micro firms). The demand for this type of credit corresponds with the need for enterprises to meet working capital requirements during difficult periods in the economic cycle.

4.4. The main reason for the majority of firms (86%) who did not take out new lending in the past 12 months was simply that they 'did not need to borrow'. A significant proportion of micro firms around 42%, expressed a 'reluctance' to seek new finance[8], compared to only 19% and 11% of small and medium firms respectively.

4.5. Non-high growth firms are being more cautious about borrowing in the current climate than high-growth firms. A much higher proportion of high-growth firms (95%) did not need to borrow, compared to non-high growth firms (84%). However, a greater number of non-growth firms showed a greater reluctance to borrow or re-financing in the last 12 months, with the majority of these stating that they would prefer not to borrow (17%) and 11% expressing the current climate as a reasons for not doing so. In contrast, fewer high-growth firms felt these were relevant issues.

[7] This figure should not be interpreted as an indicator of demand as there is no comparative figure to compare how this relates to previous year's demand.
[8] The 'reluctance to seek finance' category is based on responses for not applying, which include 'current climate, 'too expensive', 'thought they would be turned down' and 'prefer not to borrow'.



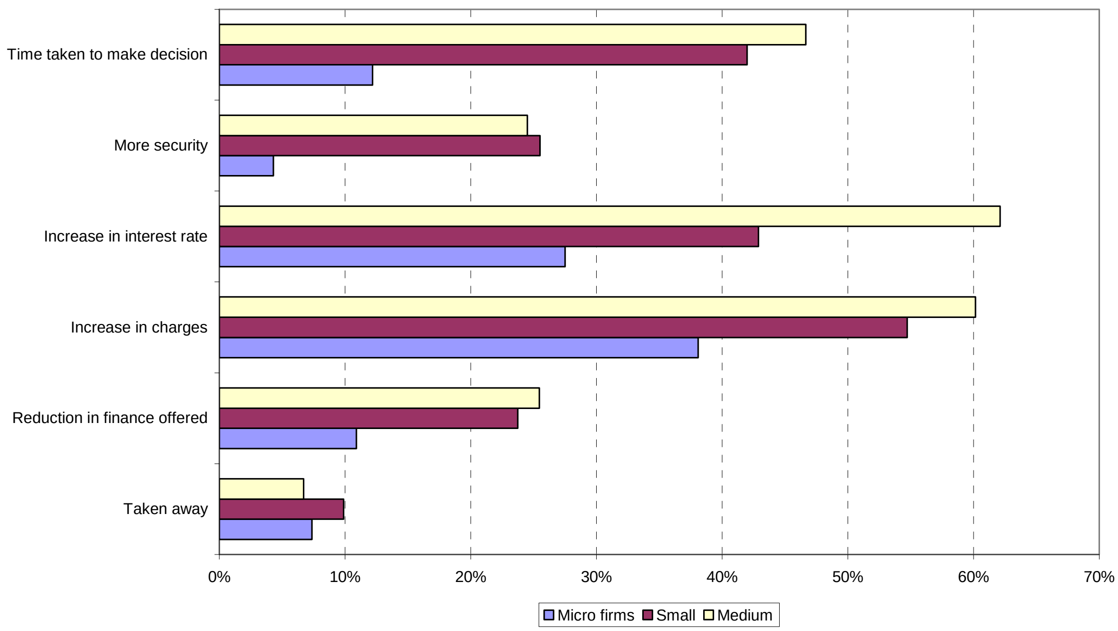
Base (2009): Commercial Loans: n=514; Overdraft: n=732; Grants: n=443; Loans from friends and family: n=438 ;Trade Credit: n=693; Credit Cards: n=637; Loans from owners: n=501; Asset based finance: n=411; Leasing or HP: n=576; Equity Finance: n=345

Changes in the cost of credit

4.6. Firms were asked to compare the ease of obtaining certain types of finance currently relative to 12 months ago. Across all types of finance 'unchanged' and 'harder' construed the vast majority of responses.

4.7. Commercial loans and mortgages and overdrafts were the two forms of finance which had seen the biggest changes, with around 40% of respondents of the opinion they had become harder to obtain. However, this experience of the increase in difficulty of obtaining that finance is perhaps not surprising given that these two types of credit facility are those that are most commonly sought by SMEs in the last 12 months.

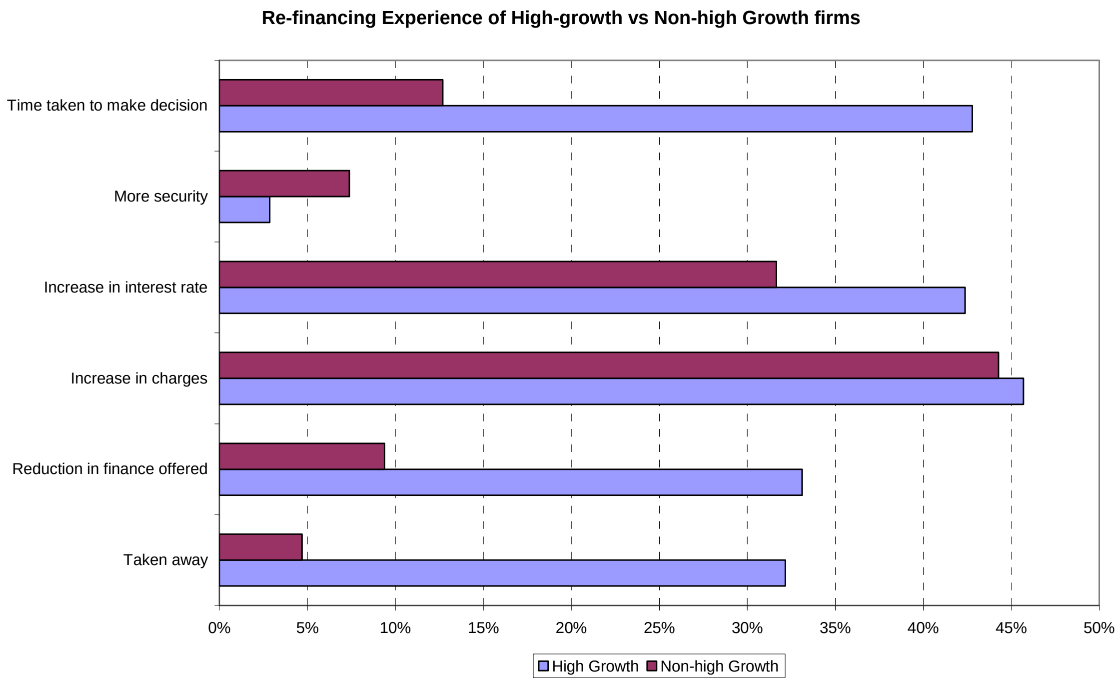
The re-financing experience



Base (2009): Micro: n=71; Small: n=84; Medium: n=31

4.8. Of those who undertook re-financing, enterprises were asked about their experience of renewing their credit facility. For all firm sizes, the key change relates to the increase in charges, with over 50% of small and medium firms indicating that this was the case. Just over 60% of medium firms felt that the increase in interest rates was a significant factor in re-financing their business.

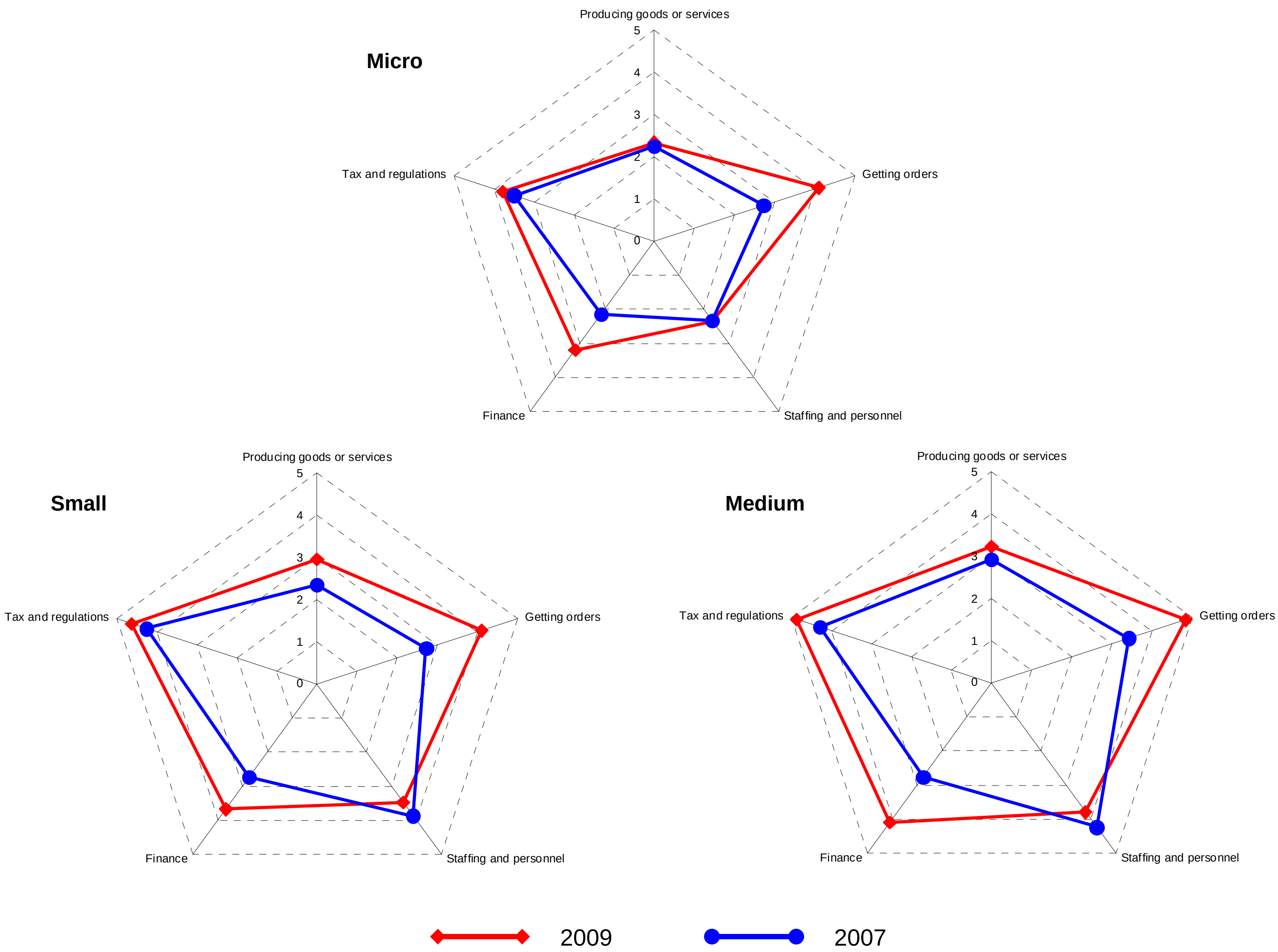
4.9. The amount of time taken to make a decision is also a significant factor for small and medium firms. These changes are perhaps also indicative of the changing behavior of financial institutions in becoming more risk-averse in dealing with applications for credit. Micro firms and small firms felt the facility being 'taken away' was more of an issue than did medium sized firms.



Base (2009): High growth: n=29; Non high growth: n=146

4.10. The difference in the re-financing experience is rather more pronounced between high-growth firms and non-high growth firms. For high-growth firms the biggest difference with non-high growth firms in the re-financing experience refers to a reduction in supply of credit – either the facility has been taken away or reduced, or there is an increase in the time taken for lenders to make a decision. These findings are in line with the analysis in the section above where approvals rate for high-growth firms have fallen considerably in 2009, and on the basis that rejection of applications for high-growth firms are based more on issues around insufficient or lack of security for credit.

Current Constraints Facing Business, 2007 and 2009

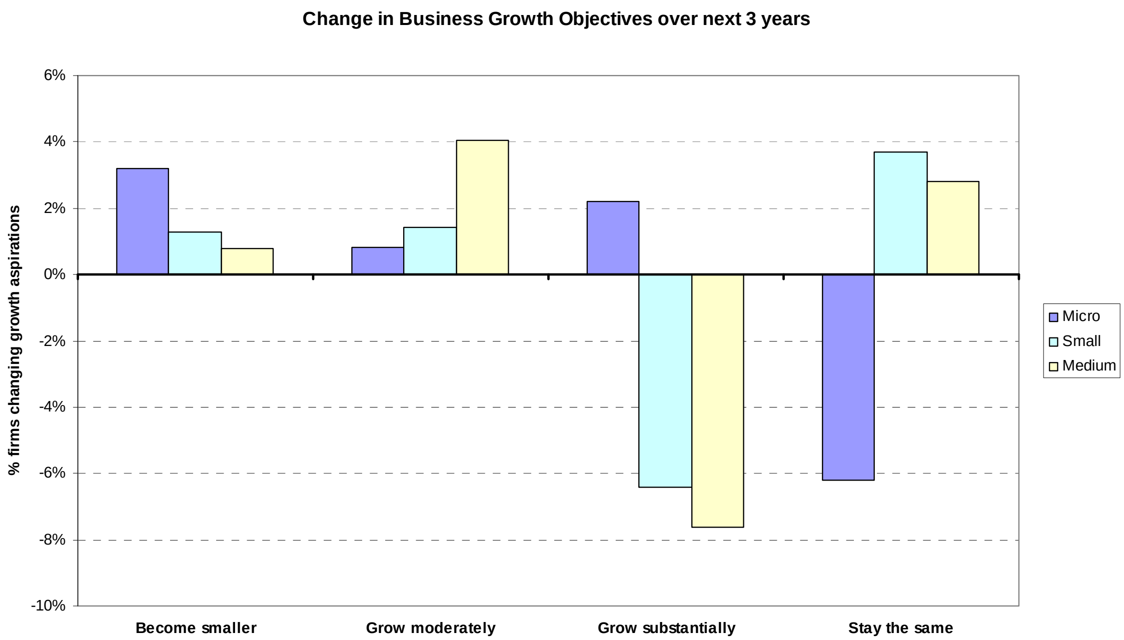


The further away from the origin, the greater the obstacle to successfully meeting business objectives.
Base (2007): Micro: n=252; Small: n=147; Medium: n=86. Base (2009): Micro: n=520; Small: n=324; Medium: n=114

Impact on business

4.11. Firms were also asked about the problems faced by their businesses in the current economic climate. The charts above illustrate how SMEs rate key areas as a constraint facing their firms compared to the previous year. In all cases, getting orders (i.e. demand for products) and the issue of tax and regulations are seen as *the most significant constraints* for all firms.

4.12. However, finance (including cost, and obtaining sufficient finance) has also become *more* of a constraint and is showing the second largest increase after demand for products, in the change in observed constraints since 2007. In line with what we would expect in a recession, staffing is less of an issue for firms in 2009 than it was in 2007.

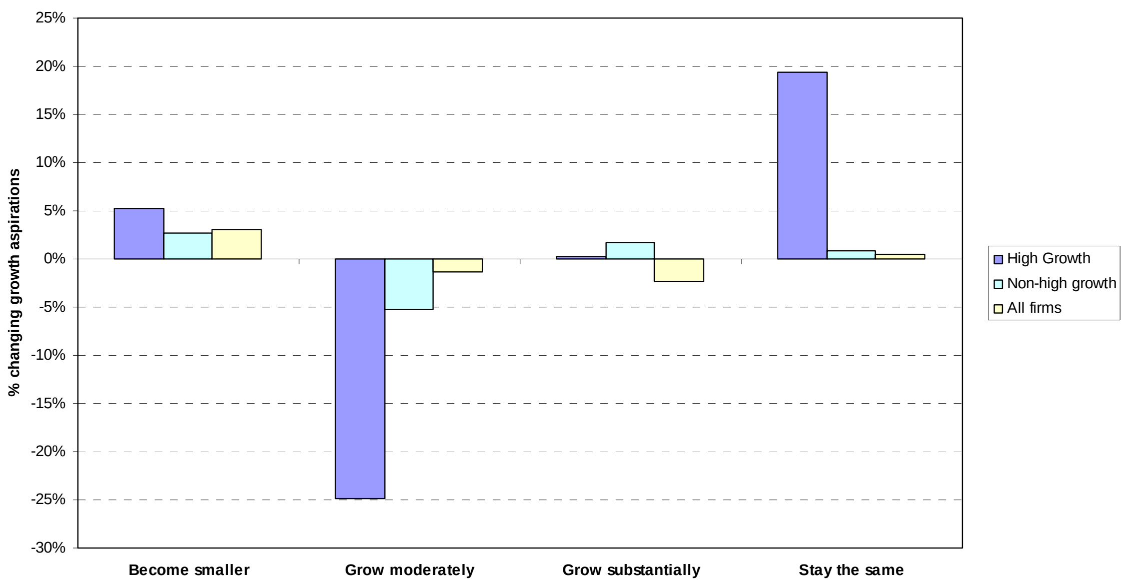


Base (2009): Micro: n=404; Small: n=310; Medium: n=108
Base (2007): Micro: n=257; Small: n=151; Medium: n=93

4.13. Growth aspirations appear to be correlated with size of firm, with aspirations of 'growing moderately' and 'growing substantially' increasing as firms get bigger. In 2007, 81% of medium size firms expected to grow both moderately and substantially compared to 66% of small firms and only 48% of micro firms.

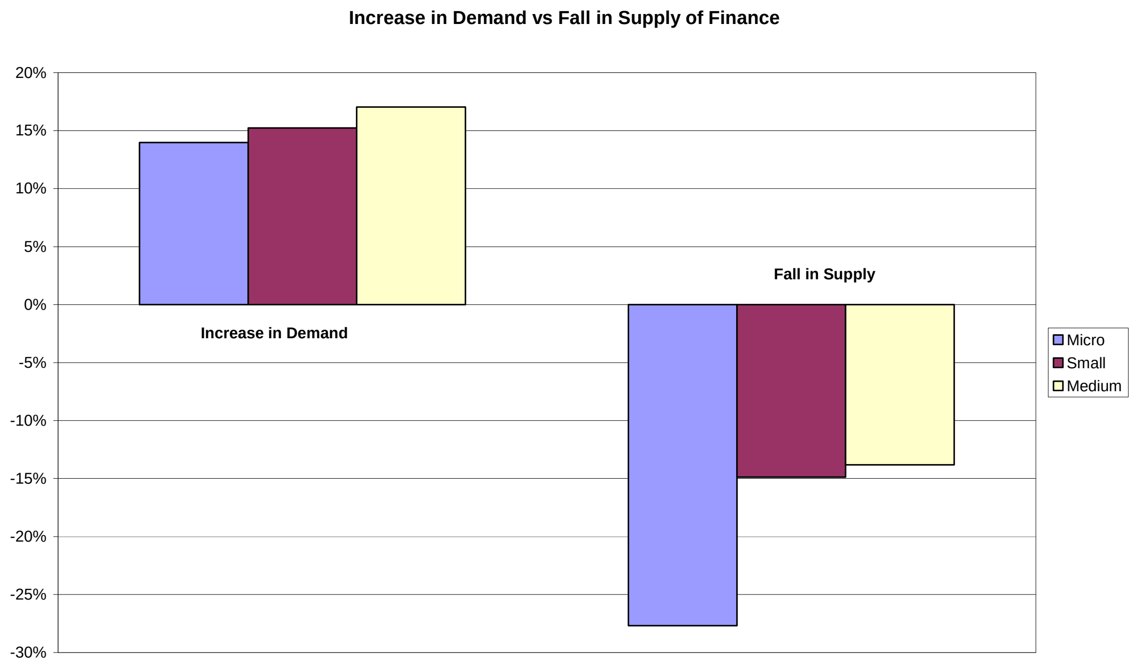
4.14. However, the majority of enterprises appear to have *revised downwards* their growth objectives in response to the current economic climate and the tightening of credit markets. The chart above shows that for medium and small firms, there is a shift away from 'growing substantially' to either 'growing moderately' or 'staying the same'. On the other hand, the majority of micro firms have revised growth expectations towards 'getting smaller' though a significant number are also expecting to grow substantially over the next three years.

Change in Business Growth Objectives over next 3 years - High Growth firms



Base (2009): High growth: n=118; Non high growth: n=704
Base (2007): High growth: n=82; Non high growth: n=328

4.15. Of these firms, it is apparent that 'high-growth' enterprises are reacting more sharply to the recession. Almost a quarter of high-growth enterprises are no longer expecting to 'grow moderately' compared to this ambition in 2007. The majority of these enterprises now expect to stay the same size, while 5% are expecting to grow smaller. This may not be surprising given that 'demand for goods' features highly as a business constraint for all firms and especially high-growth firms, so that expectations are being revised down in line with a reduced demand for those firms' outputs.



Base (2009 Applications): Micro: n=545; Small: n=340; Medium: n=116; Base (2009 rejections): Micro: n=293; Small: n=247; Medium: n= 91
Base (2007 Applications): Micro: n=257 ; Small: n=151; Medium: n=93; Base (2007 Rejections): Micro: n=103; Small: n=89; Medium: n=59

Gap Analysis and Unmet Need

4.16. The level of demand for finance from firms will always exceed supply. Financial institutions will (and should) only lend to credit-worthy and viable businesses. The current recession and the unprecedented financial crisis will undoubtedly lead financial providers to manage risk more effectively by tightening the credit application process and in increasing requirements for better credit application quality.

4.17. The analysis in the sections above show that a greater proportion of all firms, but particularly micro and high growth firms are unable to access finance they sought in 2009 compared to 2007.

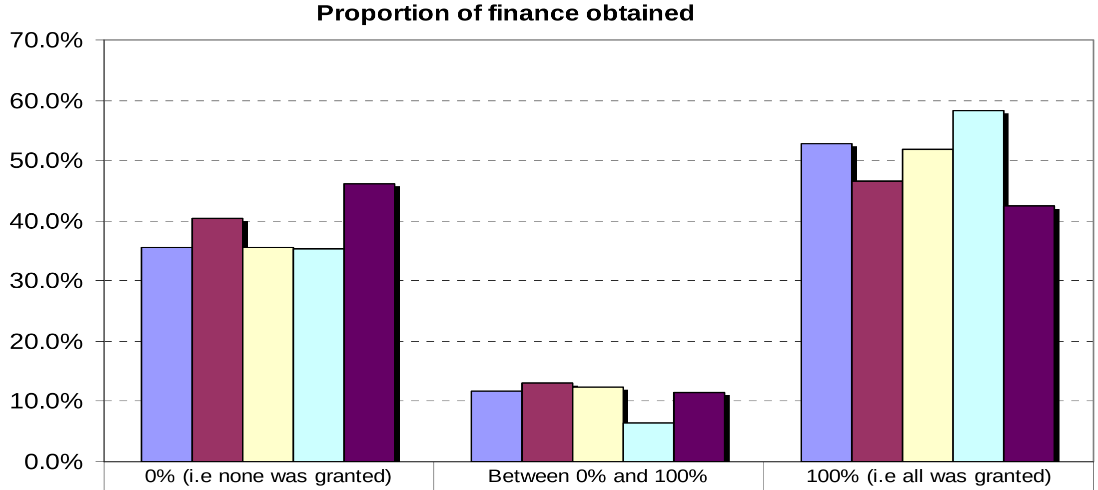
4.18. The chart above shows the rate of change in the supply of finance (approval rates) compared to the rate of change in demand for finance since 2007. The analysis suggests that the restriction in supply for micro firms has increased at a faster rate than the increase in demand, and is perhaps indicative of the fact that these firms are being adversely affected by the lending restrictions of financial institutions. Approval rates for finance have fallen at the same rate as the increase in demand from small firms and by less than the increase in demand from medium size firms.

	2009			2007		
	Micro	Small	Medium	Micro	Small	Medium
Total firms	262,145	14,120	3,575	259,795	13,950	3,490
% Applications	52%	72%	78%	38%	57%	61%
Numbers Applying for Finance	136,315	10,166	2,789	98,742	7,920	2,128
% Securing All Finance Sought	49%	61%	75%	76%	76%	89%
Numbers of Firms Successful	66,368	6,252	2,084	75,416	6,049	1,884
% Unsuccessful (securing 0% finance)	40%	21%	11%	18%	7%	1%
Numbers Unsuccessful	54,427	2,176	304	13,889	415	10
% not funded from elsewhere	62%	50%	29%	49%	48%	73%
Numbers unable to source any finance	33,745	1,088	88	6,834	197	7
UNMET DEMAND	**25%**	**11%**	**3%**	**7%**	**2%**	**0%**

4.19. The issue of ‘unmet need’ arises when *viable demand* for finance from businesses is not being met. The difficulty lies in entangling this element of demand from all other expectant demand from firms that seek finance but are not considered to be viable or credit-worthy businesses.

4.20. The table shows the estimated level of unmet demand from the Scottish SME population based on the approval and rejection rates of the firms surveyed, and the results aggregated for the total population. Taking into account the ability of firms to secure finance from elsewhere after being rejected by their main financial provider, it is estimated that in 2009, around 25% of micro firms are unable to secure finance they require from any source compared to 11% of small firms and 3% of medium size firms.

4.21. The gap in demand has increased since 2007 across all firms. In 2007, 7% of micro firms were unable to secure the finance they sought from any source, indicating that the gap has widened by around 18 percentage points during the recession in 2009. Interestingly, in 2007 almost all medium size firms were able to obtain funding they sought from one source or another.



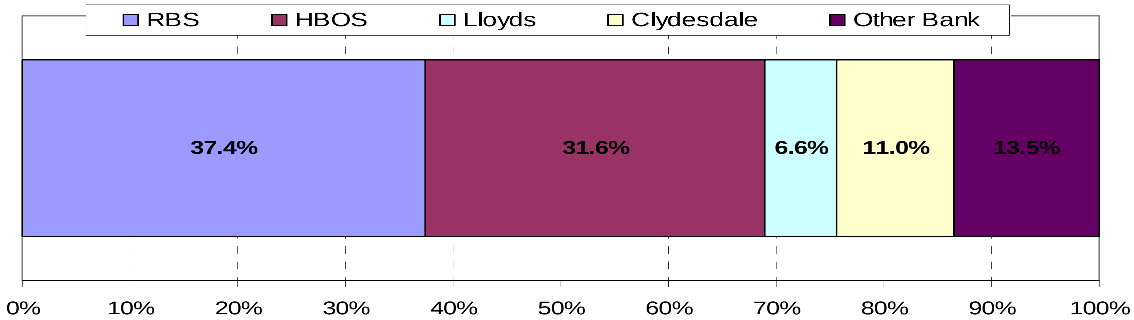
	0% (i.e none was granted)	Between 0% and 100%	100% (i.e all was granted)
RBS	35.5%	11.7%	52.7%
HBOS	40.3%	13.0%	46.7%
Clydesdale	35.7%	12.4%	51.9%
Lloyds TSB	35.2%	6.5%	58.3%
All Other Banks	46.0%	11.6%	42.4%

Base (2009): RBS: n=253; HBOS: n=209; Clydesdale: n=87; Lloyds TSB: n=36; Other: n=40

Supply by Financial Institution

4.22. The chart above shows the success of Scottish firms applying for finance from different financial providers. There does not appear to be dramatic differences in the success rates (defined as firms receiving greater than 0% of finance sought) across the 4 main Scottish banks. Lloyds TBS is most likely to approve funding applications for Scottish SMEs with around 58% of all applications being granted at the full amount (100%). However, it was the least likely bank to approve any amount in between 0 and 100%. 'All other Banks' (which includes Abbey National and Alliance & Leicester PLC) had the lowest approval rates with 46% of SMEs not securing any funding, followed by HBOS at 40%.

Percentage of total rejections by bank



Base (2009): Base (2009): RBS: n=253; HBOS: n=209; Clydesdale: n=87; Lloyds TSB: n=36; Other: n=40

4.23. As a proportion of total rejections for SME demand in 2009, the chart above shows that 69% of total rejections are being made by RBS and HBOS. This figure rises to 75% when taking into account the newly formed Lloyds Banking Group of HBOS and Lloyds TSB.

	Base Number	Market Share*
Abbey National PLC	22	4.6%
Alliance & Leicester PLC	17	1.9%
Allied Irish Banks PLC	7	0.3%
Halifax Bank of Scotland**	316	27.8%
Barclays Bank PLC	7	0.6%
Clydesdale Bank	135	11.5%
HSBC Bank PLC	16	1.0%
Lloyds TSB Bank PLC	65	7.5%
Nationwide	1	0.1%
Royal Bank of Scotland PLC (RBS)**	389	39.6%
The Co-operative Bank PLC	7	1.3%
First Trust	1	0.2%
Ulster Bank	1	1.3%
Other	5	0.9%
Don't know	12	1.4%

** based on responses to survey weighted up to reflect population of SMEs*
*** Halifax Bank of Scotland includes all respondents who answered 'Bank of Scotland', 'Halifax', or 'HBOS'. Royal Bank of Scotland includes all those who answered 'Royal Bank of Scotland' or 'NatWest'.*

4.24. In terms of market share based on our sample, it is clear that the Scottish SME banking market is very concentrated with a small number of banks. Over two-thirds of Scottish SMEs are supplied by The Royal Bank of Scotland (RBS) and Halifax Bank of Scotland (HBOS), with 40% and 28% market shares respectively. The Clydesdale Bank and Lloyds TSB have the next largest market shares, with 11.5% and 7.5% of SMEs respectively.

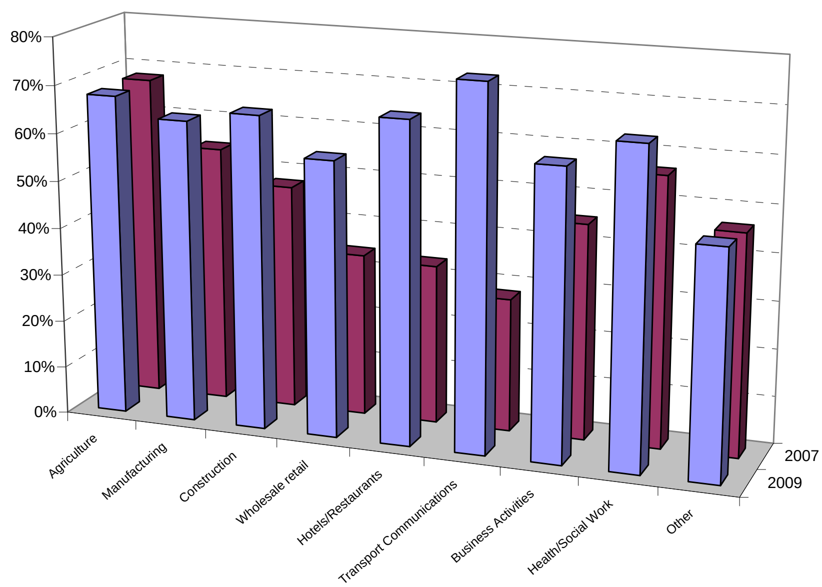
4.25. These figures, based on the sample of respondents to the survey, are broadly in line with market share information reported in a recent Office of Fair Trading report into the proposed acquisition of HBOS by Lloyds TSB and replicated in the below table.

Market shares in SMEs in Scotland, % stock (2006)	
Halifax Bank of Scotland	[30-40]
Lloyds TSB	[0-10]
Royal Bank of Scotland Group	[30-40]
Barclays	[0-10]
HSBC	[0-10]
NAB Group (includes Clydesdale)	[10-20]
Others	[0-10]

Source: Office of Fair Trading, 'Anticipated acquisition by Lloyds TSB plc of HBOS plc' 2008

4.26. Although there are not large variations in rejection rates across the banks, the concentration of the market by two lenders (taking into account the newly formed Lloyds banking group) means that any changes in the lending practices of these banks will have strong implications for the overall SME credit market.

Levels of Demand for Finance by Sector, excluding zero employee firms



Base (2009):Agriculture: n=119; Manufacturing: n=246; Construction: n=195; Wholesale/Retail: n=159; Hotels/Restaurants: n=156; Transport/Communication: n=92; Business Activities: n=213; Health/Social Work: n=92; Other Services: n=148
Base (2007):Agriculture: n=32; Manufacturing: n=97; Construction: n=88; Wholesale/Retail: n=79; Hotels/Restaurants: n=57; Transport/Communication: n=24; Business Activities: n=73; Health/Social Work: n=44; Other Services: n=116

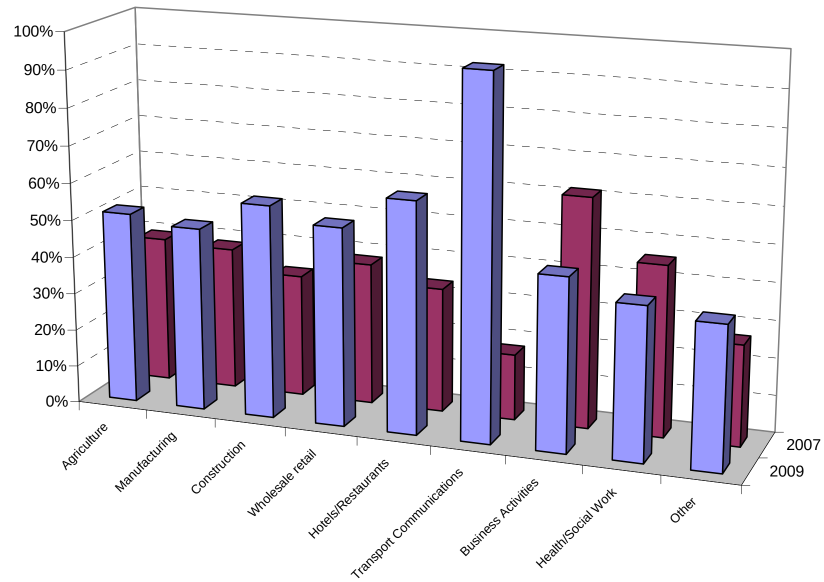
Sector Analysis – Demand

5.1. The sector analysis presents on overview of access to finance for nine sectors in the Scottish economy. A more detailed breakdown of some of the findings in the main report is not possible due to small base numbers. Some of the analysis presented below also excludes 'zero employee firms'. This is because the volume of zero employee firms is such that it can distort the overall picture by skewing the results heavily towards this category.

5.2. Around 50-60% of firms across all sectors sought finance in 2009. With the exception of Agriculture which has seen a negligible fall, there has been a rise in the number of applications for finance over the past 3 years in 2009 compared to 2007 for firms with one employee or more. The Transport/Communications and Hotels/Restaurants sectors have seen the largest rise in demand for credit in terms of number of applications, by 48 percentage points and 34 percentage points respectively. For other sectors, demand for finance has increased by 24 percentage points for Wholesale/Retail, 18 percentage points for the Construction industry, 15 percentage points for Business/Real Estate, and 9 percentage points for Manufacturing.

5.3. Although the *number* of applications for credit has risen sharply in these two sectors, the mean *amount* applied for has actually decreased in both. For all other sectors, the average amount of finance applied for has increased (see section below).

Levels of Demand for Finance, all firms by sector 2007 & 2009



Base (2009):Agriculture: n=119; Manufacturing: n=246; Construction: n=195; Wholesale/Retail: n=159; Hotels/Restaurants: n=156; Transport/Communication: n=92; Business Activities: n=213; Health/Social Work: n=92; Other Services: n=148
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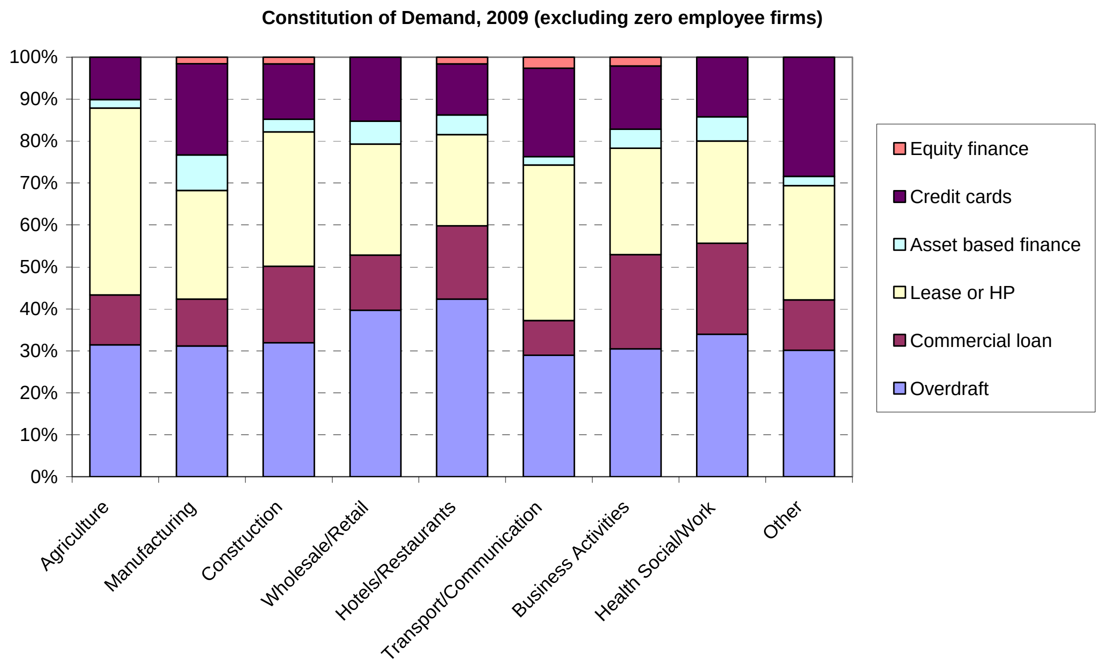
Sector Analysis – Demand

5.4. When taking zero-employee firms into account, the level of demand for finance (applications) is generally lower than firms with one employee or more. This is expected given the tendency of demand to increase with firm size. The most notable increases in demand for finance for these firms comes from Transport/ Communications (79 percentage points), Hotels/ Restaurants (29 percentage points), Construction (24 percentage points) and Wholesale/retail (15 percentage points). Demand for finance from Manufacturing firms when including zero-employee firms has increased by 11 percentage points.

5.5. Comparing *changes in demand* between the two broad categories of firm size, it appears that a greater proportion of larger firms are seeking finance in 2009 within particular sectors – namely firms in Business/Real Estate (31 percentage point difference in the increase in demand than firms with zero employees), Health/Social Work Services (15 percentage points), Wholesale/Retail (9 percentage points) and Hotels/Restaurant sectors (5 percentage points). For all other sectors – Agriculture, Manufacturing, Construction and Transport/Communications, zero-employee firms are more likely to have increased demand by a greater extent in 2009.



Base (2009):Firms who applied for finance: Agriculture: n=49; Manufacturing: n=84; Construction: n=81; Wholesale/Retail: n=63; Hotels/Restaurants: n=62; Transport/Communication: n=33; Business Activities: n=83; Health/Social Work: n=34; Other Services: n=56

5.6. There is a broadly similar pattern of what forms of new finance are being applied for across the sectors. Overdrafts and Leasing/HP are the two largest constituents in all sectors though credit cards and commercial loans applications also account for a notable proportion of overall demand.

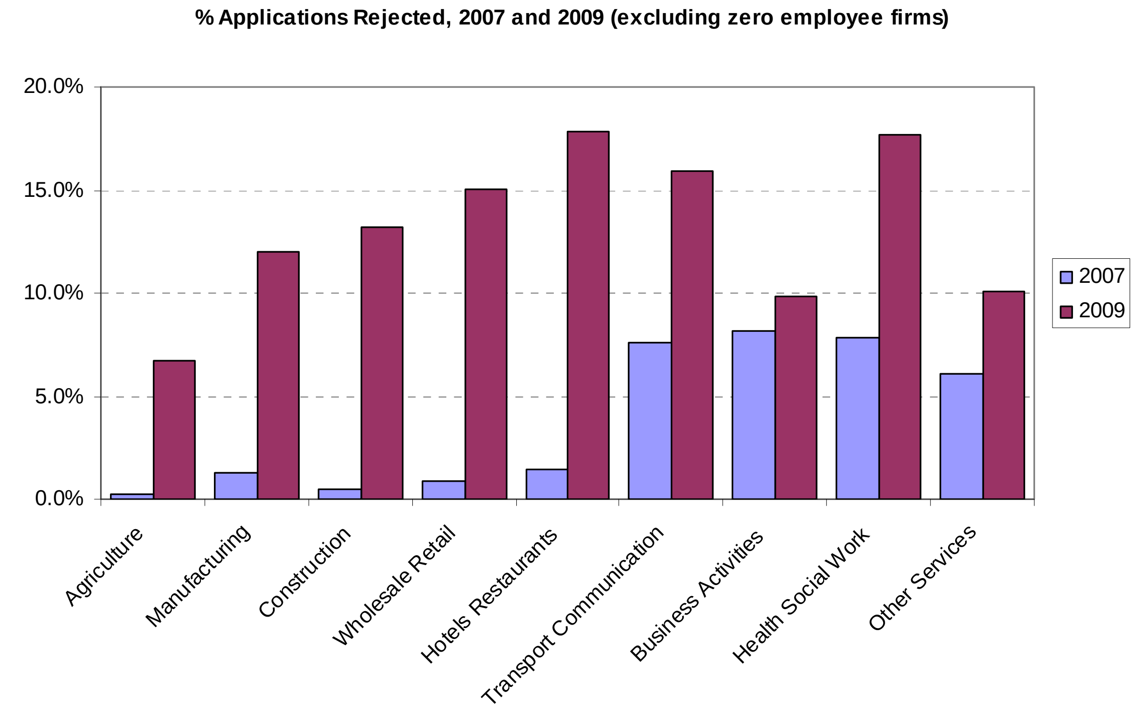
5.7. Looking more closely at the different forms of finance applied for across sectors, the increase in demand is driven largely by overdrafts and from particular sectors – Hotels/Restaurants (a 37 percentage point increase from 2007), Construction (30 percentage points) and Wholesale/Retail (20 percentage points), and to a lesser degree Manufacturing (7 percentage point increase) and Agriculture (8 percentage point increase). The pattern is the same when zero-employee firms are excluded from the analysis, but of lesser magnitude for the Construction industry (16 percentage point increase compared to 2007).

Mean Amount of Finance Sought over previous 3 years		
	2007 (>0 employees)	**2009 (>0 employees)**
Agriculture	£123k (£95k)	£64k (£100k)
Manufacturing	£98k (£255k)	£149k (£354k)
Construction	£56k (£166k)	£129k (£164k)
Wholesale/Retail	£85k (£152k)	£112k (£176k)
Hotels/Restaurants	£185k (£185k)	£68k (£90k)
Transport/Communications	£132k (£951k)	£42k (£243k)
Real Estate/Business Services	£138k (£178k)	£281k (£596k)
Health and Social Work	£105k (£293k)	£71k (£171k)
Other Services	£132k (£287k)	£79k (£192k)

Figures are unadjusted for inflation and are rounded to the nearest £1000.
Base (2009):Agriculture: n=54; Manufacturing: n=84; Construction: n=86; Wholesale/Retail: n=70; Hotels/Restaurants: n=63; Transport/Communication: n=35; Business Activities: n=84; Health/Social Work: n=35; Other Services: n=70
Base (2007):Agriculture: n=19; Manufacturing: n=36; Construction: n=41; Wholesale/Retail: n=26; Hotels/Restaurants: n=18; Transport/Communication: n=8; Business Activities: n=27; Health/Social Work: n=13; Other Services: n=45

5.8. There is a mixed picture when examining the amount of finance sought over the past 3 years across the different sectors. Manufacturing, Construction, Wholesale retail and Real Estate/Business Services sectors have all increased the amount of finance they are seeking since 2007. On the other hand, the amount of finance applied for by the Hotel/Restaurant sector has fallen quite dramatically. Agriculture, Health/Social work services and Other sectors have also reduced the amount of finance they are seeking. The pattern and magnitude is broadly consistent in each sector between firms with zero employees and those with more employees.

5.9. The largest increase in the amount of finance applied for comes from the Real Estate/Business Services sector. Given that this sector accounts for the greatest share of SMEs it appears this is the driving force behind the reported increase in the amount of finance applied for when taking all firms into account.



Base (2009):Agriculture: n=71; Manufacturing: n=125; Construction: n=118; Wholesale/Retail: n=100; Hotels/Restaurants: n=95; Transport/Communication: n=47; Business Activities: n=125; Health/Social Work: n=51; Other Services: n=100
Base (2007):Agriculture: n=26; Manufacturing: n=52; Construction: n=60; Wholesale/Retail: n=52; Hotels/Restaurants: n=45; Transport/Communication: n=19; Business Activities: n=45; Health/Social Work: n=30; Other Services: n=78

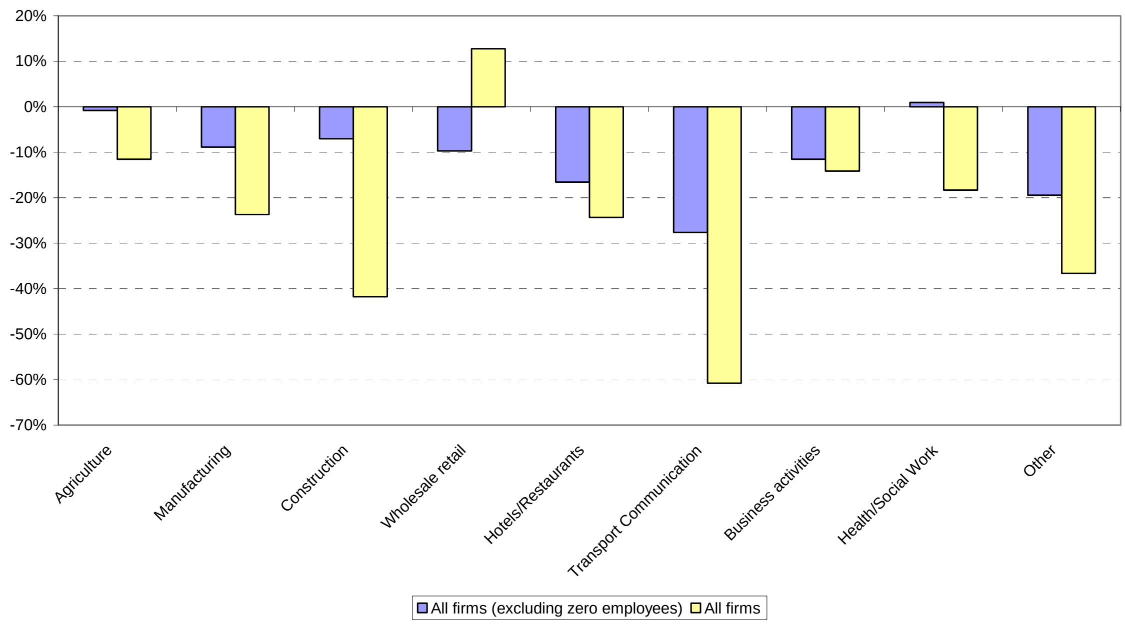
Sector Analysis – Rejections

5.10. Rejection rates have increased across all sectors, but there appears to be a marked switch towards particular industries that are most likely to be rejected for finance. In 2007, the sectors which were most likely to be rejected were Real Estate/Business sectors (8.1%), Transport/Communications (7.6%), Health/Social work (7.8%) and Other services (6%). The remaining sectors had very low rejection rates – typically fewer than 3% of applications within each sector.

5.11. In contrast, both in absolute terms and in terms of the relative change since 2007, there has been a significant increase in rejections for Hotels/Restaurants (18 percentage points), Wholesale/Retail (15 percentage points), Construction (13. percentage points) and Manufacturing (12 percentage points). Rejection rates for Transport/Communications and Health/Social Work industries remain at high levels as in 2007, and rejections in Real Estate/Business Activities appear to have only increased marginally.

5.12. When taking zero employee firms into account, a similar pattern in rejection rates emerges although rejections rates are typically higher for zero-employee firms in 2009 for Manufacturing, Construction, Wholesale/Retail, Transport/ Communications and Other sectors.

Change in Approval rates by Sector



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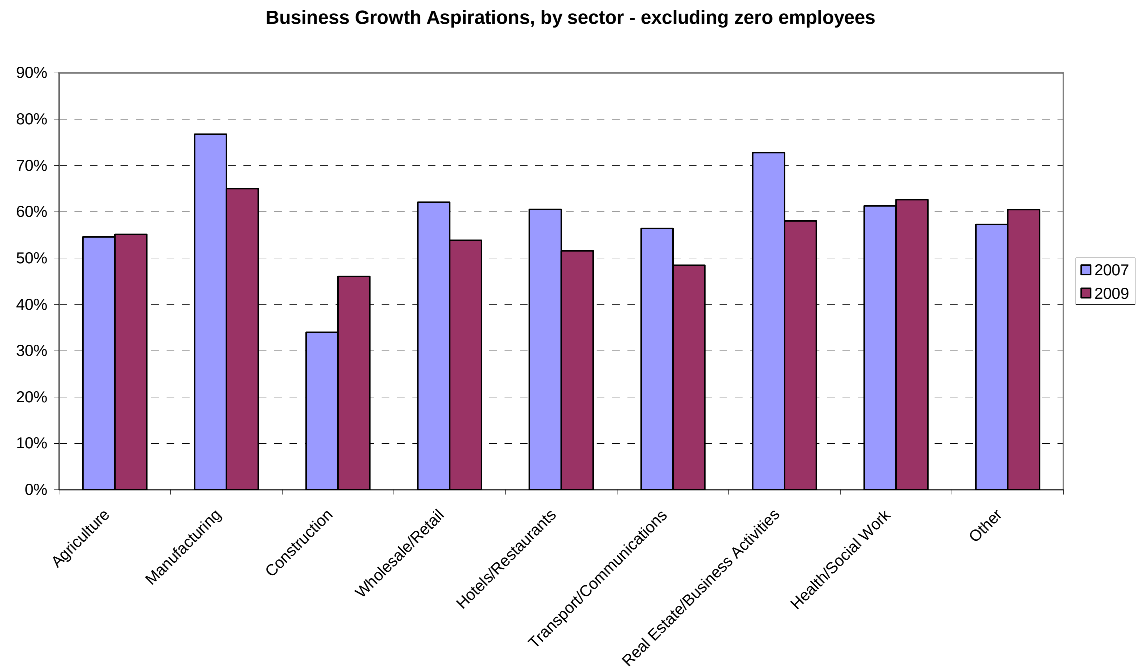
Sector Analysis – Approval Rates/Supply

5.13. The supply of finance has fallen across all sectors. The most marked decline is in Transport/Communication sectors. Generally, the pattern is similar but with a more pronounced fall in approval rates when comparing the data for all firms and when zero-employee firms are excluded.

5.14. The table below shows the approvals rates and change in approvals for each sector in 2007 and 2009.

	Approvals Rate % - zero employees excluded			Approvals Rate% - all firms		
Sector	**2009**	**2007**	***Change***	**2009**	**2007**	***Change***
Agriculture	90%	91%	*-1%*	82%	94%	*-12%*
Manufacturing	82%	91%	*-9%*	73%	96%	*-24%*
Construction	80%	87%	*-7%*	55%	97%	*-42%*
Wholesale retail	68%	78%	*-10%*	75%	62%	*13%*
Hotels/Restaurants	64%	80%	*-17%*	50%	75%	*-24%*
Transport Communication	72%	100%	*-28%*	39%	100%	*-61%*
Business activities	70%	82%	*-12%*	57%	71%	*-14%*
Health/Social Work	94%	93%	*1%*	78%	97%	*-18%*
Other	80%	100%	*-19%*	63%	100%	*-37%*

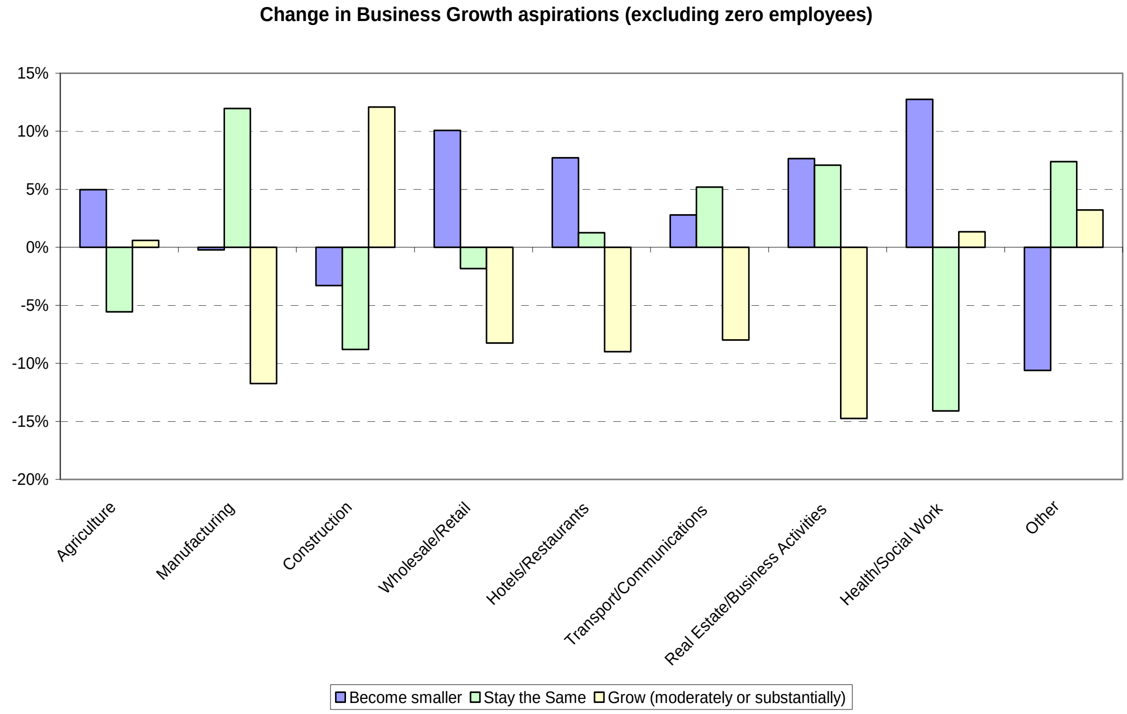


Base (2009):Agriculture: n=119; Manufacturing: n=246; Construction: n=195; Wholesale/Retail: n=159; Hotels/Restaurants: n=156; Transport/Communication: n=92; Business Activities: n=213; Health/Social Work: n=92; Other Services: n=148
Base (2007):Agriculture: n=32; Manufacturing: n=97; Construction: n=88; Wholesale/Retail: n=79; Hotels/Restaurants: n=57; Transport/Communication: n=24; Business Activities: n=73; Health/Social Work: n=44; Other Services: n=116

Business Growth Aspirations

5.15. The survey asked firms about their ambitions to grow over the next 3 years. This included whether firms thought they would be getting smaller, staying the same, growing moderately or growing substantially. Over 50% of all firms (excluding zero employees) across nearly all sectors had ambitions to grow either moderately or substantially in 2007. This included over 70% of firms in Manufacturing and Business/Real Estate sectors. The majority of sectors have revised growth expectation downwards - the notable exception being in Construction, and also marginally in Health/Social work and Other sectors.

5.16. When including zero employee firms within the analysis, there is a similar pattern of growth aspirations although the proportion of firms expressing an ambition to grow moderately or substantially is lower across the board. The only exception to this is the Wholesale/Retail sector in 2009, in which a greater proportion of firms with zero-employees expressed an ambition to grow compared to 2007. This may reflect the figures in the approvals rate table above, which shows that the approvals rate increased for Wholesale/Retail firms when zero-employee firms are included in the analysis. Again, all firms (with zero employees included) show a fall in growth ambitions with the exception of the three sectors – Construction, and again marginally Health/Social work and Other sectors.



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Change in Business Growth Objectives

5.17. The extent of the changes in growth ambitions of firms by sector excluding zero-employees is shown above. The most pessimistic sectors appear to be Agriculture, Wholesale/Retail, Hotels/Restaurants, and Real Estate/Business where revisions to growth ambitions are more skewed towards becoming smaller than staying the same or expanding. The proportion of firms becoming smaller is also significant in Health/Social work sector, although a slight proportion of firms are still expecting to grow either moderately or significantly.

5.18. Manufacturing and Transport/Communications sectors appear to be more cautious, where the balance of firms who are reducing growth ambitions have stated intentions to 'stay the same' than become smaller. On the other hand, in the Construction sector, there is an increase of 12 percentage points of firms who are expecting to grow than stay the same or become smaller, compared to 2007.

Conclusions

6.1. This report has presented the findings of the SME Access to Finance survey 2009. The main messages show that although the majority of firms in Scotland are able to access the finance they need, there is a significant increase in the proportion of firms that are being rejected for finance, and this is particularly the case for micro and high-growth firms. Certain sectors are also facing increasing difficulties in accessing finance. The hardest hit sectors appear to be Transport/Communications, Hotels/Restaurants, Real Estate/Business, and Wholesale/Retail. Zero-employee firms within the Construction, Manufacturing and Hotels/Restaurant sectors have also seen significant reductions in the supply of finance.

6.2. In addition, the costs of finance as perceived by business appear to have risen, with a significant proportion of firms finding it harder to obtain certain types of finance compared to a year ago. The increase in costs and the time taken to make a decision regarding re-financing or new lending is seen to be having an impact on business. High-growth firms, in particular, are finding that the credit facility is either being taken away, or a reduction in finance is offered on new lending or re-financing.

6.3. The survey also shows evidence that the gap in unmet demand has increased since 2007. The unmet demand largely relates to micro firms, however, given that these account for 94% of total SMEs in Scotland, this implies a significant proportion of firms are not being able to access the finance that they seek. The difficulty lies in entangling how much of this unmet demand is viable demand from credit-worthy businesses that are facing barriers to borrowing a result changes to bank lending practices which have arisen as a consequence of the economic and financial crises.

6.4. The real value from this report comes from being able to provide a thorough assessment of the financing needs of SMEs in Scotland, particularly during the recession. This will undoubtedly help in underpinning the evidence base for future policy development in this area. However, it is clear that further work remains to be done to achieve a better understanding of the constraints and drivers behind the changes in supply and demand of finance.

6.5. The key streams of further work that have been identified are:

- the restrictions in supply of finance in Scotland – an assessment of the impact of market shares in the SME finance market, and of the lending practices of banks, including whether Scottish firms are less likely to obtain finance than other regions within the UK as a results of other factors such as credit application quality, types of finance sought etc.

- the nature of demand for finance – for longer-term financing needs, what role and scope there is for other forms of non-traditional finance such as equity financing for firms.