# SME Access to Finance – Update Survey November 2009

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http://www.scotland.gov.uk/Topics/Economy/

**SME Access to Finance Survey November 2009 Report**

In July 2009, the Scottish Government published its first survey on SME Access to Finance which assessed credit conditions for firms during the height of the economic and financial crises. A further survey was commissioned in November 2009 to monitor levels of demand and supply for business finance over the six month period, and to determine whether there has been any improvement on levels of business confidence since March. This report presents findings of the November 2009 update survey.

## Introduction

1. In July 2009, the Scottish Government published the results of its first survey on SME Access to Finance[1]. The survey was undertaken in March 2009, and interviewed 1001 small and medium sized enterprises to assess how the economic downturn and the financial crisis in the banking sector at the end of 2008, had impacted on the demand and supply for finance to businesses in Scotland.

2. The key findings from the March 2009 survey showed that demand for finance had risen and the supply had become constrained - particularly for micro businesses, high-growth firms and within certain sectors. In addition, the cost of arranging finance had increased and the majority of businesses had revised downwards their growth ambitions over the next three years.

3. The Scottish Government subsequently commissioned an update to the survey in November 2009 to monitor - as far as possible - any changes to credit conditions and to determine whether there have been any improvements in business confidence to accessing finance over the preceding six month period. The analysis in this report presents the findings of the November update survey on SME Access to Finance, along with comparative findings against the earlier surveys.

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



[1] http://www.scotland.gov.uk/topics/economy/access-finance

## Summary Conclusions

- Over a six month period, it is difficult to make definitive statements on the changes in levels of demand and supply for SME finance. The results from the November survey, can however, provide an indication of the direction of travel in credit conditions and the current evidence indicates that firms continue to report that access to finance, particularly the costs of obtaining finance remains an issue for them.

- The November survey reveals that, fewer firms appear 'reluctant' to borrow than in the March survey suggesting that demand is not being suppressed. Many firms also appear to have revised down their own growth objectives since March which may translate into weaker demand for long-term finance. Evidence of low demand therefore, may reflect conditions in the economy more generally.

- The majority of SMEs surveyed have reported that the ease in which they are able to obtain finance remains unchanged to March 2009. The results suggest that banks appear more willing to lend to viable business propositions, but the survey suggests that lower amounts of finance are being obtained.

- The results from the survey do not provide a clear picture on the relationship between the perceived or actual price of finance for firms (including terms and conditions, fees and charges imposed), and the extent to which this is interacting with any continuing constraints on the supply of finance in Scotland.

- This suggests that there is an important role for continued dialogue between government, the banks and businesses in the months ahead to ensure that there is a balance between effective demand and supply of lending.

## Demand

- There has been a continued demand for short-term finance over the last six months, driven in the main by the need for working capital finance. There has also been a notable shift away from certain types of finance – from credit cards to overdrafts and loans.

- Around one fifth of the SMEs surveyed sought external finance over the last six months, with the majority looking to refinance existing deals as opposed to taking out new lending.

- There is no strong evidence from the survey to suggest demand is being constrained. Of those not demanding finance, 90% stated that they had no need to seek funding at this time.

- This may indicate that there may be weaker demand for growth finance as firms defer investment plans, perhaps reflecting conditions in the general economy rather than in the banking sector.

**Supply**

- For the majority of SMEs surveyed, the response has been that the ease of obtaining most types of credit appears unchanged relative to March 2009. Trade credit and commercial loans remained the most difficult forms of finance to obtain for SMEs.

- Relative to March 2009, the biggest *change* in the ease of obtaining different types of finance related to trade credit, with the firms surveyed reporting that it appeared to be significantly harder to obtain than previously.

- On supply, the emerging evidence on new lending indicates lower outright rejection rates compared to March 2009, showing a marked improvement in initial approval rates.

- However, firms have also reported that they are less likely to secure 100% of the funding sought. On the one hand, this may reflect either lower final offers from banks who are reflecting risk more appropriately, or firms themselves being unable (or unwilling) to meet the terms secured, or deciding not to proceed with the offer for other reasons.

**Costs of Finance**

- Nearly 40% of firms surveyed had the perception that the cost of finance was higher than one year previous.

- The main experience for SMEs refinancing over the period from March 2009 was an increase in costs. This included either increased margins over the base rate or increased fees and charges for arrangement.

- This may reflect the fact that low cost finance is no longer as freely available as banks move towards pricing risk more appropriately. Firms may perceive this adjustment on the pricing of finance as an increase to the cost of borrowing.

## Executive Summary

i. This summary is an extract of the report on 'SME Access to Finance, November 2009 Update Survey'. The findings are based on the results of a representative survey of 655 Scottish SMEs undertaken by the Scottish Government on access to finance over a six month period. The report also makes comparisons where possible, against results from an earlier survey conducted in March 2009, at a time when the international financial crisis led to sharp declines in output throughout the global economy.

## Main forms of finance used

ii. As in March 2009, the main forms of finance currently used by SMEs in Scotland are overdrafts (42%) and credit cards (34%). Use of finance tends to increase with firm size.

iii. The main change in the types of credit used by businesses since March 2009, is the reduction in the use of credit cards, which fell by 13 percentage points and leasing/hire purchase which decreased by 11 percentage points. Use of overdraft facilities and loans/mortgages rose by 5 percentage points and 4 percentage points respectively.

iv. High-growth firms are using the same types of finance as non-high growth firms in similar proportions. The types of credit facilities used by firms with greater levels of turnover differs from those with lower turnover, where the use of overdrafts and unsecured loans is proportionally greater for smaller enterprises.

v. The main reasons cited for having any type of financing is for working capital purposes (54%) and to assist with cash flow (52%). Small and medium sized firms are most likely to use external financing to help with expansion, to buy new assets, and to develop new products.

vi. The amount of security provided for current financing varies by firm size. Micro firms are less likely to provide any form of security or guarantee (70%) compared to small businesses (40%) and medium sized enterprises (43%). This is unsurprising given the types of funding sought by businesses of different sizes. Nearly 30% of small firms have given a personal guarantee such as their main family home to secure financing. This compares to 10% of micro firms, and 14% of medium sized businesses.

## Applications (Demand)

vii. The survey results suggest that the demand for finance tends to increase with firm size. Over the last six months, around 18% of micro businesses, 25% of small firms and 34% of medium enterprises surveyed sought some form of financing (new lending or re-financing existing facilities). The relative proportion of those seeking to re-finance compared to new lending is greater across all firm sizes.

viii. Based on turnover, the demand for finance increases as turnover increases, but then declines as the firm gets larger at a turnover level of £500,000 or above. Below this threshold, firms are more likely to seek new lending than re-finance, with the exception of the smallest of firms.

ix. The vast majority of re-financing by the firms surveyed over the last six months has been for overdrafts (over 90%). However, a significant proportion of medium sized businesses – nearly 40% - also sought secured loans, followed by mortgages (17%) and asset-based finance (15%).

x. For those firms in the survey who did not seek new lending or re-finance, the predominant reason for not doing so was that they 'did not need to borrow' (90%). There appear to be fewer 'reluctant' borrowers than in March 2009 indicating that firms are not suppressing demand that would otherwise exist. Firms are less likely to rely on 'family and friends' as a source of finance than previously.

**Approvals/Rejections (Supply)**

xi. The proportion of firms rejected for new lending appears to have fallen. In November 2009, the *outright* rejection rate for new applications stood at 8%. This compares to a rejection rate of 15% in March 2009, and 4% in 2007.

xii. Despite this, the survey results suggest that SMEs are *less* likely to secure the full amount of the funding sought relative to previous surveys. The explanation for this apparent contradiction between improving rejection rates but lower success in securing funding may reflect a number of factors: lower final offers from banks who are reflecting risk more appropriately, or firms being unable (or unwilling) to meet the terms secured, or deciding not to proceed with the offer for other reasons.

xiii. Of those firms who undertook re-financing in the last six months, the main experience appears to be one of increased costs of obtaining finance – both in terms of the margins applied over base rate and on the charges associated with the finance product. The experience varies by firm size, with medium firms most likely to be adversely affected by the costs of re-financing (around 75%).

xiv. Firms were asked about the 'ease of obtaining finance compared to six months ago'. A significant proportion of firms thought that trade credit (49%) commercial loans (44%) and grants (38%) had got harder to obtain. Compared to a similar question asked in March 2009, there has been an increase in respondents stating that finance is 'harder to obtain' for most types of credit.

**Costs of Finance**

xv. Nearly 40% of firms surveyed reported that the costs of credit had increased. Of those who believed there was an increase, 81% stated that overdrafts had become more expensive. This was followed by 59% of those firms reporting that secured loans were now more costly than a year ago and 59% felt that this was also the case for credit cards.

**Business Conditions**

xvi. Around one-third of all businesses surveyed responded that they had experienced cash-flow problems over the last six months. Larger firms appear to have been worst affected by cash flow problems – around 40% of medium firms reporting cash-flow problems compared to 33% of micro firms and 32% of small firms.

xvii. Of those who experienced cash flow problems, 57% of medium firms stated this had no impact on their business but this was the case for only 40% of micro firms and 33% of small firms. Medium sized firms appear to have greater control in seeking to manage their debtors, creditors and credit agreements with customers when faced with cash flow difficulties. Around 17% of all businesses who experienced cash flow problems said they got into 'serious financial difficulties' as a result, and 9% of micro firms had delayed bill payments or left them unpaid.

xviii. Firms were asked about the main constraints faced by their businesses. For all firm sizes, the main change in constraints is the increase in firms reporting finance as a greater constraint to business activity than other factors since March 2009, with little change in other factors. Staffing continues to remain less of an issue for firms in November 2009 than it was in March 2009 and 2007.

xix. Business confidence does not appear to have improved substantially since the March 2009 report. In general, fewer businesses stated that they are planning to grow (either moderately or substantially) over the next three years than they did in March 2009. The exception to this is high-growth businesses, of which there has been an increase of 16 percentage point in those reporting plans to 'grow moderately'.

**Future Financing**

xx. Firms which plan to grow over the next three years were asked about how they intend to finance growth in their business. The vast majority (over 80%) stated that they would use funds generated by the business. In addition, for external financing needs, the most common type of finance likely to be sought to fund growth is loans (both secured and unsecured), with 30% of medium firms, 23% of small firms and 18% of micro firms citing this form of finance.

**Supply by Financial Institution**

xxi. The November 2009 survey confirmed the extent to which the Scottish SME finance market is dominated by two main banks – Royal Bank of Scotland and Lloyds Banking Group. Together they account for over 70% of SMEs surveyed.

### Business Attitudes to Banking

xxii. Over the last twelve months, around 12% of the SMEs surveyed had changed bank, moved some existing business to another provider or started using another provider for some new financial services.

xxiii. The majority of firms (77%) surveyed had not considered changing their bank. Of those who did consider changing bank, firms were asked why they decided against doing so. 21% reported that it was 'too much hassle', while 16% reported that 'banks were all the same/lack of choice'.

## SECTOR ANALYSIS

xxiv. 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 sectors.

### Demand by Sector

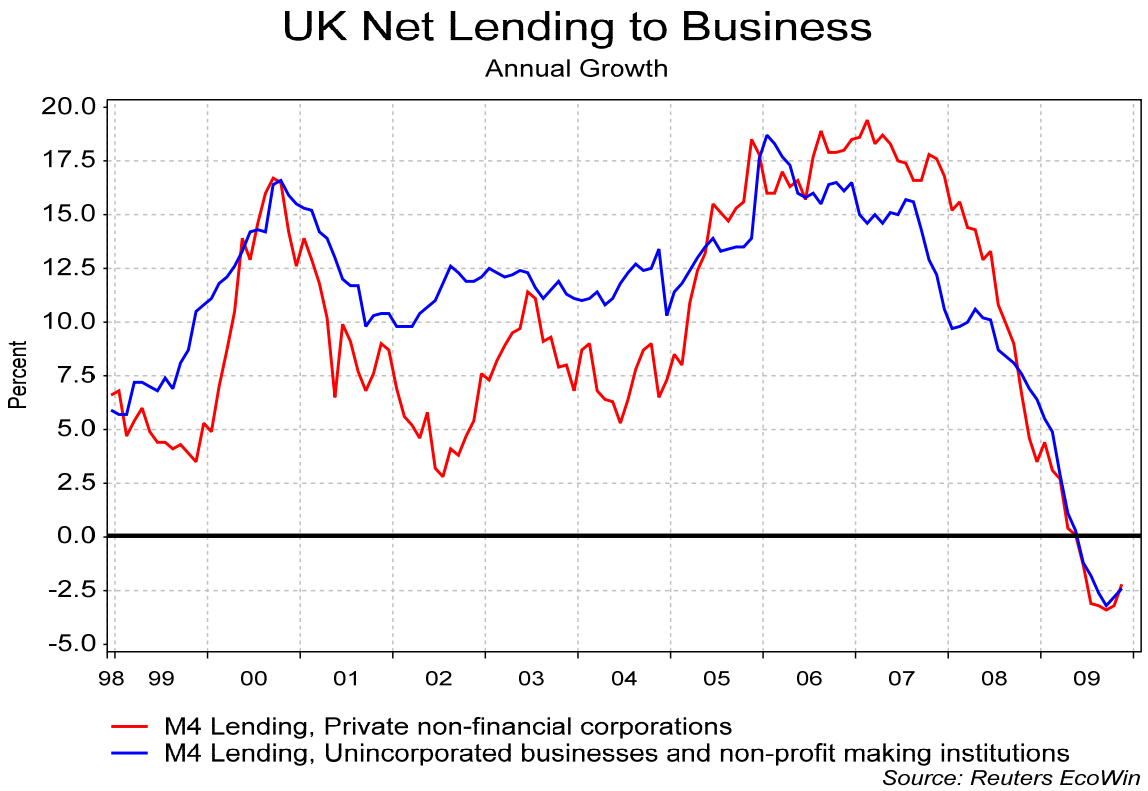
xxv. Demand for finance varies by sector. The greatest demand for finance over the last six months was from the wholesale/retail sector (26% of firms looking to re-finance and 17% seeking new lending) and the lowest demand was from the construction sector – where only 1% were re-financing, but with 7% applying for new lending.

### Business Conditions by Sector

xxvi. In the last six months, over 50% of wholesale/retail firms have experienced cash flow problems. The other main sectors that experienced problems are Construction (40%), Manufacturing (40%) and Transport/Communication (32%). The agricultural sector experienced the least amount of financial difficulty (0.4% reporting 'considerable' problems, and 14% experiencing 'some' problems).

### Future Financing

xxvii. The top three forms of external finance identified by all firms for financing any future growth were overdrafts, loan facilities, and looking for investors/equity. The most popular method was to extend or obtain a loan (40% of Transport/Communication firms, and 29% of Agricultural firms). Obtaining or extending an overdraft facility was found to be popular amongst all sectors. Demand for investors was shown to vary across sectors, with construction and agricultural firms not planning to look for any investors, compared to 38% of all Transport/Communication firms.




**Macro-economic Context**

1.1. Since the last survey was undertaken in March/April 2009, conditions in both the Scottish and global economies have changed significantly. Many advanced economies moved out of recession in the second half of 2009 following a return to growth in output. The improvement in conditions in the global economy have been attributed in part to the unprecedented policy measures which have been introduced over the past 18 months which have stabilised the financial system and stimulated demand.

1.2. The UK economy moved out of recession in Q4 2009, one quarter behind every other G7 country, with growth of 0.1% on the previous quarter. The latest data for Scottish GDP is for Q3 2009, where GDP fell by 0.2% compared to the previous quarter. This represented a significant easing of the rate of decline in GDP compared to the first half of 2009 and was in line with the corresponding figure for the UK in Q3 2009.

1.3. The latest business surveys indicate a further improvement in conditions in the Scottish economy in the final quarter of 2009, with reports of growth continuing to return to parts of the economy.

1.4. Following the sharp rise in unemployment in the first half of 2009, Scottish unemployment has continued to rise but at a slower rate. The Scottish

unemployment rate was 7.4% for the three-month period September to November 2009, below the 7.8% for the whole of the UK.

1.5. The various interventions by governments across the world have stabilised the international financial system and stemmed the risk of a re-intensification of the financial crisis. Since the last survey was undertaken in March/April 2009, the Bank of England has kept interest rates at 0.5%, the lowest level in the Bank's history. In addition, the Bank of England increased its quantitative easing programme from £150bn to £200bn in order to expand the money supply in the UK.

1.6. Despite these interventions, credit conditions in the UK remain tight, with the latest data from the Bank of England highlighting that the flow of net lending to UK businesses in November 2009 was positive for the first time since January 2009[2]. However, annual growth in net lending to UK businesses remains negative. In other words, the repayment of loans by businesses has outweighed new lending activity.

1.7. Furthermore, the IMF[3] predicts that the growth in lending in the coming years will be relatively weak as banks continue to address the write-downs of bad debt associated with the financial crisis. If this is the case, tight lending conditions could act as a constraint on the future performance of the global economy.

1.8. 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/Dec-2009

[2] Trends in Lending, Bank of England, January 2010
[3] Global Stability Report, IMF, October 2009.

**Survey Design and Methodology**

2.1. The November survey interviewed 655 small and medium sized businesses across the private sector in Scotland. The fieldwork was carried out by an independent market research company, Continental Research, who also conducted the previous survey on Scottish SME Access to Finance in March 2009. The analysis has been written and produced by the Office of the Chief Economic Adviser within the Scottish Government.

2.2. The purpose of the update survey is to assess whether firms are reporting any improvements in accessing finance over the **six month period** since the March survey. The design of the questionnaire and the report, therefore, broadly follow the same format as the previous survey. However, because some of the questions refer to a different time-frame in order to capture information relating specifically to the six months to November, direct comparisons on some of the aspects of the survey cannot be made. This includes measuring any change in the level of demand for finance since March 2009[4], although statements can be made on actual levels of demand. However, where comparisons are possible to allow changes in credit conditions and business confidence to be assessed, these have been included in the report.

2.3. The structure of the questionnaire is as follows: After demographic questions (both business and respondent) the survey asked firms questions regarding current borrowings. Firms are then asked about all facilities they had applied for over the last six months, 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, and the actual amount of finance secured. Several new questions have been included in the November survey to explore attitudes to banking, levels of security provided on finance products, impact of recession on cash flow and also how firms plan to finance any future growth. The survey data can be cut in a number of ways including by employee size band, turnover, high-growth, sector, ethnicity and gender.

2.4. A key feature of the update survey has been to maximise the number of re-contacts from the March 2009 survey to allow additional analysis to assess the impact of the recession on businesses over time, as part of any future follow-up work. Of the 655 SMEs interviewed, around 45% (310) were re-contact firms. The remaining sample of SMEs has been drawn from Dun & Bradstreet and Experian data sources.

2.5. Quotas have been set for the sample to allow for statistical reliability for each category. This includes quotas by size of firm (number of employees), by sector, for new start businesses and for those trading in deprived areas. Larger businesses and smaller sectors are 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.

[4] The March 2009 and 2007 surveys asked firms about applications for credit over the past three years, allowing a direct comparison to be made on the change in the level of demand for finance. The November 2009 survey asks about applications for finance over the last 6 months only.

| | | Size | | | |
|---|---|---|---|---|---|
| | | Micro (<10) | Small (10-49) | Medium (50-249) | Total |
| SECTORS | AB Agriculture | 39 | 10 | 1 | 50 |
| | D Manufacturing | 34 | 42 | 27 | 103 |
| | F Construction | 46 | 32 | 9 | 87 |
| | G Wholesale/Retail | 39 | 30 | 11 | 80 |
| | H Hotels/Restaurants | 29 | 16 | 10 | 55 |
| | I Transport/Communication | 23 | 14 | 7 | 44 |
| | K Business Activities | 56 | 27 | 17 | 100 |
| | N Health/Social Work | 24 | 17 | 9 | 50 |
| | O Other Services | 52 | 20 | 14 | 86 |
| | Total | 342 | 208 | 105 | 655 |

2.6. Throughout the report, weighting has been applied by size and sector so that the results are representative of the Scottish SME population. No sectors were excluded from the sampling in 2009.

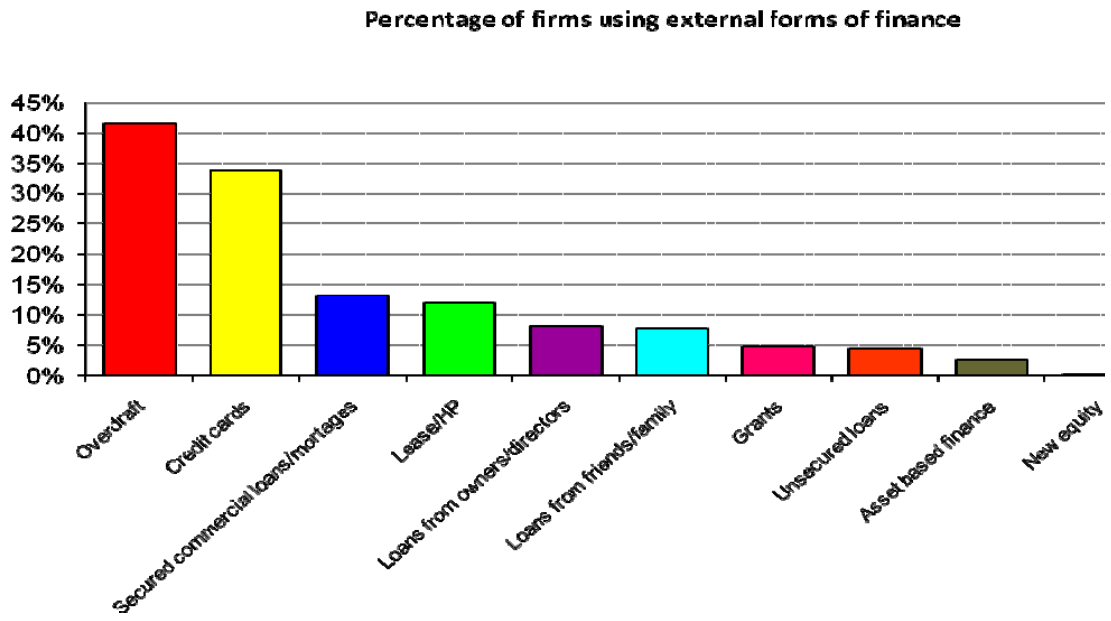
2.7. The size of the sample in the survey means that the headline findings can be reported with a relatively high degree of statistical reliability. For instance, a finding of 50% at the overall level (all 655 firms included) in November 2009 has a statistical error of ±4.4 percentage points, while the corresponding error for the March 2009 survey is ±3.1 percentage points[5].

2.8. 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 an increase in turnover of 20% 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.

2.9. 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. In addition, the analysis in this section has been rather more limited than what the report was able to cover in March, largely due to limitations with small sample sizes, particularly on demand and supply of finance over a shorter time-period.

2.10. There are approximately 289,000 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.

[5] This is based on a 95% confidence interval. So using the example of an estimate of 50% with a confidence limit ±4.4 percentage points, this means that 19 times out of 20 we would expect the true estimate to lie between 45.6% and 54.4%. The smaller the confidence limits,, the more reliable the estimate.



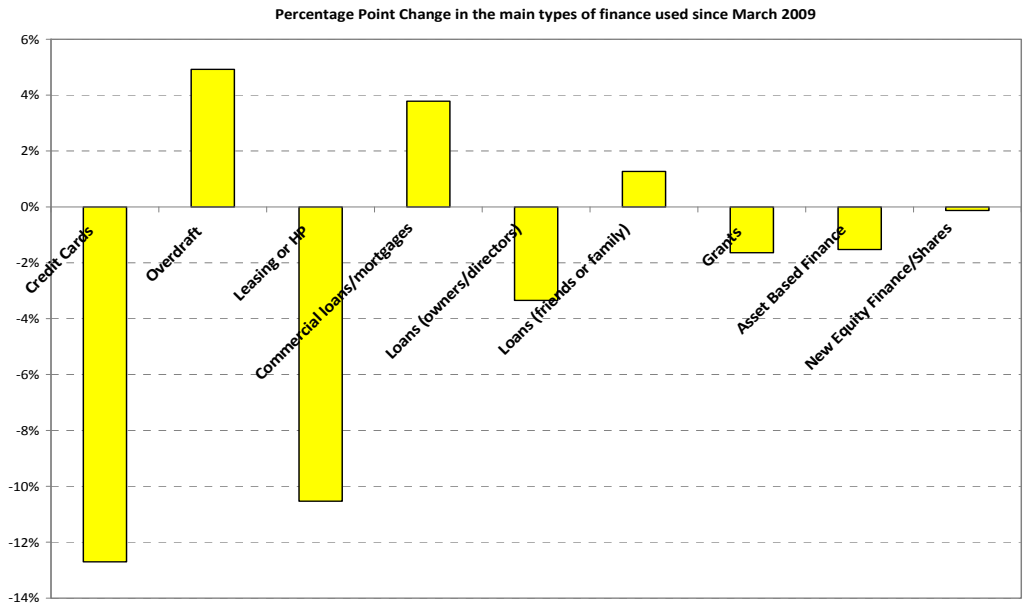

*Base (2009): n=655*

## Use of External Finance among SMEs in Scotland

3.1. This section considers the types and use of finance by SMEs in Scotland. Overdrafts (42%) and credit cards (34%) continue to be the most common form of finance used by all SMEs in November 2009, followed by secured commercial loans/mortgages (13%), and leasing/hire-purchase (12%) facilities.

3.2. The pattern of demand for the different types of facilities is similar across all firm sizes, although the relative proportion using each credit facility increases with size. The only exception to this is loans from family and friends, where a greater percentage of micro firms (8%) are using this as a source of finance compared to only 3% of small and 4% of medium sized businesses in November.

| Main Types of Finance currently used by Firms, Nov 2009 | | | |
|---|---|---|---|
| Finance Facility | Micro | Small | Medium |
| Deposit accounts | 37% | 51% | 65% |
| Overdraft | 41% | 64% | 59% |
| Credit cards | 34% | 39% | 51% |
| Leasing or hire purchase | 11% | 26% | 46% |
| Secured commercial loans / mortgages | 12% | 34% | 39% |
| Grants | 4% | 6% | 25% |
| Asset based finance | 2% | 10% | 23% |
| Loans from the owners etc | 8% | 14% | 22% |
| Unsecured commercial loans | 4% | 6% | 19% |
| Loans from friends or family | 8% | 3% | 4% |
| New equity finance | 0% | 1% | 3% |

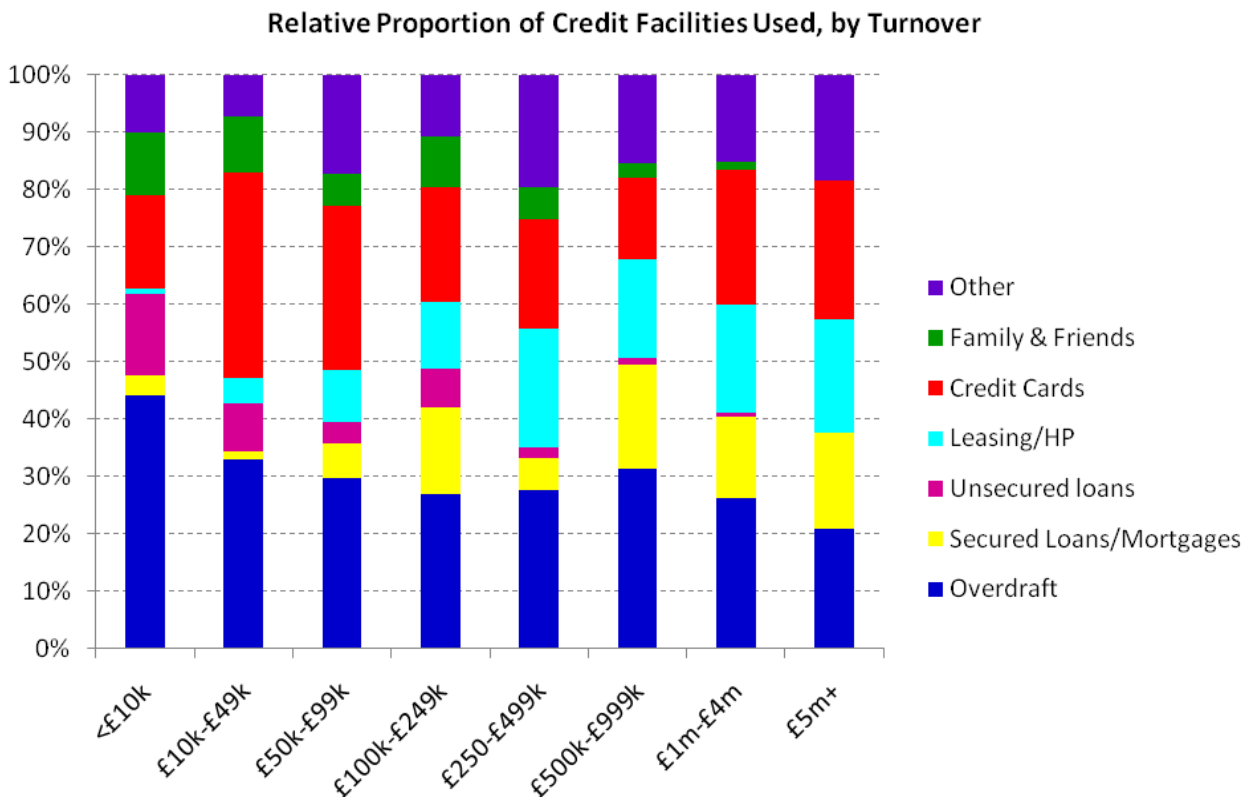



*Base (Nov 2009): n=655*
*Base (Mar 2009); n=1001*

**Change in the Use of External Finance among SMEs in Scotland**

3.3. There have been some changes in the reported use of finance over the six month period to November. The proportion of SMEs in the survey using overdraft facilities has increased by 5 percentage points and use of commercial loans/mortgages by 4 percentage points since March 2009. However, there has been an overall reduction in the use of most other types of finance – notably credit cards and leasing/hire purchase facilities, where the percentage of firms using these facilities has fallen by 13 percentage points and 11 percentage points respectively. These results are not surprising given that the demand for overdrafts had risen during the economic recession as firms have increasingly sought to use their overdraft facilities for working capital purposes.

3.4. The survey also revealed that there does not appear to be any difference in the types of financing used by high-growth and non-high growth firms in November 2009. This is unlike March 2009, when high-growth firms were found to be using relatively more credit cards and loans from owners/directors to finance their business than other firms. In November 2009, the findings show a fairly pronounced drop in the use of these credit facilities by high-growth firms, and a shift towards using overdrafts. The results appear to be consistent with the findings of the March survey, which showed a marked reduction in the supply of finance to high-growth firms, and particularly high rejections for credit cards. High credit card use in an early period is likely to have reflected temporary cash flow issues and the need to access new arrangements with financial providers.



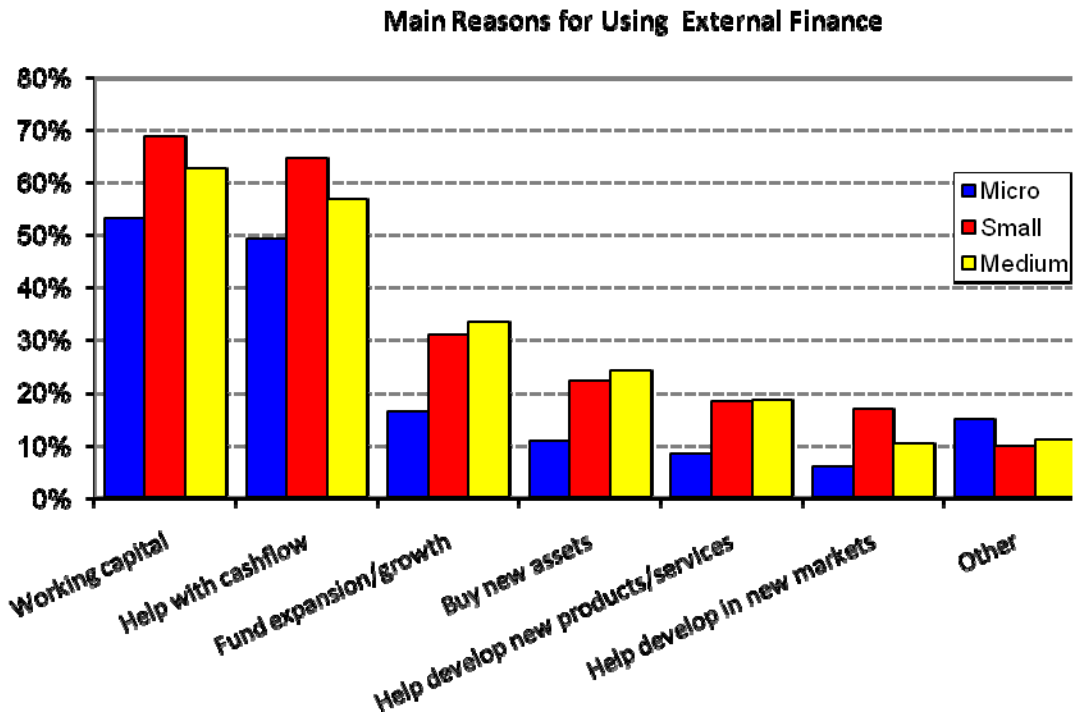

*Base (Nov 2009): All businesses: n=655*

**Use of External Finance, by turnover**

3.5. In general, the use of external finance and the range of facilities used increases as turnover increases. However, the relative proportions of firms using each type of finance product varies by turnover, indicating that the financing needs of businesses are different as the firm size increases based on turnover generated.

3.6. The November 2009 survey shows that the proportion of firms using overdrafts and unsecured loans is inversely correlated with size – with a greater proportion of lower-turnover firms financing their businesses with overdrafts and unsecured loans, compared to those with greater turnover. On the other hand, leasing/hire purchase and secured loans feature more prominently as a source of finance for firms with greater turnover, and the demand for these increases with size.

3.7. The use of credit cards as a source of finance is common across firms of all turnover bands. 'Other' forms of credit include grants, equity, asset-based financing and loans from owners/directors/shareholders - of which larger firms tend to use proportionally more.



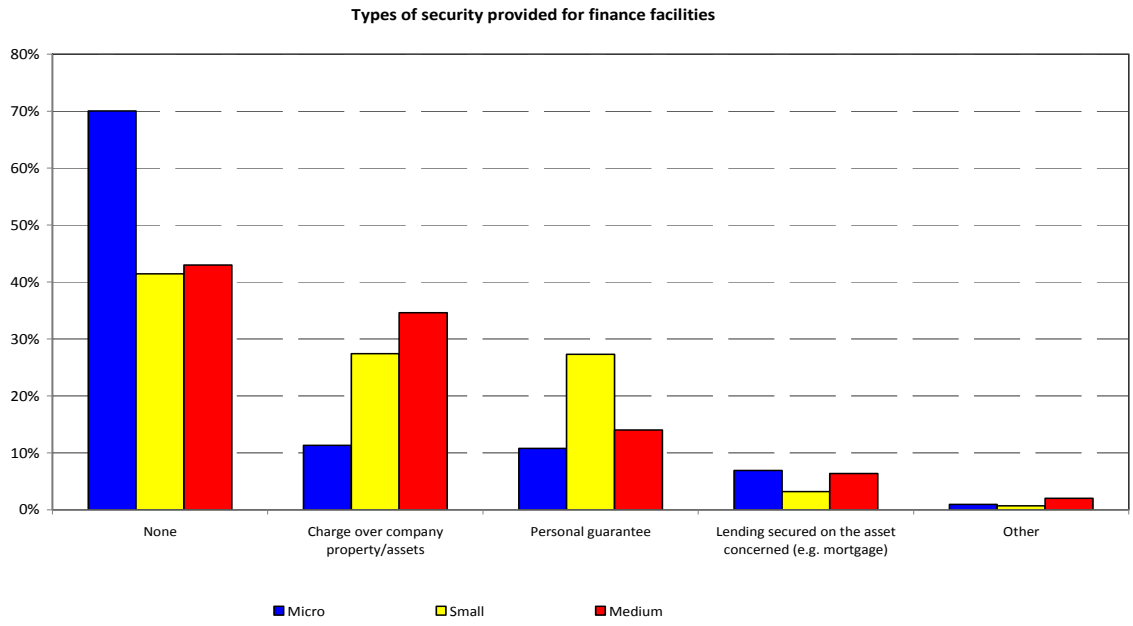

*Base (Nov 2009); All those with financing: Micro n=227; Small n=171; Medium n=95*

**Main reasons for using finance**

3.8. From the survey, the main reason for using external financing is for working capital purposes, which was reported by the majority of firms – 53% of micro firms, 68% of small, and 63% of medium businesses. This was followed by 'help with cash flow', which features more prominently for small businesses where 65% of small businesses stated they used external financing for this purpose.

3.9. Relatively greater proportions of small and medium sized enterprises than micro firms use external financing for a range of other reasons – including to fund expansion and growth, where this was a reason given by 31% and 33% of small and medium sized firms respectively, compared to 16% of micro firms.

3.10. Almost 20% of small and medium firms in the survey use external financing to help develop new products and services compared to 8% of micro firms. In addition, 17% small and 10% of medium firms use funding to help develop their business in new markets.



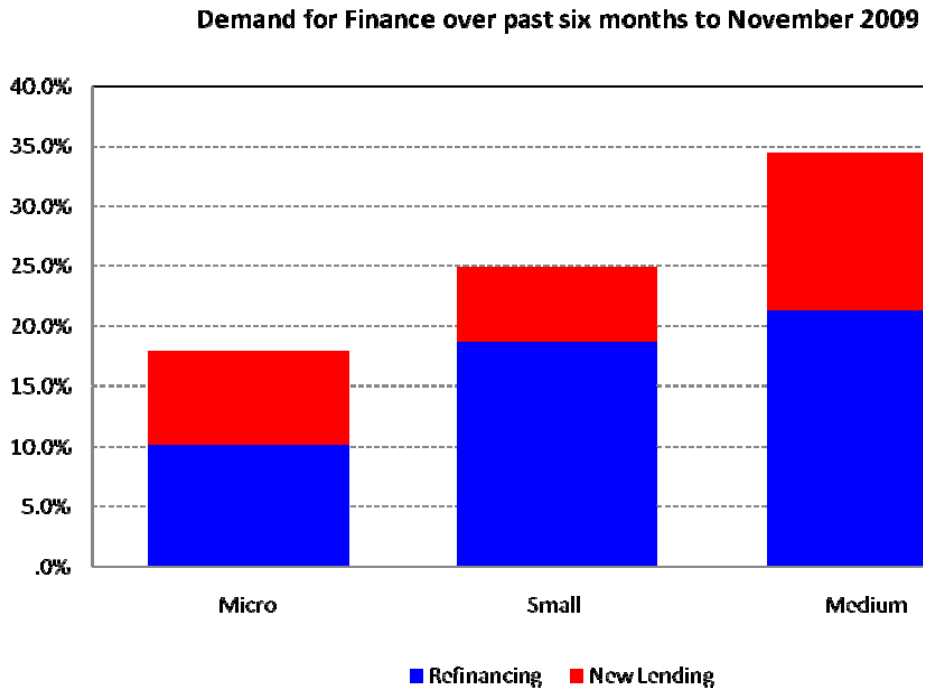

*Base (Nov 2009): Firms with any kind of financing; Micro: n=227; Small: n=171; Medium: n=95*

## Types of Security Provided on Finance Facilities

3.11. The November 2009 survey sought to ask firms about security provided on current financing. A significant proportion of micro firms (70%) stated that no security was given on their existing arrangements. However, only 40% of small businesses did not have to provide a guarantee and similarly, only 43% of medium sized businesses reported having no security on facilities.

3.12. Where security was provided, a greater percentage of medium sized firms (35%) secured financing by providing a charge over company property or assets and a further 14% gave a personal guarantee (including a charge over their main or family home). This compares to 27% of small firms who provided guarantees over their company property or assets, or a personal guarantee (including a charge over their main family home) in equal measure.

3.13. The differences in the relative scale of guarantees provided between micro, and small and medium sized firms is likely to be explained by differences in amounts of financing sought, and the types of facilities demanded by firms – where smaller firms are likely to seek smaller value loans on average, and tend to use more overdraft facilities than larger firms who are more likely to use secured loans and other types of financing.

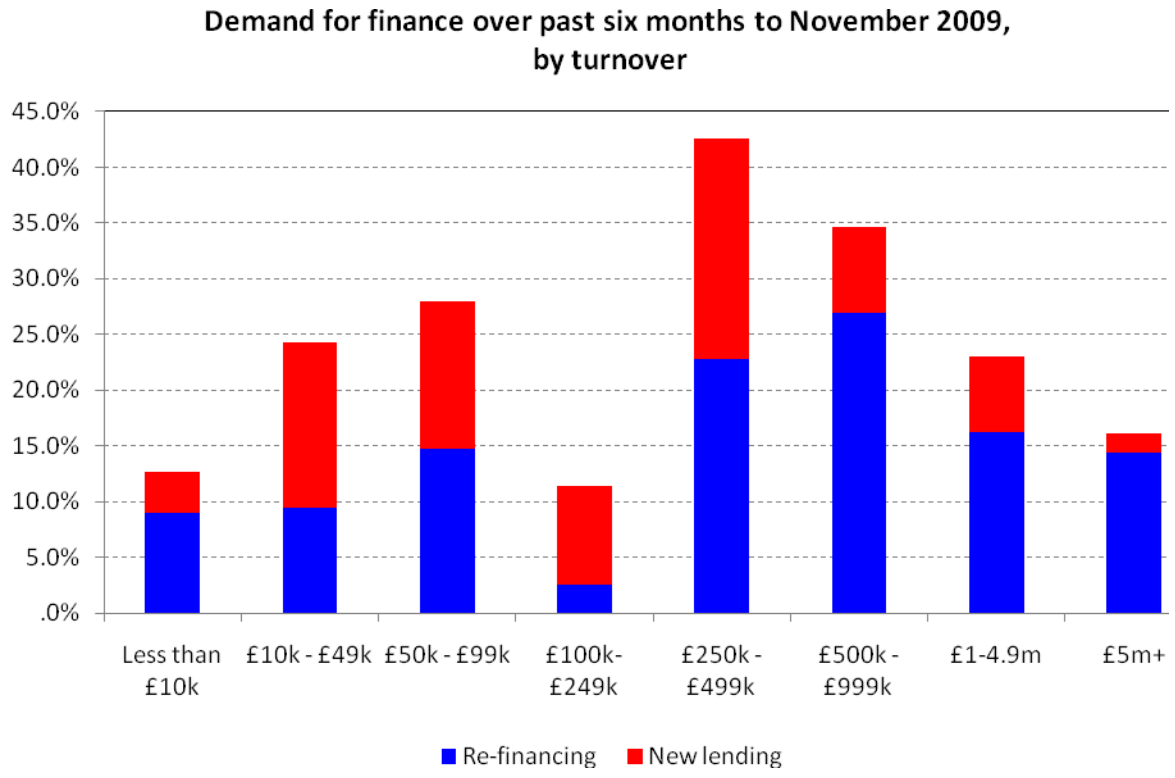



*Base (2009): All firms; Micro n=342; Small n=208; Medium n=105*

**Demand for Finance, May to November 2009**

3.14. Firms were asked about all applications for new lending or re-financing over the six month period to November 2009. Demand for finance increases with firm size - and 18% of micro firms sought some form of financing, compared to 25% of small and 34% of medium sized enterprises. There were a greater proportion of firms looking to re-finance than take out new lending, across all firms sizes.

3.15. It is not possible to make assessments on the change in the levels of demand for finance since the March 2009 report. This is because the last report looked at total demand over a three year period, whereas the November survey has only asked about demand since the last six months - which will inevitably capture a smaller proportion of firms given the shorter time-period. For example, in the March 09 survey, around 53% of firms sought finance over the past three year period, compared to only 17% of all firms over the last six months. However, the analysis on why firms did not undertake borrowing (page 21) can shed some light on the factors which can influence levels of demand, and whether the number of 'reluctant' borrowers has changed since March 2009.



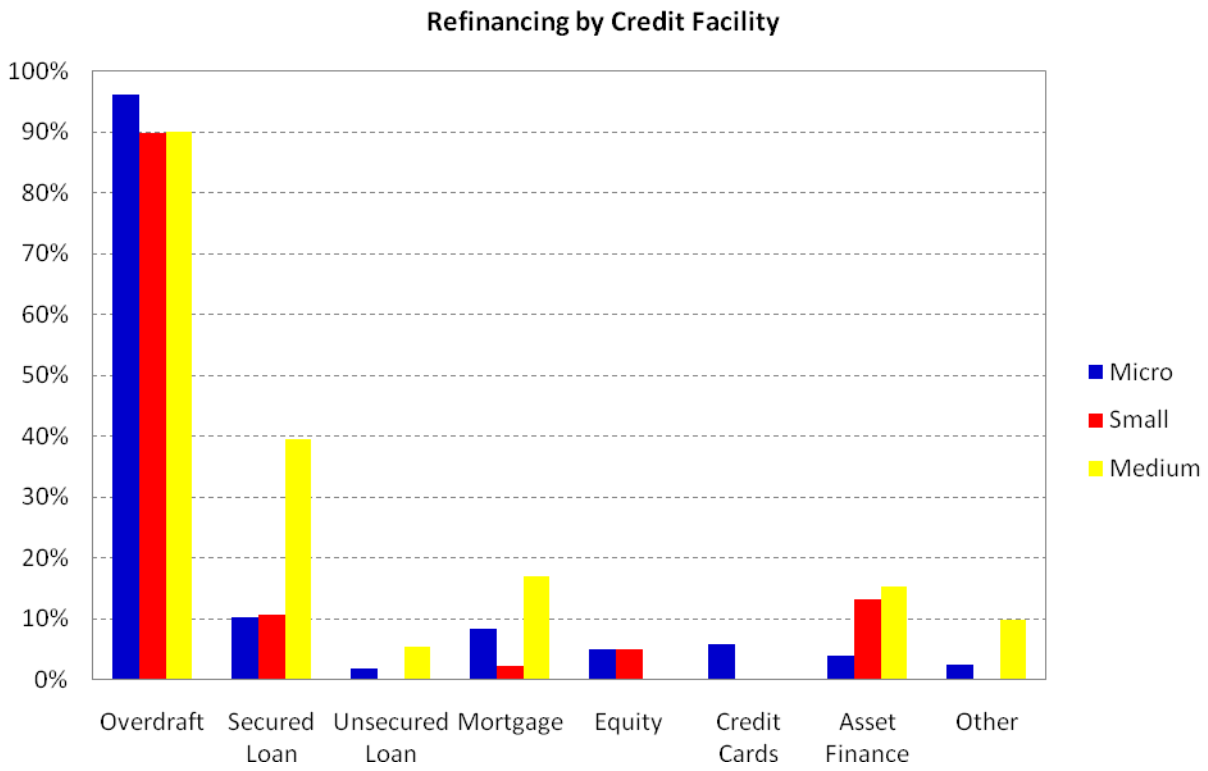

*Base (2009): n=655; Less than £10k: n=30; £10k-49k: n=50; £50-99k: n=42; £100k-249k: n=24;£250k-249k: n=25; £500k-999k: n=41; £1m-4m: n=103; £5m+: n=41*

**Demand for Finance, by firm turnover**

3.16. The financing needs of a firm and its requirements for particular types of finance can vary depending on its turnover. The chart shows that the demand for finance tends to increase with turnover and then begins to decline for firms with turnover of greater than £500,000.

3.17. The greatest demand for finance over the last six months was from businesses with a turnover of £250k-£499k, of which 43% sought to either re-finance (22%) or take out new lending (20%). This was followed by 35% of enterprises with a turnover of between £500k-£999k, the majority (27%) were re-financing; and 28% of businesses with a turnover of between £50k -£99k who were seeking any form of finance.

3.18. In general, demand for new lending over the last six months has been driven by firms with a turnover of under £500k, with the exception of the smallest firms where only 4% were seeking new lending compared to 9% of these firms looking to re-finance. In contrast to this, a relatively small proportion of larger turnover firms (above £500k) sought access to new finance, and of those who did, the majority were re-financing.

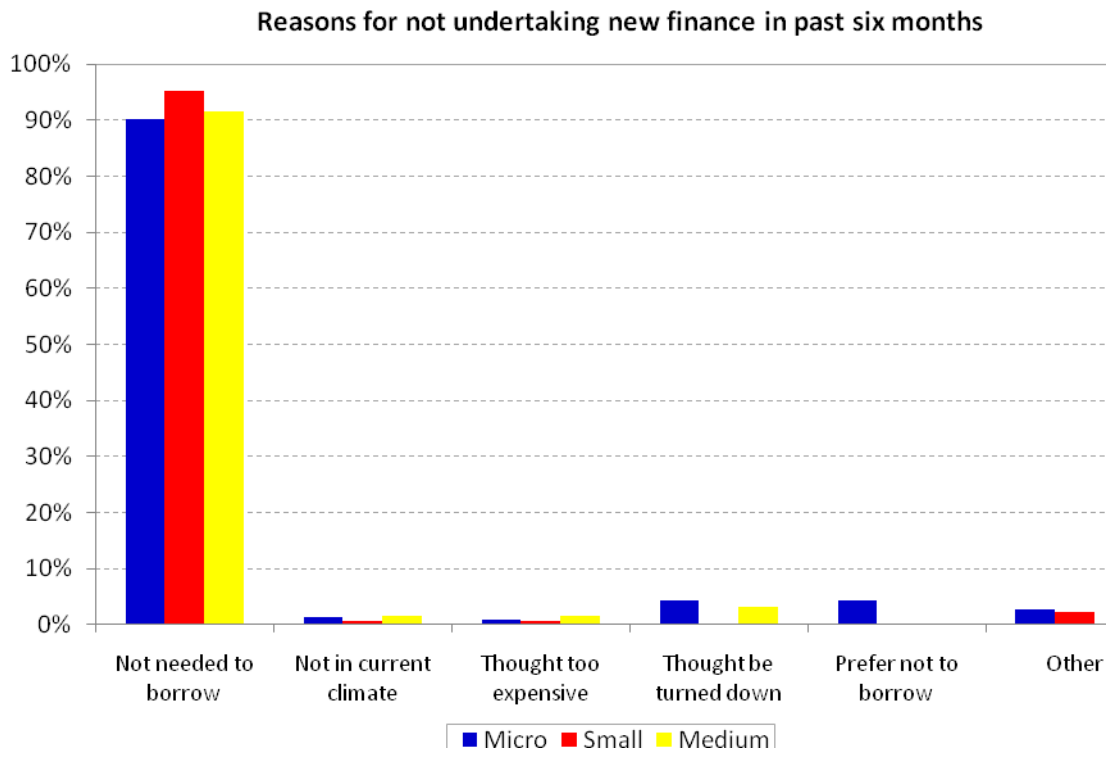



*Base (Nov 2009): All those refinancing: Micro n=41; Small n=50; Medium n=21*

**Types of Finance Applied For**

3.19. The most common type of finance applied for when firms were refinancing was overdrafts, which were sought by 96% of micro firms and 90% of small and medium sized enterprises. Secured loans accounted for around 40% of demand by medium size firms, but considerably less for both micro and small enterprises (10% and 11% respectively). Around 5% of micro and small firms sought to re-finance equity.

3.20. In terms of new lending, the numbers applying are too small to analyse by type of facility at a sufficiently robust level, but indication of the pattern of demand suggests that overdrafts and secured loans are the two most frequent type of financing sought. Surprisingly, credit cards do not feature as prominently as they did in March 2009, when they were the most common form of finance used by businesses. However, this is likely to be the result of the impact of high levels of credit card rejections which were evident from the March survey.




*Base (Nov 2009): Micro n=273; Small n=143; Medium n=79*

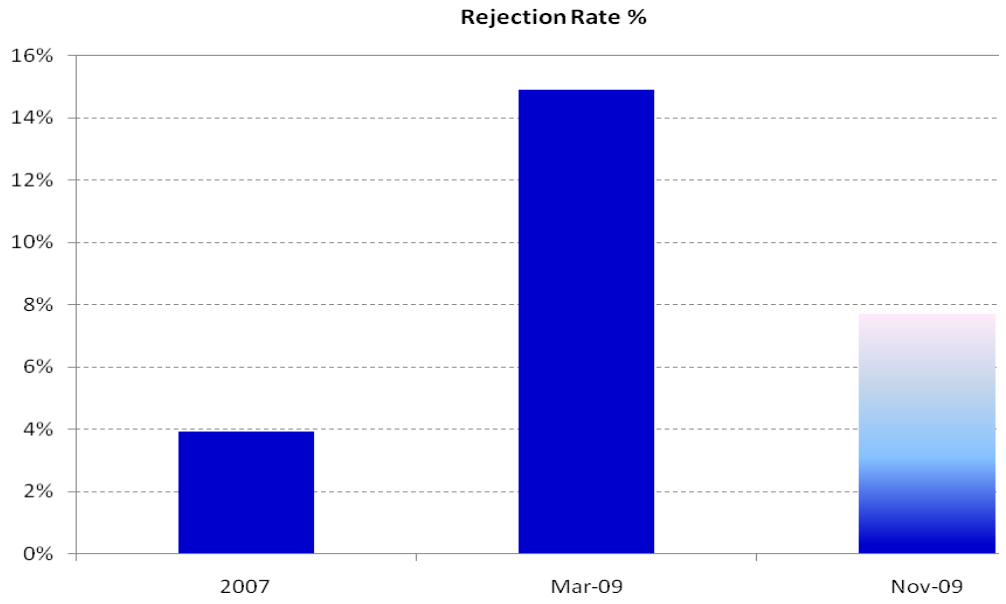
## Reasons for Not Borrowing

3.21. For the large majority of businesses across all firm sizes within the sample, who did not take out new lending or re-finance over the last six months, the main reason was simply that they did 'not need to borrow'.

3.22. There appear to be relatively far fewer 'reluctant borrowers'[6] compared to March 2009 where around 42% of micro firms expressed a reluctance to borrow, and 19% of small firms and 11% of medium firms respectively. This compares to November 2009 when asked a similar question only 11% of micro, 1% small and 7% medium sized enterprises stated that they did not borrow because of factors such as economic climate, cost of credit, concerns about rejection and a preference not to borrow.

3.23. In addition, citing family and friends as a reason not to borrow (that is, in providing an alternative to bank finance) did not feature at all in November 2009, unlike in March where it provided an alternative source of funding for around 7% of micro firms. This is perhaps not surprising given the impact of the economic recession on households as well as businesses.

[6] Reluctant borrowers are defined as those who did not borrow for reasons such as economic climate, 'thought too expensive', 'thought they would be turned down' and 'prefer not to borrow'.




*Base (Nov 2009): Firms which had applied for finance: n=57*
*Base (Mar 2009): Firms which had applied for finance: n=631*
*Base (2007): Firms which had applied for finance: n=251*

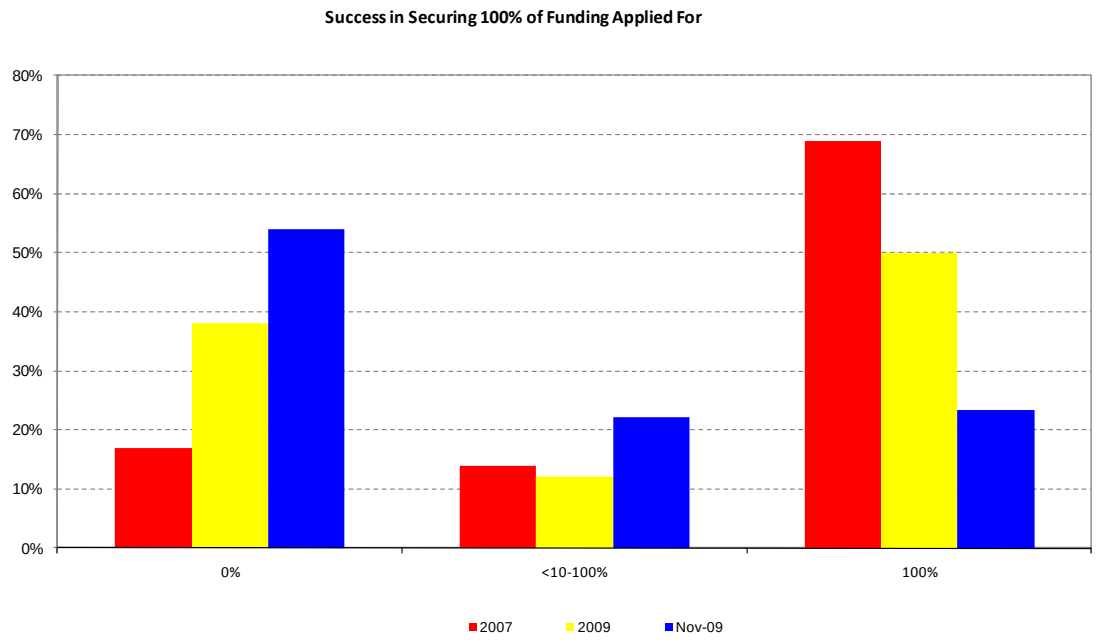
**Supply of Finance- Outright Rejection rates (new lending)**

3.24. The numbers of firms being *rejected outright* for finance applications appears to have fallen in the November 2009 survey – indicating an improvement in new lending application approvals of around 7 percentage points. In the November 2009 survey, the rejection rate was 8% of applications made, compared to 15% for all firms in the March 2009 survey and a rejection rate of 4% in the 2007 survey[7].

3.25. Overdrafts and credit cards are the most common types of rejections (as in March), followed closely by asset finance and secured loans.

3.26. The reasons for rejection in applications could not be examined in any great detail due to the small numbers of rejections for new lending – but the overall indication is that applications were rejected on the basis of poor credit history and insufficient security rather than other factors such as 'economic climate/credit crunch' or 'industry too risky' - reasons which featured predominately for rejection in the March survey.

[7] It should be noted that the rejection rate for 2007 and March 2009 is based on a higher percentage of firms who had applied for finance over a longer time-period. The November 2009 outright rejection rate is based on applications and rejections over a six month period, and is therefore an indication of the emerging rate of rejection.



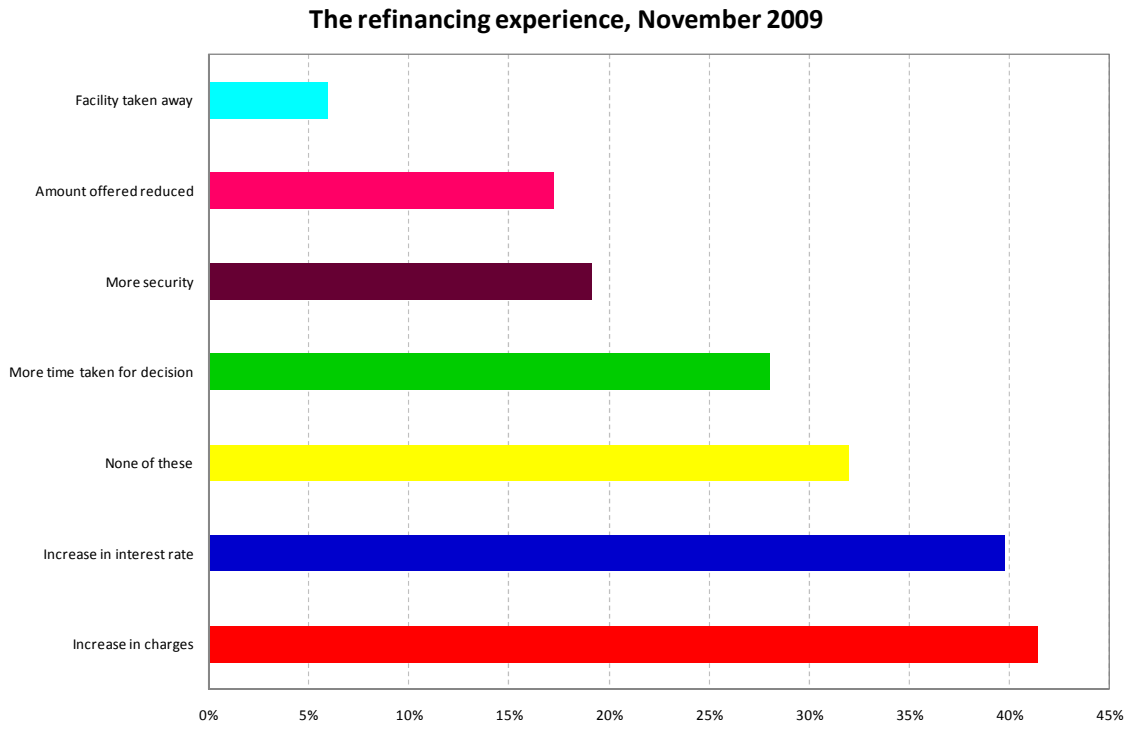

*Base (Nov 2009): Firms which had applied for finance: n=57*
*Base (Mar 2009): Firms which had applied for finance: n=631*
*Base (2007): Firms which had applied for finance: n=251*

**Success in obtaining 100% of finance sought**

3.27. In terms of success in obtaining the full amount of finance sought in the November 2009 survey, only 23% of all firms reported that they managed to obtain the full amount (100%) of funding sought while 54% did not manage to secure any funding. This latter figure includes those rejected outright. As can be seen from the chart above, this compares rather less favourably to the March 2009 and 2007 surveys, when 50% and 69% of firms successfully secured all funding sought.

3.28. It is difficult to interpret the high percentage of firms securing zero finance given the fall in the outright rejection rate. It would also appear from the survey results that banks were more willing to offer some amount of finance in November 2009 compared to previous years, but overall the average amount being secured is less than previous surveys.

3.29. The findings appear contradictory to the figures showing a falling rejection rate (page 22). As with the rejection rate fall, the sample is not large enough to allow for further analysis given the small numbers applying for finance over the last six months, but if this trend is accurate then it does suggest a deteriorating position. In terms of possible explanations, it is plausible that approval rates could be rising while overall levels of lending are falling. This may reflect either lower final offers from banks who are reflecting risk more appropriately, or firms being unable (or unwilling) to meet the terms secured, or deciding not to proceed with the offer for other reasons.



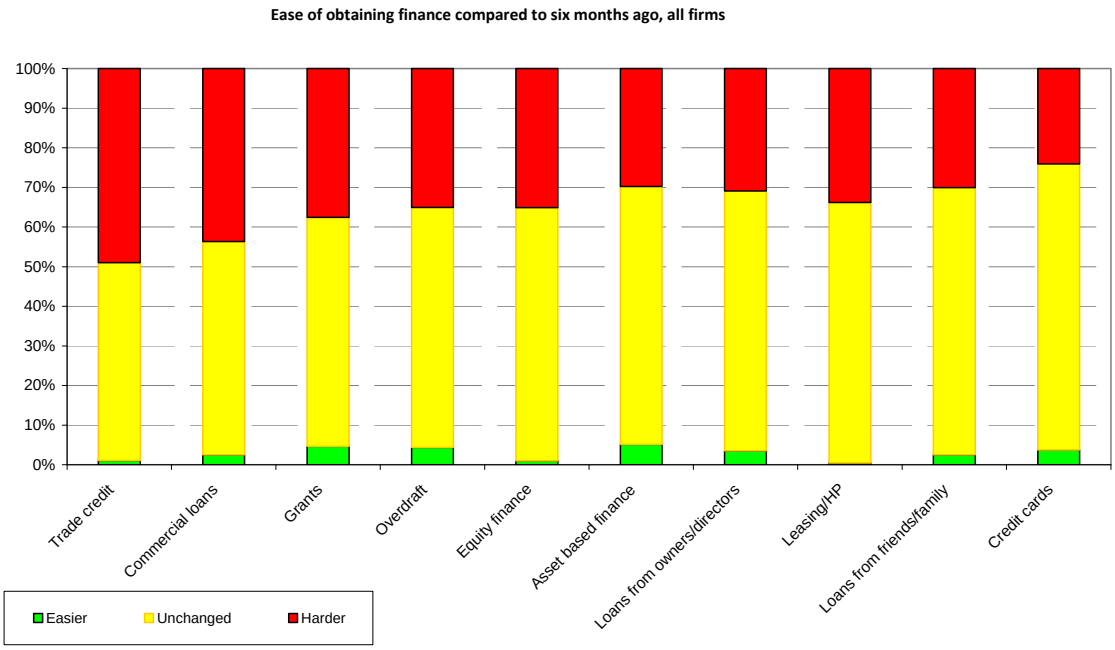

*Base (2009): All those re-financing: n=113*

## The Refinancing Experience

3.30. Of those in the sample who undertook refinancing in the last six months, around 32% renewed their facilities without any change to their existing agreement. When considering firm size, however, medium sized firms appeared to be most affected by changes to existing agreements, with only 10% of firms citing no changes to their re-financing agreement.

3.31. The most significant factor in re-financing cited by all businesses in the survey is the increase in margins over the base rate (interest rate) and the increase in charges faced by firms, of which 42% and 40% of firms reported these respectively. Of medium sized enterprises, around 75% cited these as an issue when re-financing. In addition, the amount of time taken to make a decision is also a significant factor for medium (42%) and micro firms (28%). Around 20% of micro and medium sized firms faced increased security requirements.

3.32. Compared to the March 2009 survey, a higher proportion of medium sized firms have found that the facility has been taken away when re-financing – an increase of 4 percentage points to 11% in November 2009, and a 16 percentage point increase in micro firms reporting more security being required.



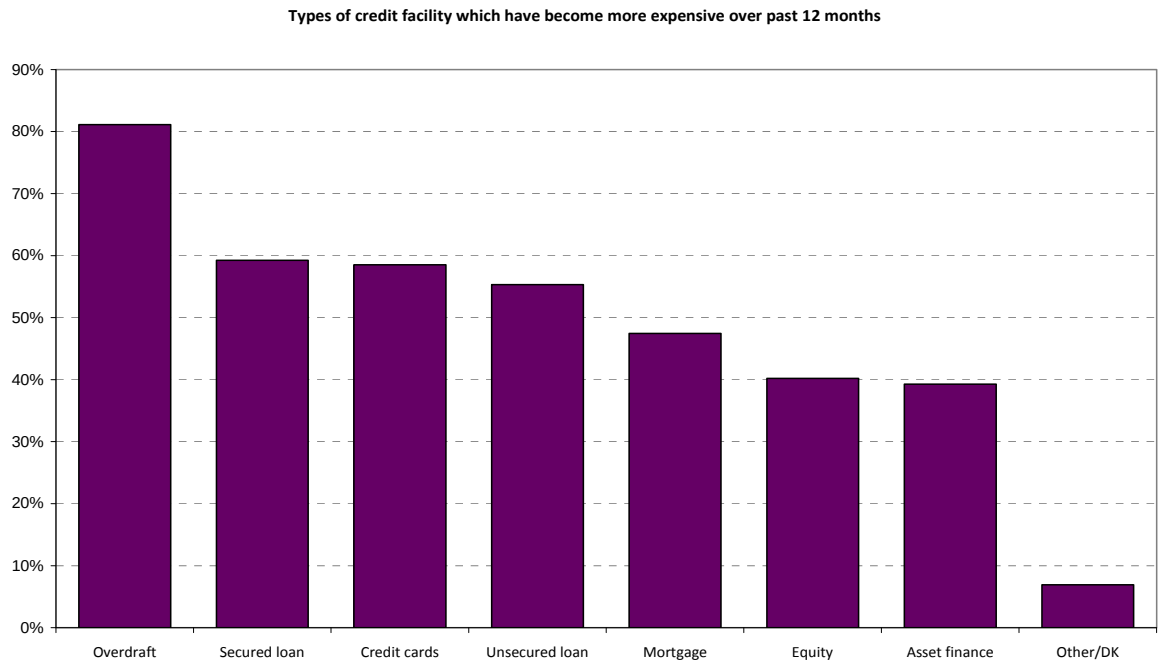

*Base (Nov 2009): n=655*

## Ease of Obtaining Finance Compared to 6 Months Ago

3.33. Firms were asked about the ease of obtaining certain types of finance compared to six months ago. In all cases, the majority of responses stated that it remained unchanged. However, significant proportion of firms thought trade credit has got harder to obtain (49%), followed by commercial loans (44%) and grants (38%).

3.34. The table below shows the relative change in responses since the March 2009 survey, when SMEs were asked about ease of access of obtaining the same type of finances compared to the previous year. The results imply that ease of obtaining credit has got harder across the board, but particularly so for trade credit, equity and asset-based finance.

| | Mar-09 | | | Nov-09 | | | *Change on 'Harder'* |
|---|---|---|---|---|---|---|---|
| | Easier | Unchanged | Harder | Easier | Unchanged | Harder | *% points* |
| Trade credit | 3% | 76% | 22 % | 1% | 50% | 49% | *27%* |
| Commercial loans | 2% | 56% | 43% | 3% | 54% | 44% | *1%* |
| Grants | 1% | 70% | 30% | 5% | 58% | 38% | *8%* |
| Overdraft | 4% | 59% | 38% | 4% | 61% | 35% | *-3%* |
| Equity finance | 0.3% | 88% | 12% | 1% | 64% | 35% | *23%* |
| Asset based finance | 1% | 82% | 17% | 5% | 65% | 30% | *13%* |
| Loans from owners/directors | 2% | 81% | 17% | 4% | 66% | 31% | *14%* |
| Leasing/HP | 5% | 79% | 17% | 0.5% | 66% | 34% | *17%* |
| Loans from friends/family | 2% | 74% | 24% | 3% | 68% | 30% | *7%* |
| Credit cards | 3% | 78% | 19% | 4% | 72% | 24% | *5%* |



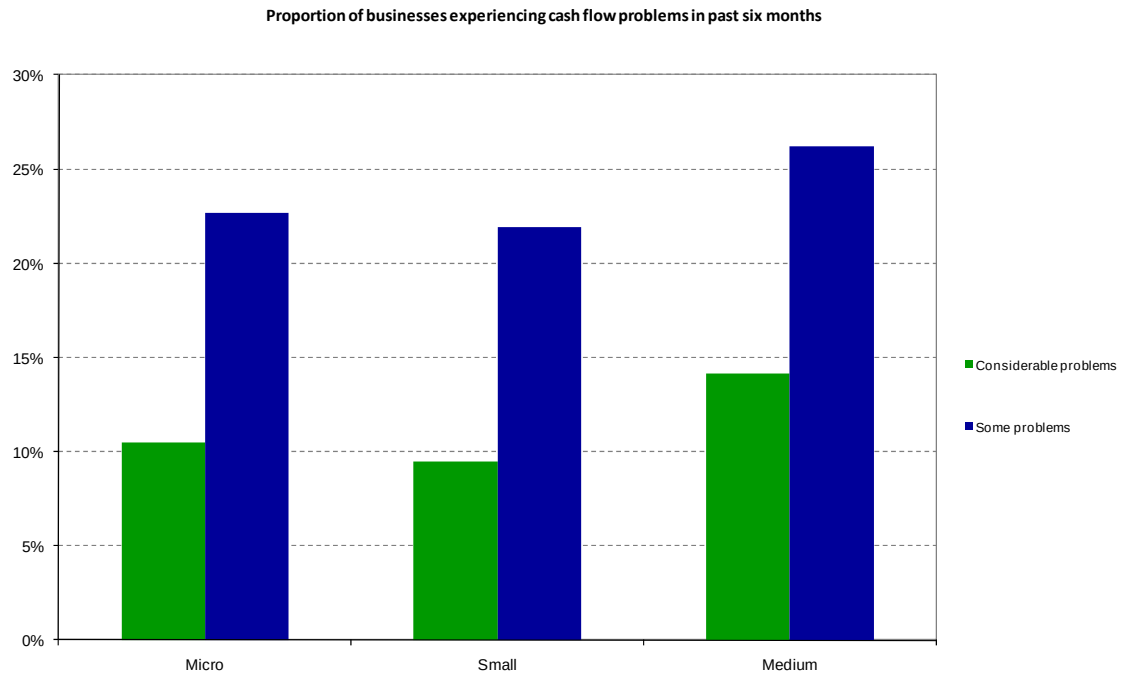

*Base (Nov 2009) All those who thought credit had got more expensive: n=288*

## Changes in Cost of Credit

3.35. Firms were asked about the change in the overall cost of new credit over the last 12 months. 39% of firms reported that they felt that it had increased, 32% stated that it has stayed the same, and a quarter (25%) said that they did not know.

3.36. Of those who reported an increase in the overall cost of obtaining new credit, a significant proportion of enterprises thought that overdrafts (81%), loans - both secured (59%), and unsecured (55%), and credit cards (59%) were more expensive than they were 12 months ago. Around 48% also felt that the costs of taking out new mortgage lending and new equity and asset based finance (40%) had also increased.

3.37. The increase in overall costs of new credit can explain why relatively greater proportions of businesses thought that most forms of credit had also become harder to obtain than in March 2009 (page 25) above. However, this may also reflect that fact that low-cost credit is no longer as freely available as previously as banks move towards pricing risk more appropriately. Firms may perceive this adjustment on the pricing of finance as an increase to the cost of borrowing.



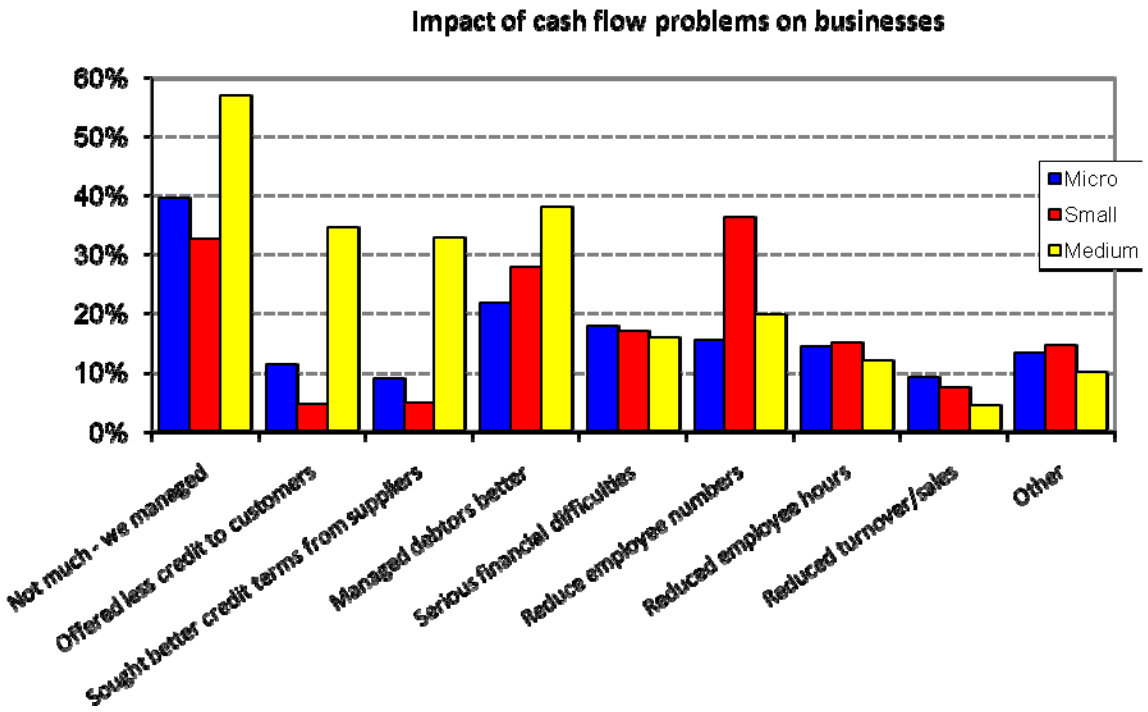

*Base (Nov 2009) n=655*

## Business Conditions - Cash Flow Problems

4.1. Around one third of all businesses reported experiencing cash flow problems over the last six months, with the majority of these firms reporting that they had 'some problems'. The most affected appear to be medium firms, where 26% faced some problems, and 14% had 'considerable problems'. This compares to around 10% of micro and small firms reporting considerable problems, and around 23% and 22% respectively, experiencing 'some cash flow problems'.

4.2. The table below shows the change in turnover reported by businesses compared to the last 12 months. The majority of firms said that turnover had fallen – around 44% of micro businesses compared to 42% of small firms and 50% medium enterprises.

| Change in turnover compared to the last 12 months | | | |
|---|---|---|---|
| | Micro | Small | Medium |
| Increased | 26% | 26% | 20% |
| Decreased | 44% | 42% | 50% |
| Stayed the same | 30% | 32% | 30% |



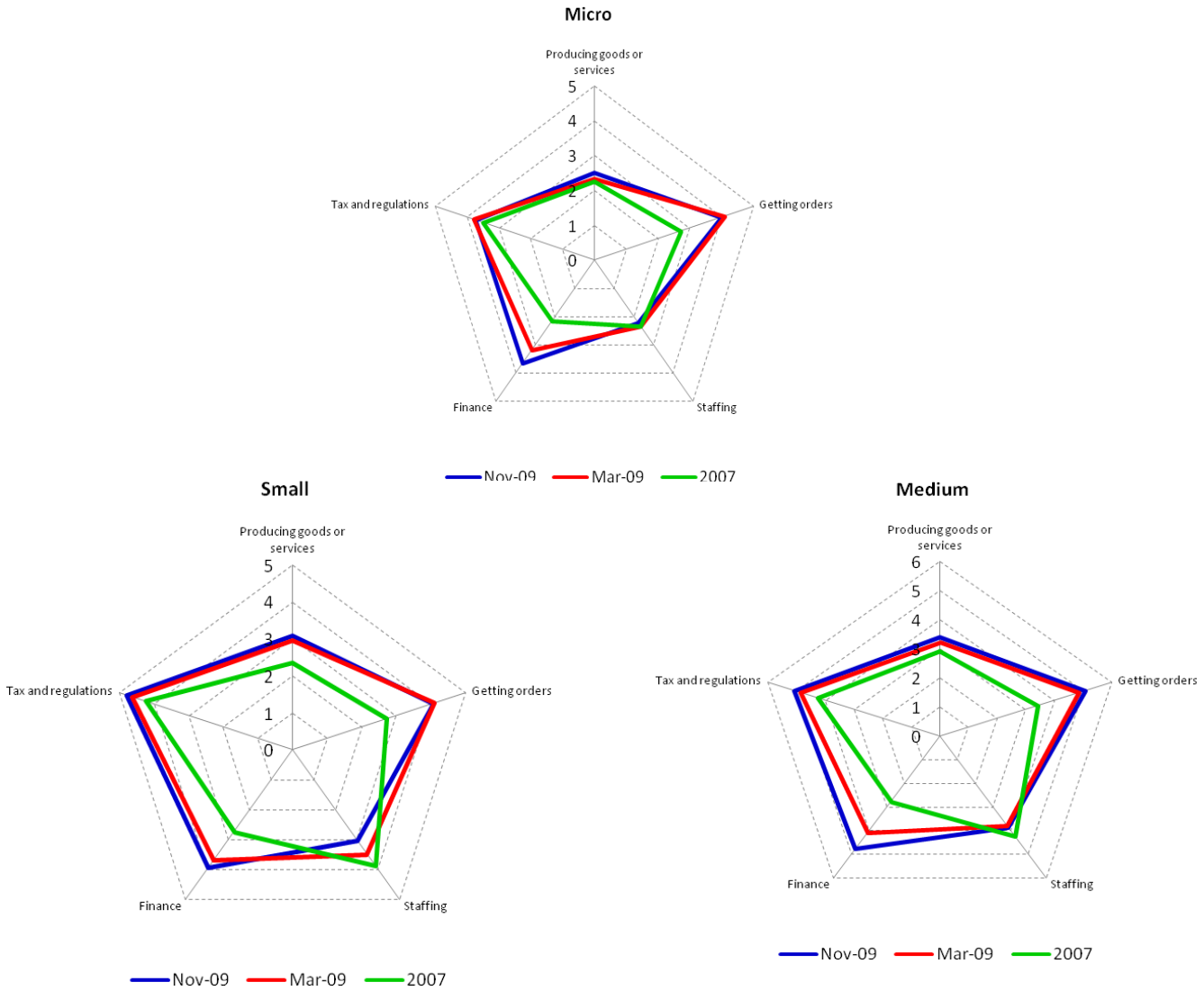

*Base (Nov 2009): All those experiencing cash flow problems; Micro n=119; Small n=81; Medium n=34*

**Business Conditions – Impact of Cash Flow Problems**

4.3. Firms who stated that they had experienced cash-flow problems over the last six months were asked about the impact that this had on their business. 57% of medium firms reported that it did not have much impact of their business, compared to 40% of micro firms and only 33% of small firms felt that there had been no impact.

4.4. A far greater proportion of medium sized firms took steps to manage cash flow problems by seeking better to manage their finance arrangements better with creditors (32%) and debtors (38%) and customers (35%). This compares to fewer than 10% of small and micro firms offering less credit to customers, or seeking better terms from their suppliers. Around 17% of all businesses - regardless of size - reported that they got into 'serious financial difficulties' as a result of their cash flow problems.

4.5. The impact of the firm's cash flow problems had a more pronounced impact on staff employed in small firms – 36% of small firms had to lay off staff, compared to 20% of medium firms and 16% of micro firms. In addition to reducing employee numbers, between 12-14% of all enterprises who experienced cash flow problems also reduced employee hours. Of the 'other' responses, the vast majority of micro firms stated that they had to delay bill payments or left them unpaid (9.2%) while small and medium firms – 6.5% and 7.2% respectively - said that they generally became more frugal.

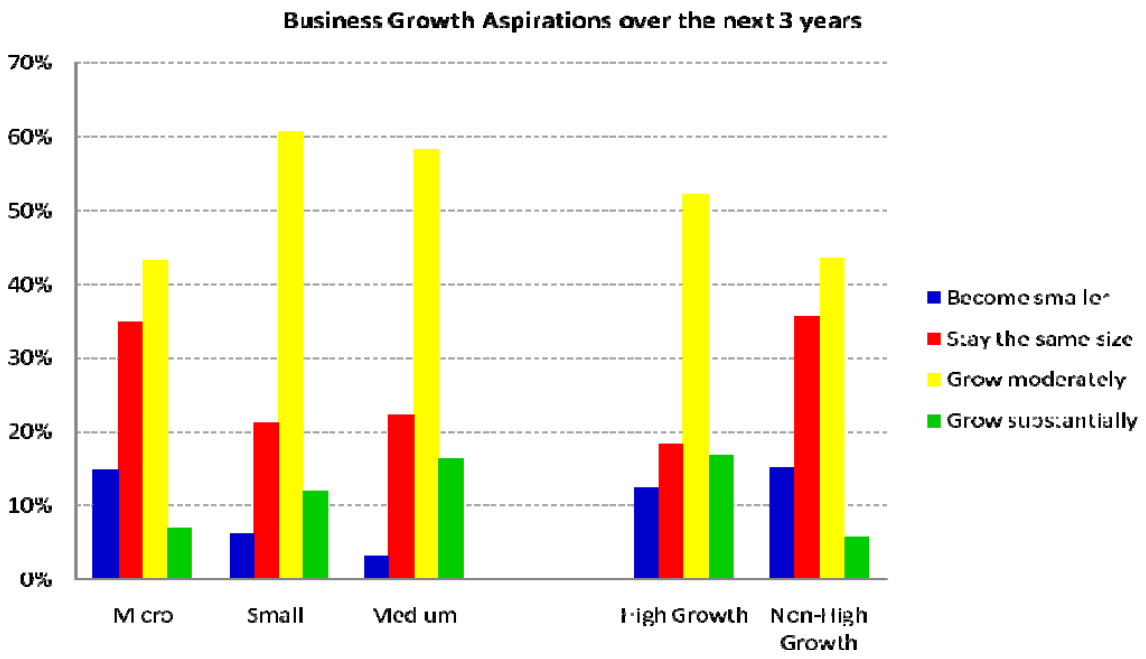



*The further away from the origin, the greater the obstacle to successfully meeting business objectives*
*Base (Nov 2009): Micro n=342; Small n=208; Medium n=105*
*Base (Mar 2009): Micro n=520; Small n=324; Medium n=114*
*Base (2007): Micro n=252; Small n=147; Medium n=86*

## Business Constraints

4.6. Firms were asked about the extent to which they considered key factors to be constraints facing their business – these were producing goods or services, getting orders (demand for products), staffing, finance (cost, and access) and tax and regulations. The charts above illustrate how the constraints felt by businesses have eased or worsened since the 2007 and March 2009 surveys.

4.7. The biggest change in constraints over time appears to be in finance, where firms are reporting that the cost and access to sufficient finance has become more of a constraint than earlier that year in March 2009. Unsurprisingly, staffing has become less of a problem than in previous years for small and medium firms and getting orders remains just as much of a constraint than in March 2009.



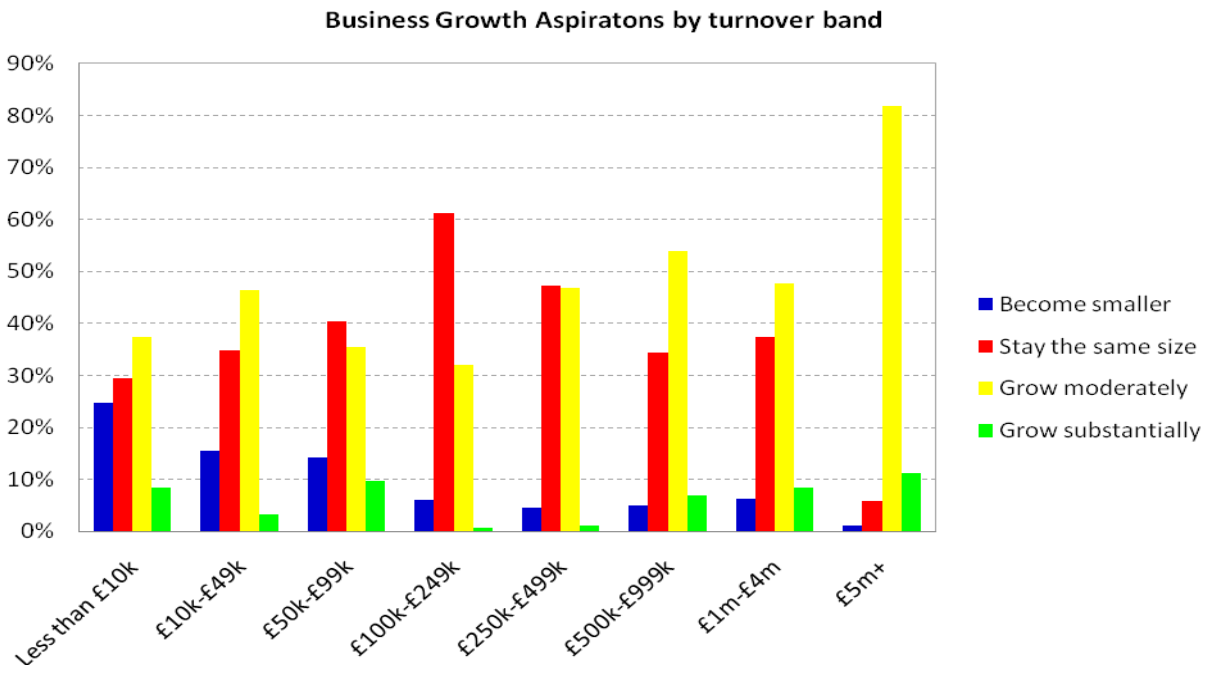

*Base (Nov 2009): Micro n=342; Small n=208; Medium n=105; High Growth n=99; Non-high Growth n=521*

## Business Growth Objectives

4.8. The chart above depicts growth aspirations by size of firm, and between high-growth and non-high growth firms. In general, growth ambitions tend to increase with firm size. High-growth firms are more likely to aspire to either 'grow moderately' or 'grow substantially' than non-high growth firms, with 52% stating that they would grow moderately and 17% planning to grow substantially, compared to 44% and 6% of non-high growth firms.

4.9. The table below shows changes in business growth ambitions since March 2009. There appears to have been a marginal improvement in business confidence for small businesses where there has been a shift away from 'staying the same' to 'growing moderately' since March 2009. However, in general fewer businesses are stating that they will grow over the next three years than previously in March. The exception to this is high-growth businesses where there has been downward revision to expectations to 'grow substantially' but an increase in those reporting that they plan to 'grow moderately' by 16 percentage points.

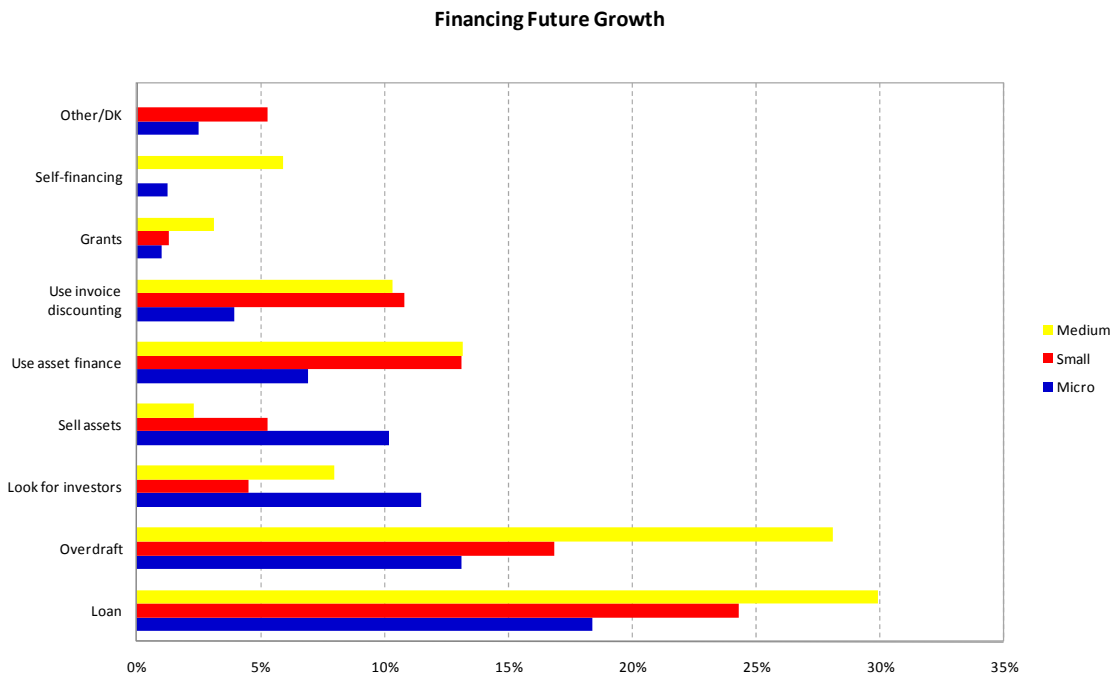
| | Percentage Point Change in Growth Aspirations since March 2009 | | | | |
|---|---|---|---|---|---|
| | Micro | Small | Medium | High Growth | Non-high Growth |
| Become smaller | 7% | 0.6% | 0.1% | 7% | 5% |
| Stay the same size | -6% | -12% | 3% | -15% | -13% |
| Grow moderately | -0.1% | 9% | 0.2% | 16% | 6% |
| Grow substantially | -0.6% | 3% | -3% | -7% | 2% |




*Base (Nov 2009): Less than 10k n=30; £10-99k n=50; £50-99k n=42;£100k-249k n=24; £250-249k n=25;£500k-999k n=41;£1-4m n=103;£5m+ n=41*

4.10. The growth aspirations of businesses over the next three years indicate that a greater proportion of businesses with lower turnover are more likely to become smaller or stay the same size compared to those with greater turnover.

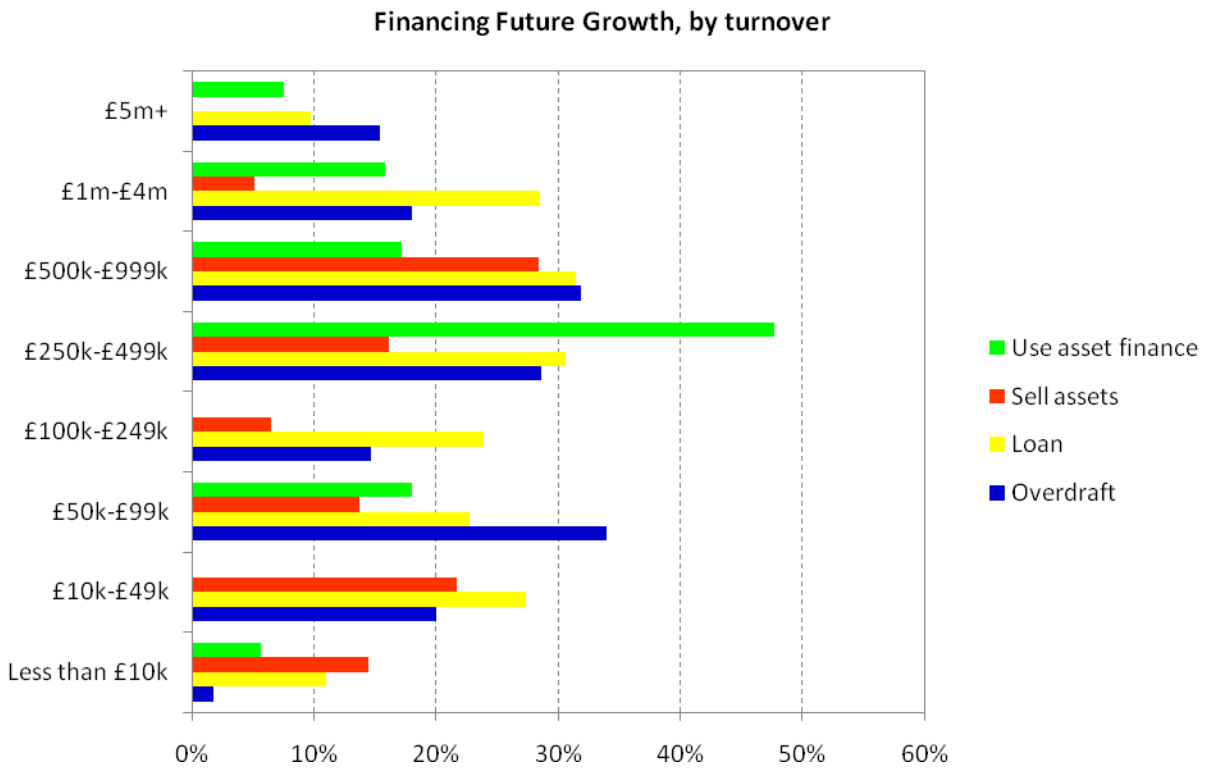
4.11. No more than 10% of firms in any turnover band are planning to grow substantially, but a very high proportion of businesses with £5m+ turnover (82%) stated that they plan to grow moderately over the next three years.




*Base (Nov 2009): Micro n=342; Small n=208; Medium n=105;*

4.12. Of those firms surveyed who were planning to grow over the next three years (those who stated that they would grow either moderately, or significantly) the majority of firms – over 90% - plan to finance this growth using funds generated by their business. In line with current use of finance, loans (both secured and unsecured) and overdrafts are likely to be the main types of external finance sought with around 30% of medium enterprises reporting a demand for each, compared to 23% (loans) and 17% (overdrafts) of small firms, and 18% and 13% of micro firms respectively.

4.13. The main difference in the requirements for future finance between high-growth and non-high growth is that a greater proportion of non-high growth firms are more likely to seek all forms of external financing than high-growth firms. The only exception to this is to 'look for investors', where 17% of high-growth firms stated that they would plan to finance any future growth through this method, compared to 10% of non-high growth firms. 6% of high-growth firms also reported that they 'did not know' what form of finance they would use, against only 1% of non-high growth firms.

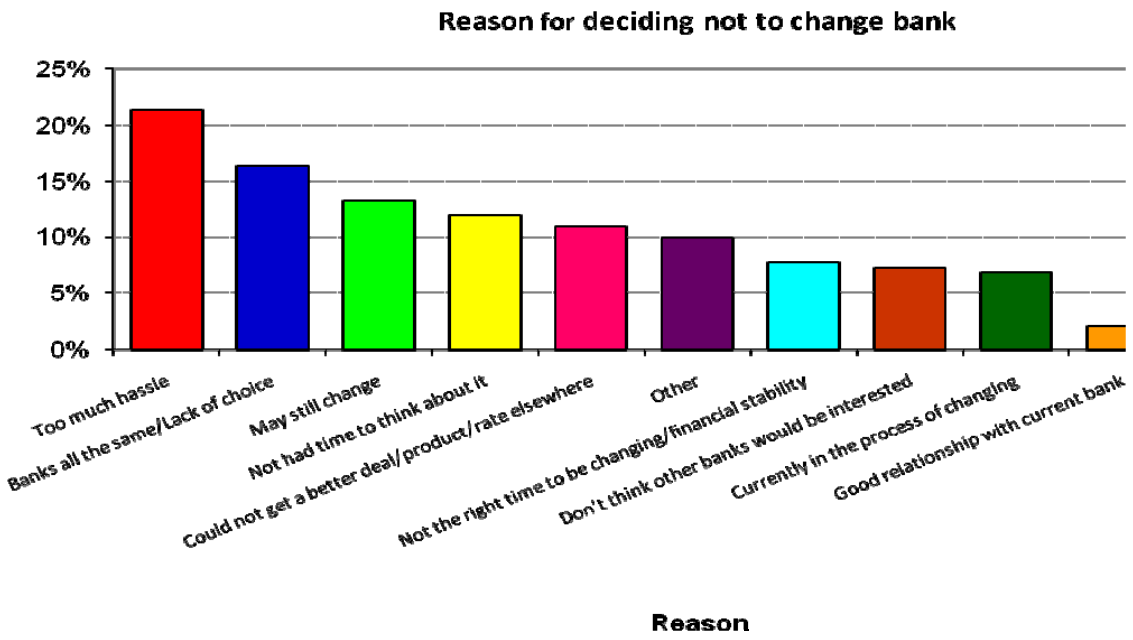



*Base (Nov 2009): Less than 10k n=30; £10-99k n=50; £50-99k n=42;£100k-249k n=24; £250-249k n=25;£500k-999k n=41;£1-4m n=103;£5m+ n=41*

**Financing Future Growth, by turnover**

4.14. The chart above shows the potential requirements for the top four types of credit facility required by firms to fund growth objectives, based on their annual turnover. This excludes 'funds generated by business' which was reported widely as a source of future funding for over 85% of all firms.

4.15. The requirements for most facilities tend to increase with turnover, and then begin to decline as the turnover for firms gets greater. For example, a smaller percentage of enterprises with a turnover of over £5m reported that they plan to finance any future growth with overdrafts (16%), loans (10%) or asset-based finance (8%). This compares to say, firms with a turnover of between £500k to £999k who state their potential funding being sourced from overdrafts (32%), loans (32%), selling assets (28%) and using asset based finance (17%). At the lower end, firms with a turnover of between £10k to £49k would be seeking to obtain or extend overdrafts (20%), loans (27%) and sell assets (22%). A significant proportion of enterprises (34%) with between £50k-£99k turnover reported that they would fund any growth with the use of overdrafts.




*Base (Nov 2009) n=157*

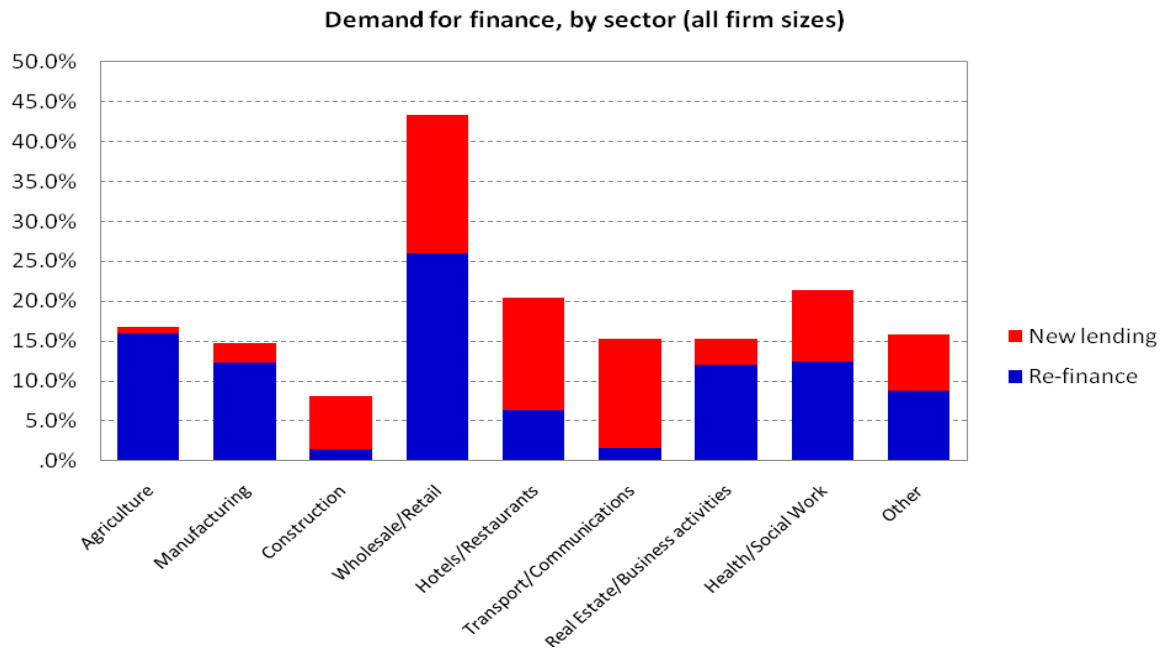
**Attitudes towards Banking**

4.16. The March 2009 survey estimated the market shares of the various financial providers for SME finance, which was based on 1001 SMEs. The November 2009 survey confirms these findings with estimated market shares remaining broadly similar.

4.17. Over 70% of Scottish SMEs are financed by The Royal Bank of Scotland (RBS) and the Lloyds Banking Group. The Clydesdale Bank has the next largest market share, with nearly 13% of SMEs banking with them, based on the November survey.

4.18. Around 12% of all SMEs had either changed their main bank, or moved some existing or new business over to another provider over the past year. When asked whether firms had considered changing bank, 77% had stated that they did not consider changing their main bank for business services compared to 23% who had considered doing so.

4.19. Of those who had considered changing bank but subsequently did not do so, the predominant reason for not changing banks was reported by firms to be that it was 'too much hassle' (21%). This was followed by 16% of respondents stating that 'banks are all the same' or there was a 'lack of choice'. 7% of firms thought that other banks would not be interested in financing their business, and an additional 8% felt that it was not the right time to be changing banks given the instability of the financial system.

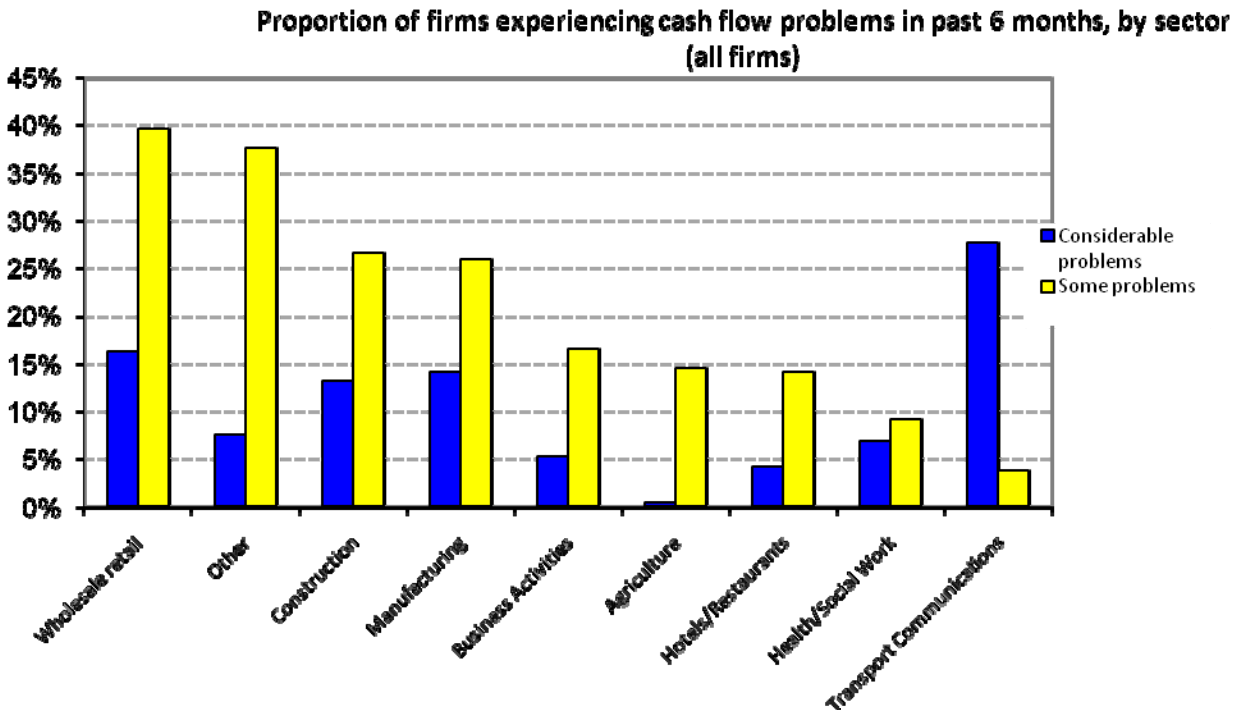



*Base (2009): Agriculture n= 50 ; Manufacturing n=103 ; Construction n=87 ; Wholesale/retail n=80 ; Hotels/Restaurants n= 55; Transport/Communications n=44 ; Real Estate/Business sectors = 100; Health/Social work n=50 ; Other n=86*

**Sector Analysis – Demand for Finance**

4.20. Within the overall sample, the demand for finance over the last six months varies across sectors. The greatest demand appeared to be from the wholesale/retail sector (where 26% of firms within that sector were looking to re-finance and 17% seeking new lending), followed by health/social work (13% refinancing, 9% new lending) and hotels and restaurants (6% refinancing and 14% new lending). The majority of manufacturing firms seeking finance were re-financing existing agreements (12%) compared to the construction sector – where only 1% were re-financing but with 7% applying for new lending.

4.21. It is not possible to analyse rejection rates for new lending split by sector, given the overall sample size and small percentages of firms making applications during the six months period since March. However, the chart on page 19 indicates a relatively low rejection rate of 7% - this will apply to those sectors who are undertaking new lending.

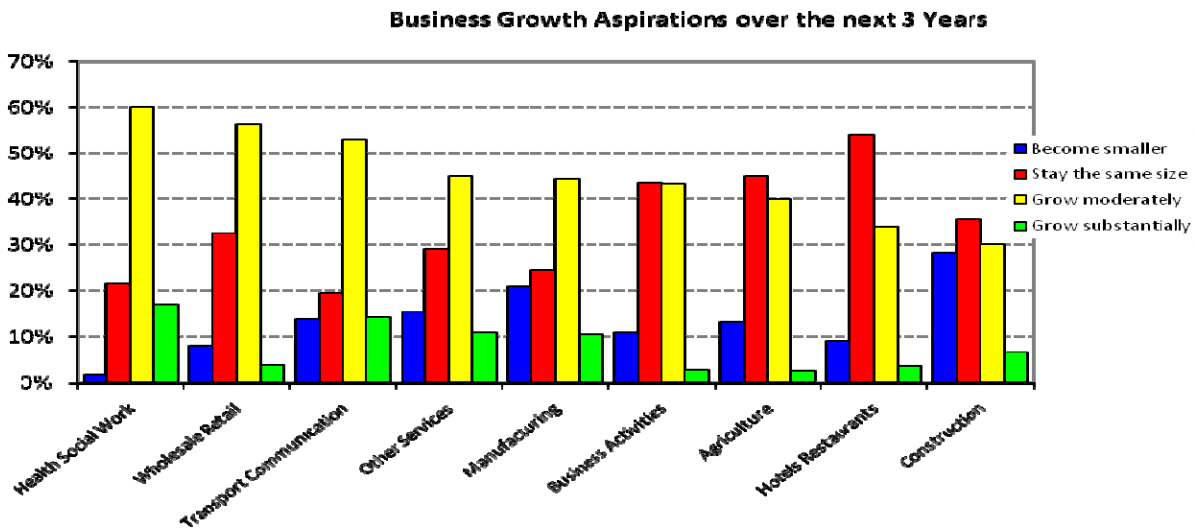



*Base (2009): Agriculture n=50 ; Manufacturing n=103 ; Construction n=87 ; Wholesale/retail n=80 ; Hotels/Restaurants n=55 ; Transport/Communications n=44 ; Real Estate/Business sectors =100 ; Health/Social work n=50 ; Other n=86*

**Business Conditions**

4.22. Firms were asked if they had experienced financial difficulties in the last six months. The above chart shows that nearly 60% of wholesale/retail firms and 45% of firms in 'other' sectors experienced cash flow problems during this time, of which the majority of firms reported these as being 'some problems' rather than 'considerable problems'. However, the sectors which reported the most considerable problems were transport/communications (32% of which 28% said 'considerable'), and 40% of construction and manufacturing firms, of which considerable cash flow problems affected 13% of construction and 14% of manufacturing firms respectively. The agricultural sector experienced the least amount of financial difficulty, with only 0.4% reporting 'considerable' problems and 14% experiencing 'some' problems.

4.23. When excluding zero employee firms from the analysis (given the tendency of micro firms to skew the results), there appears to be an even greater percentage of firms reporting 'considerable' problems with cash flow in the manufacturing sector (18%), followed by the wholesale/retail sector (16%) and construction (13%).



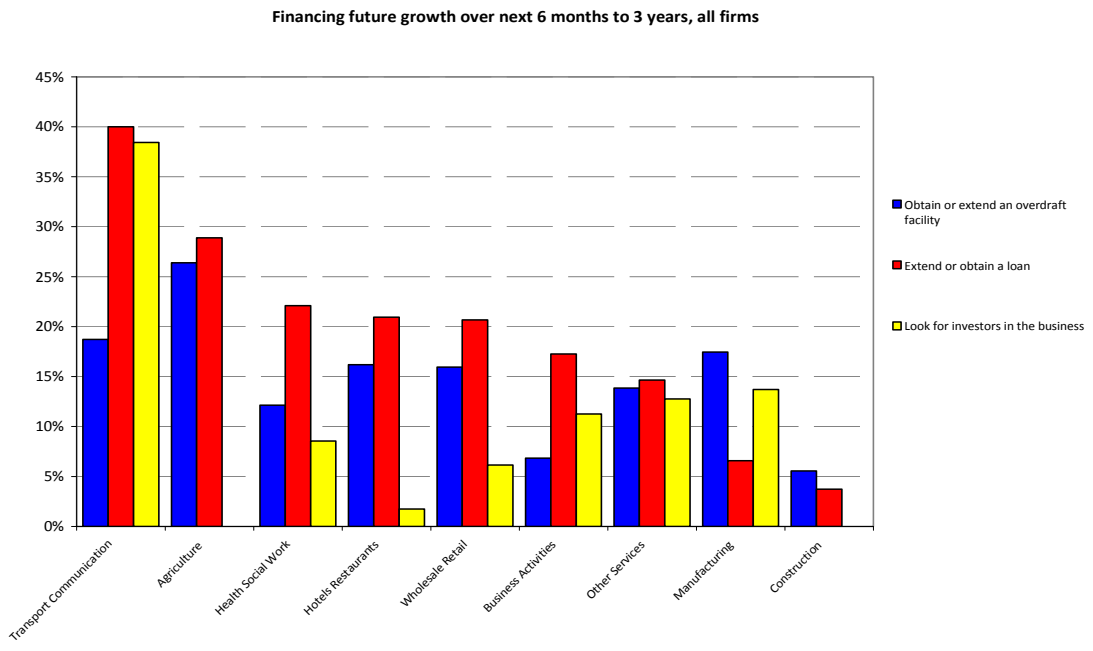

*Base (2009): Agriculture n=50 ; Manufacturing n=103 ; Construction n= 87; Wholesale/retail n=80 ; Hotels/Restaurants n=55 ; Transport/Communications n=44 ; Real Estate/Business sectors = 100; Health/Social work n=50 ; Other n=86*

**Business Conditions – business growth objectives**

4.24. The most pessimistic sectors in terms of business growth objectives appear to be the construction sector, where 28% of firms think they will become smaller over the next three years, and manufacturing where 21% of firms believe the same. Over 50% of firms in health/social work, wholesale/retail, transport/communication, other services, and manufacturing stated that they plan to grow (either moderately or substantially) over the next three years.

4.25. The table below shows the change in growth aspirations of firms (excluding zero employees) since March 2009. In general, there appears to be a downward revision in growth aspirations across most sectors with the exception of wholesale/retail (12 percentage point increase in those planning any growth), transport/communication (26percentage points) and health/social work (18 percentage points).

| | Change in Growth Aspirations since March 2009 (excluding zero employee firms) | | | |
|---|---|---|---|---|
| | Become smaller | Stay the same size | Grow moderately | Grow substantially |
| Agriculture | 1% | 6% | -3% | -4% |
| Manufacturing | 10% | 5% | -11% | -4% |
| Construction | 30% | -15% | -17% | 2% |
| Wholesale Retail | 1% | -13% | 18% | -6% |
| Hotels Restaurants | 8% | 13% | -20% | -2% |
| Transport Communication | 11% | -37% | 25% | 0.8% |
| Business Activities | 3% | 10% | -6% | -7% |
| Health Social Work | -14% | -4% | 10% | 8% |
| Other | 22% | -7% | -24% | 9% |




*Base (2009): Agriculture n=50 ; Manufacturing n=103 ; Construction n= 87; Wholesale/retail n=80 ; Hotels/Restaurants n=55 ; Transport/Communications n=44 ; Real Estate/Business sectors = 100; Health/Social work n=50 ; Other n=86*

## Business Conditions – Future Financing Needs

4.26. The sector analysis on future financing needs looks at demand for the top three forms of external finance, identified by all firms for financing any future growth. These were overdrafts, loan facilities, and looking for investors in the business.

4.27. The previous chart identifies the top four sectors which want to grow over the next three years as transport/communication, health/social work, wholesale retail, and those listed as 'other services'. The above chart shows that the most popular form of external finance for financing future growth for these sectors is to extend or obtain a loan (40% of transport/communication firms, 22% of health/social work firms, 20% of wholesale retail firms and 15% of 'other services'). Those seeking investors however are likely to be from transport/communication (38%), business activities (11%), other services (13%), and manufacturing (14%). In addition to transport and agriculture, just over 20% of firms in health/social work, hotels/restaurants and wholesale/retail state that they would be seeking loans to fund any future growth.

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