# 5. Financial context – how are SMEs funding themselves?

## This chapter provides

an overview of the types of external finance being used by SMEs, including the use of personal finance and trade credit within a business.

## Key findings

Attitudinally, many SMEs appear to prefer self-funding their business rather than taking on external debt:

- YEQ2 2016, 80% agreed that their plans were based on what they could afford to fund themselves and, in new questions for 2016, 71% agreed that they would accept a slower growth rate rather than borrow to grow faster, while 47% agreed that they never think about whether the business could or should use (more) external finance. Smaller SMEs were more likely to agree with all these statements.
- 46% of SMEs agreed that they were happy to borrow to help the business grow. Current use of finance is a key predictor of agreement with this statement and 57% of those currently using finance would be happy to borrow compared to 37% of those not currently using finance.

36% of SMEs YEQ2 2016 used external finance, increasing by size of SME from 31% of those with 0 employees to 62% of those with 50-249 employees.

- This is little changed from 2015 as a whole, when 37% used external finance, but remains lower than in previous years (in 2012, 44% of SMEs were using external finance).
- The decline was primarily due to fewer SMEs using core forms of finance: In 2012, 36% of SMEs were using loans, overdrafts and/or credit cards but by 2014 this had fallen to 29%. It has been relatively stable since (29% YEQ2 2016).
- Use of other forms of finance such as invoice discounting has been more stable over time (16% for YEQ2 2016).

YEQ2 2016, 28% of SMEs reported an injection of personal funds into the business. This was as likely to have been a choice (15%) as something they felt forced to do (13%).

- Smaller SMEs remained more likely to inject funds (30% of those with 0 employees compared to 8% of those with 50-249 employees).
- The proportion reporting *any* injection of funds fell from 43% in 2012 to 29% in 2014 primarily due to fewer SMEs feeling that they had to inject funds (25% in 2012 to 15% in 2014). It has been fairly stable since.

A third of SMEs (32%) use trade credit, increasing by size of SME to 58% of those with 50-249 employees. Two thirds of those who received trade credit said that it reduced their need for external finance.

Combining injections of personal funds and trade credit with use of external finance results in 63% of SMEs using any business funding and this has changed little in the time the relevant questions have been asked.

YEQ2 2016, 46% of SMEs qualified as Permanent non-borrowers with no apparent appetite for finance. This group increased in size from 34% of SMEs in 2012 to 47% in 2015.

- Whilst the smallest SMEs remained the most likely to meet the definition (50% of 0 employees SMEs qualified as PNBs YEQ2 2016), just over a quarter of the largest SMEs with 10-249 employees were PNBs.
- Since the start of 2015 more SMEs have met the definition of a PNB than used external finance and the gap is starting to widen. In Q2 2016 itself, 36% of SMEs were using external finance while 47% met the definition of a PNB.

## Use of external finance

SMEs were asked some initial questions about their use of external finance:

- Which of a specified list of sources they were currently using
- Whether they had used any form of external finance in the past 5 years.

Use of external finance for YEQ2 2016 was 36%, in line with 2014 and 2015 (both 37%). This remains lower than in previous years.

Analysis by recent quarter showed use of external finance in Q2 2016 itself was 36%, in line with most of 2015, after a slight 'dip' in Q1 2016:

**Use of external finance in last 5 years**

| Over time – all SMEs<br>By date of interview | Q2 2014 | Q3 2014 | Q4 2014 | Q1 2015 | Q2 2015 | Q3 2015 | Q4 2015 | Q1 2016 | Q2 2016 |
|---|---|---|---|---|---|---|---|---|---|
| *Unweighted base:* | *5008* | *5023* | *5024* | *5038* | *5001* | *5004* | *5003* | *4500* | *4500* |
| Use now | 39% | 40% | 36% | 36% | 36% | 36% | 40% | 33% | 36% |
| Used in past but not now | 3% | 3% | 3% | 3% | 3% | 4% | 2% | 2% | 3% |
| Not used at all | 58% | 58% | 62% | 61% | 60% | 61% | 57% | 65% | 61% |

Q14/15 All SMEs

As the table below shows, the 'dip' in Q1 2016 was due to lower levels of usage of external finance amongst smaller SMEs. Amongst those with 10-249 employees use was more stable and such SMEs remained more likely to be using external finance:

**Currently use external finance**

| Over time – all SMEs<br>By date of interview<br>– row percentages | Q2 2014 | Q3 2014 | Q4 2014 | Q1 2015 | Q2 2015 | Q3 2015 | Q4 2015 | Q1 2016 | Q2 2016 |
|---|---|---|---|---|---|---|---|---|---|
| All | 39% | 40% | 36% | 36% | 36% | 36% | 40% | 33% | 36% |
| 0 emp | 35% | 35% | 32% | 32% | 32% | 31% | 35% | 28% | 31% |
| 1-9 emps | 50% | 53% | 44% | 48% | 47% | 49% | 53% | 44% | 50% |
| 10-49 emps | 59% | 64% | 55% | 61% | 60% | 59% | 59% | 60% | 61% |
| 50-249 emps | 64% | 65% | 61% | 58% | 63% | 60% | 63% | 63% | 64% |

Q14/15 All SMEs

The table below shows use of finance by risk rating for recent quarters. In Q2 2016, those with a better risk rating remained more likely to be using external finance:

**Currently use external finance**

| Over time – all SMEs<br>By date of interview<br>– row percentages | Q2 2014 | Q3 2014 | Q4 2014 | Q1 2015 | Q2 2015 | Q3 2015 | Q4 2015 | Q1 2016 | Q2 2016 |
|---|---|---|---|---|---|---|---|---|---|
| All | 39% | 40% | 36% | 36% | 36% | 36% | 40% | 33% | 36% |
| Minimal | 51% | 46% | 35% | 41% | 48% | 51% | 49% | 40% | 48% |
| Low | 44% | 36% | 37% | 51% | 46% | 41% | 50% | 40% | 50% |
| Average | 38% | 40% | 33% | 35% | 38% | 39% | 40% | 36% | 35% |
| Worse than average | 36% | 39% | 37% | 31% | 29% | 31% | 36% | 28% | 33% |

Q14/15 All SMEs , base varies slightly each quarter

As already reported, use of external finance has declined over time and these longer term changes are summarised in the table below which shows the decline in use of external finance since 2012 by key business demographics:

| **Currently use external finance**<br>Over time – all SMEs<br>By date of interview – row percentages | 2012 | 2013 | 2014 | 2015 | H1 2016 |
|---|---|---|---|---|---|
| All | 44% | 41% | 37% | 37% | 34% |
| 0 emp | 38% | 35% | 32% | 32% | 29% |
| 1-9 emps | 58% | 55% | 49% | 49% | 47% |
| 10-49 emps | 70% | 67% | 61% | 60% | 60% |
| 50-249 emps | 73% | 73% | 63% | 61% | 64% |
| Minimal external risk rating | 57% | 50% | 44% | 47% | 44% |
| Low | 52% | 51% | 40% | 47% | 46% |
| Average | 46% | 42% | 36% | 38% | 36% |
| Worse than average | 41% | 38% | 35% | 32% | 30% |
| Agriculture | 51% | 44% | 43% | 44% | 45% |
| Manufacturing | 49% | 44% | 44% | 39% | 38% |
| Construction | 41% | 38% | 33% | 33% | 34% |
| Wholesale/Retail | 56% | 50% | 50% | 45% | 43% |
| Hotels & Restaurants | 53% | 47% | 42% | 44% | 43% |
| Transport | 47% | 41% | 38% | 38% | 32% |
| Property/ Business Services | 41% | 39% | 34% | 35% | 28% |
| Health | 32% | 31% | 28% | 33% | 31% |
| Other | 38% | 42% | 33% | 39% | 40% |
| All excl PNBs | 66% | 68% | 65% | 70% | 67% |

Q14/15 All SMEs

## Use of core forms of finance

To understand more about the use of external finance over time, the table below shows the overall reported use of the core forms of finance (overdrafts, loans and credit cards) across recent quarters. The 'dip' in overall use of finance seen in Q1 2016 is reflected here in a lower proportion of SMEs using any of the core forms of finance in that quarter:

**Use of external finance**

| Over time – all SMEs<br>By date of interview | Q2 2014 | Q3 2014 | Q4 2014 | Q1 2015 | Q2 2015 | Q3 2015 | Q4 2015 | Q1 2016 | Q2 2016 |
|---|---|---|---|---|---|---|---|---|---|
| *Unweighted base:* | *5008* | *5023* | *5024* | *5038* | *5001* | *5004* | *5003* | *4500* | *4500* |
| Bank overdraft | 18% | 17% | 16% | 16% | 16% | 15% | 17% | 14% | 16% |
| Bank loan/Commercial mortgage | 8% | 7% | 7% | 8% | 6% | 7% | 8% | 6% | 6% |
| • *Bank loan* | | *5%* | *6%* | *7%* | *5%* | *6%* | *6%* | *5%* | *4%* |
| • *Comm. Mortgage* | | *1%* | *1%* | *2%* | *2%* | *2%* | *2%* | *2%* | *3%* |
| Credit cards | 15% | 16% | 14% | 15% | 15% | 15% | 17% | 15% | 17% |
| ***Any core products – all SMEs*** | ***30%*** | ***31%*** | ***28%*** | ***29%*** | ***28%*** | ***29%*** | ***32%*** | ***25%*** | ***30%*** |

Q15 All SMEs

From Q3 2014, use of bank loans and commercial mortgages has been recorded separately and each is now shown in the table above. Excluding the use of commercial mortgages from the core finance definition reduces the figure for Q2 2016 from 30% to 29% with a similar decrease for 2015 as a whole (30% to 29%).

The table above shows that use of core finance (including commercial mortgages) has been relatively stable over recent quarters. A longer term view, shown in the table below, shows how use of core finance declined from 36% in 2012 to 29% in 2014 and has been stable since. This earlier decline in use of finance was due to the increase in Permanent non-borrowers, as once they are excluded, use of core finance has been fairly consistent year to year with around half of such SMEs using these forms of finance.

The longer term changes in the use of core finance are summarised in a new table below showing the decline since 2012 by key business demographics:

| **Currently use core finance**<br>Over time – all SMEs<br>By date of interview – row percentages | 2012 | 2013 | 2014 | 2015 | H1 2016 |
|---|---|---|---|---|---|
| All | 36% | 32% | 29% | 30% | 28% |
| 0 emp | 31% | 27% | 25% | 25% | 24% |
| 1-9 emps | 48% | 44% | 40% | 40% | 36% |
| 10-49 emps | 62% | 57% | 50% | 50% | 52% |
| 50-249 emps | 67% | 64% | 55% | 53% | 56% |
| Minimal external risk rating | 48% | 42% | 35% | 39% | 38% |
| Low | 46% | 43% | 34% | 39% | 39% |
| Average | 39% | 34% | 30% | 31% | 30% |
| Worse than average | 31% | 28% | 26% | 24% | 22% |
| Agriculture | 44% | 37% | 36% | 36% | 36% |
| Manufacturing | 40% | 35% | 37% | 31% | 32% |
| Construction | 34% | 31% | 25% | 26% | 29% |
| Wholesale/Retail | 47% | 39% | 41% | 36% | 36% |
| Hotels & Restaurants | 45% | 38% | 34% | 37% | 32% |
| Transport | 36% | 30% | 29% | 29% | 24% |
| Property/ Business Services | 33% | 31% | 26% | 29% | 22% |
| Health | 25% | 24% | 22% | 26% | 25% |
| Other | 30% | 32% | 25% | 29% | 31% |
| All excl PNBs | 54% | 53% | 51% | 55% | 53% |

Q15 All SMEs

YEQ2 2016, 78% of credit card users reported that they usually paid off the balance on their card in full each month (excl DK answers), so these businesses were not necessarily using their card as a source of finance, but as a payment mechanism. The larger the SME the more likely they were to pay off their credit card (73% of 0 employee SMEs with a credit card typically paid off the balance compared to 95% of those with 50-249 employees). The proportion typically paying off the balance has changed very little over time (it was 79% for Q2-Q3 2013).

7% of SMEs only use credit cards of all the forms of external finance reported. 84% of this group said that they usually pay off the balance each month. This is the equivalent of 6% of all SMEs who might be considered not to be using external finance, given that they use only credit cards and typically pay the balance off each month.

Excluding credit cards from the core product table above would result in 19% of SMEs YEQ2 2016 with either an overdraft and/or loan and this proportion has declined over time from 26% in 2012 (it was 20% for 2015).

From Q4 2012 those using core finance were asked whether any of those facilities were in their personal name, rather than that of the business. For YEQ2 2016, a third of those using such facilities (37%) said that one or more facilities were in their personal name, the equivalent of 10% of **all** SMEs having a facility in their personal name (or 18% of SMEs excluding the Permanent non-borrowers). This had varied relatively little across the quarters in which the question has been asked.

As the table below shows, the incidence of facilities in a personal name varied by size of business. Amongst SMEs with loans, overdrafts and/or credit cards, 4 in 10 of those with 0 employees had some facility in their personal name (44%) compared to 9% of those with 50-249 employees. SMEs with these facilities, and who also had an average or worse than average risk rating, were more likely to have a facility in their own name (37% and 42%), than those with a minimal or low risk rating (both 25%) but the equivalent figures for **all** SMEs continued to show relatively little difference by risk rating:

| **Have element of facility in personal name**<br>YEQ2 16 – row percentages | Of those with an overdraft, loan or credit card | Equivalent % of all SMEs |
|---|---|---|
| Total | **37%** | **10%** |
| 0 employees | 44% | 10% |
| 1-9 employees | 28% | 10% |
| 10-49 employees | 15% | 7% |
| 50-249 employees | 9% | 8% |
| Minimal risk rating | 25% | 9% |
| Low risk rating | 25% | 9% |
| Average risk rating | 37% | 10% |
| Worse than average risk rating | 42% | 9% |

Q15bbb All SMEs with one of these facilities

Those operating their business banking through a personal account were somewhat less likely to be using any external finance (YEQ2 2016, 21% were using a core form of external finance, compared to 31% of those operating through a business bank account). However, if they *did* use the relevant forms of external finance, then almost all (86%) said that some or all of the loan, overdraft or credit card facilities that they had were in their personal name. Those with facilities who used a business account, were much less likely to say that there were facilities in their personal name. (28%)

As a result, amongst all SMEs, those using a personal account for their business were twice as likely to have a facility in their personal name as those using a business account (17% of all those using a personal account had a facility in their personal name compared to 8% of all those using a business account).

From Q3 2014, SMEs using loans, overdrafts or credit cards were asked about each individual type of facility they held, rather than simply whether any of these facilities were in a personal name. In all instances, those with 0 employees were more likely to have a facility in a personal name:

**Facilities in a personal name YEQ2 2016 (excl DK)**

| | |
|---|---|
| Overdrafts | 20% of all SMEs with an overdraft said it was in a personal name, of which 84% were 0 employee SMEs. 8% said they had facilities in both personal and business names.<br><br>27% of 0 employee SMEs with an overdraft said that it was in a personal name. This declined by size to 10% of those with 1-9 employees, 4% of those with 10-49 employees and 1% of those with 50-249 employees. |
| Loans | 23% of all SMEs with a loan said it was in a personal name, of which 79% were 0 employee SMEs. 6% said they had facilities in both personal and business names.<br><br>32% of 0 employee SMEs with a loan said that it was in a personal name. This declined by size to 14% of those with 1-9 employees, 2% of those with 10-49 employees and 1% of those with 50-249 employees. |
| Credit cards | 27% of all SMEs with a credit card said it was in a personal name, of which 79% were 0 employee SMEs. 14% said they had facilities in both personal and business names.<br><br>35% of 0 employee SMEs with a credit card said that it was in a personal name. This declined by size to 18% of those with 1-9 employees, 6% of those with 10-49 employees and 3% of those with 50-249 employees. |

## Any use of external finance

The table below shows the full list of the different types of funding being used by SMEs YEQ2 2016. It includes both the core forms of finance already reported and the other forms of finance on which data has been collected, some of which may also be obtained from the bank.

Larger businesses continued to make use of a wider range of forms of funding. Amongst SMEs with employees, 51% were using external finance – 41% were using any form of core finance and 27% any of the other forms of finance listed:

| **External finance currently used** YEQ2 16 – all SMEs | Total | 0 emp | 1-9 emps | 10-49 emps | 50-249 emps |
|---|---|---|---|---|---|
| *Unweighted base:* | *19,007* | *3800* | *6203* | *6103* | *2901* |
| Core products (any) | 29% | 25% | 39% | 51% | 55% |
| -Bank overdraft | 16% | 14% | 21% | 24% | 22% |
| -Credit cards | 16% | 13% | 22% | 34% | 40% |
| -Bank loan | 5% | 4% | 8% | 12% | 14% |
| -Commercial mortgage | 2% | 1% | 4% | 7% | 8% |
| Other forms of finance (any) | 16% | 12% | 26% | 36% | 37% |
| -Leasing or hire purchase | 8% | 6% | 12% | 22% | 22% |
| -Loans from directors, family & friends | 6% | 4% | 10% | 9% | 6% |
| -Equity from directors, family & friends | 2% | 2% | 4% | 5% | 5% |
| -Invoice finance | 2% | 1% | 4% | 9% | 12% |
| -Grants | 2% | 1% | 3% | 5% | 6% |
| -Loans from other 3rd parties | 2% | 1% | 3% | 5% | 5% |
| *Any of these* | *36%* | *31%* | *49%* | *60%* | *62%* |
| *None of these* | *64%* | *69%* | *51%* | *40%* | *38%* |

Q15 All SMEs

SMEs that import and/or export were asked about use of Export/Import finance. YEQ2 2016, 1% of such SMEs used these products, with limited variation by size of business (1-4%).

A summary analysis for YEQ2 2016 by risk rating showed that:

- 48% of SMEs with a minimal and 45% of those with a low risk rating were using external finance at all, compared to 38% of those with an average risk and 32% of those with a worse than average risk rating.
- Those with a minimal (40%) or low (39%) risk rating were more likely to be using core forms of finance than those with an average (31%) or worse than average (24%) rating.
- This was also true for other forms of finance. 20% of those with a minimal and 21% of those with a low risk rating were using other forms of finance compared to 15% of those with either an average or worse than average rating.

SMEs in the Hotel & Restaurant, Agriculture and Wholesale/Retail sectors remained more likely to be using core forms of finance. There was more variation by sector in terms of the use of other forms of finance than has been seen in the past, with those in Agriculture again more likely to be using such finance:

**External finance currently used**

| YEQ2 16 – all SMEs | Agric | Mfg | Constr | Whle Retail | Hotel Rest | Trans | Prop/ Bus | Hlth SWrk | Other Comm |
|---|---|---|---|---|---|---|---|---|---|
| *Unweighted base:* | *1350* | *1790* | *3349* | *1912* | *1500* | *1909* | *3550* | *1645* | *2002* |
| Core finance | 37% | 33% | 28% | 36% | 36% | 27% | 25% | 26% | 30% |
| Other finance | 25% | 18% | 14% | 22% | 22% | 18% | 13% | 13% | 18% |
| *Any finance* | *45%* | *40%* | *34%* | *44%* | *46%* | *36%* | *31%* | *31%* | *40%* |

Q15 All SMEs

From Q1 2014 SMEs using leasing, HP and vehicle finance were asked where this funding was obtained from, with SMEs able to give more than one source. From Q1 2015, those using these forms of finance have been asked to name the supplier(s) used and these have then been coded into the categories below to provide a more accurate analysis of how funding is being provided.

For YEQ2 2016 leasing, HP and vehicle finance was obtained as follows:

- 34% obtained this funding from a bank/bank subsidiary: 16% from their main bank/subsidiary, 18% from another bank/subsidiary
- 16% from an equipment manufacturer
- 24% from another leasing provider
- 4% from a broker

These results are virtually unchanged from 2015 as a whole and not that dissimilar to those in 2014 (when the SME self-identified the type of supplier used). Mentions of a bank are now slightly higher (having been 26% in 2014) and mentions of another leasing provider are somewhat lower (having been 39%).

Amongst those using leasing, HP or vehicle finance, use of <u>any</u> bank for this finance was slightly more common amongst larger SMEs for YEQ2 2016:

- 34% of 0 employee SMEs using leasing, HP or vehicle finance were using a bank
- 31% of those with 1-9 employees
- 38% of those with 10-49 employees
- 44% of those with 50-249 employees.

The table below details the use of all of these forms of funding over recent quarters. Loans and equity from family/friends/directors and bank loans/ commercial mortgages can now be reported separately as sufficient data has been collected.

The long term decline in the use of core forms of finance has already been reported. Use was stable in 2015 but has been somewhat lower in the first half of 2016 and this is also true for other forms of finance:

**Use of external finance**

| Over time – all SMEs<br>By date of interview | Q2 2014 | Q3 2014 | Q4 2014 | Q1 2015 | Q2 2015 | Q3 2015 | Q4 2015 | Q1 2016 | Q2 2016 |
|---|---|---|---|---|---|---|---|---|---|
| *Unweighted base:* | *5008* | *5023* | *5024* | *5038* | *5001* | *5004* | *5003* | *4500* | *4500* |
| Core products (any) | 30% | 31% | 28% | 29% | 28% | 29% | 32% | 25% | 30% |
| -Bank overdraft | 18% | 17% | 16% | 16% | 16% | 15% | 17% | 14% | 16% |
| -Bank loan/Commercial mortgage | 8% | 7% | 7% | 8% | 6% | 7% | 8% | 6% | 6% |
| *-Bank loan* | | *5%* | *6%* | *7%* | *5%* | *6%* | *6%* | *5%* | *4%* |
| *-Comm. Mortgage* | | *1%* | *1%* | *2%* | *2%* | *2%* | *2%* | *2%* | *3%* |
| -Credit cards | 15% | 16% | 14% | 15% | 15% | 15% | 17% | 15% | 17% |
| Other forms of finance (any) | 18% | 20% | 16% | 16% | 17% | 16% | 19% | 15% | 15% |
| -Leasing, hire purchase or vehicle finance | 7% | 8% | 6% | 7% | 6% | 7% | 8% | 7% | 8% |
| -Loans from directors/family/friends* | 8% | 8% | 6% | 7% | 7% | 6% | 8% | 4% | 5% |
| -Equity from directors/family/friends* | 2% | 3% | 2% | 2% | 2% | 3% | 3% | 2% | 2% |
| -Invoice finance | 3% | 3% | 2% | 2% | 2% | 3% | 2% | 2% | 2% |
| -Grants | 2% | 2% | 1% | 2% | 2% | 2% | 2% | 2% | 1% |
| -Loans from other third parties | 1% | 2% | 2% | 2% | 2% | 2% | 2% | 2% | 1% |
| *Any form of finance – all SMEs* | *39%* | *40%* | *36%* | *36%* | *36%* | *36%* | *40%* | *33%* | *36%* |

Q15 All SMEs

The table below shows how sole use of core and other forms of finance has varied over the longer term, as the proportion using <u>none</u> of these forms of finance increased from 56% to 66% of SMEs:

| **External finance currently used**<br>Over time - all SMEs | 2012 | 2013 | 2014 | 2015 | H1 2016 |
|---|---|---|---|---|---|
| *Unweighted base:* | *20,055* | *20,036* | *20,055* | *20,046* | *9000* |
| Only use core products | 26% | 23% | 20% | 20% | 19% |
| Only use other forms of finance | 8% | 9% | 8% | 8% | 7% |
| Use both forms of finance | 10% | 9% | 9% | 9% | 8% |
| Use none of these forms of finance | 56% | 59% | 63% | 63% | 66% |

Q15 All SMEs

The decline in the use of external finance is driven by the decline in use of core finance (26% to 19%), with the use of other forms of finance, whether alone or in combination with core forms of finance, being somewhat more stable.

SMEs can use one or more of the forms of finance listed above, but most used just one if they used any (58% of SMEs using *any* external finance were only using one of the forms of finance listed). The table below shows the number of forms of finance used by <u>all</u> SMEs (including those using no external finance). Around a quarter of all SMEs in each size band used just one form of external finance. While 4% of the smallest SMEs were using 3 or more forms of finance, this proportion increased to around 1 in 5 of those with 10-49 or 50-249 employees:

| **Forms of external finance currently used**<br>YEQ2 16 – all SMEs | Total | 0 emp | 1-9 emps | 10-49 emps | 50-249 emps |
|---|---|---|---|---|---|
| *Unweighted base:* | *19,007* | *3800* | *6203* | *6103* | *2901* |
| None | 64% | 69% | 51% | 40% | 38% |
| 1 form of finance | 22% | 21% | 26% | 24% | 25% |
| 2 forms of finance | 8% | 7% | 13% | 16% | 16% |
| 3 forms of finance | 3% | 2% | 6% | 9% | 11% |
| 4 or more forms of finance | 3% | 2% | 5% | 11% | 11% |

After further questioning, 2% of SMEs (YEQ2 2016) said that they were using an additional form of external finance not on the list detailed in full above. This did not vary much by size (2-4%) or risk rating (2-4%), or by sector (1-4%), and has varied little over time.

There was no difference in use of these other forms of finance by whether the SME was also using one of the *specified* forms of external finance (2% for those also using the specified forms of external finance and 2% for those not). This means that 1% of **all** SMEs are classed as non-users of finance in this report (because they do not use any of the specified forms of external finance) but said at this question that they were using some other form of finance.

The form of funding used is not known but amongst the nearly 500 SMEs who said they were using a form of finance not specified in the survey, 21 went on to report at a later question that they were using crowd funding.

## The impact of crowd funding and alternative finance

A later chapter in this report covers awareness and usage of crowd funding/peer to peer lending.

These products are currently used by a minority of SMEs. If they were to be included in the definition of external finance used in this chapter, the use of external finance in 2015 would stay unchanged at 37% and for H1 2016 it would increase marginally from 34% to 35%.

More analysis will be provided over time.

## Injections of personal funds

SMEs were asked whether personal funds had been injected into the business in the previous 12 months by the owner or any director, and whether this was something they had *chosen* to do or felt that they *had* to do.

The table below shows that in Q2 2016, a quarter of SMEs (25%) reported an injection of personal funds and that this was slightly more likely to have been a choice (14%) than something they felt they had to do (11%). These figures are at the lower end of the range seen over recent quarters:

**Personal funds in last 12 months**

| Over time – all SMEs<br>By date of interview | Q2 2014 | Q3 2014 | Q4 2014 | Q1 2015 | Q2 2015 | Q3 2015 | Q4 2015 | Q1 2016 | Q2 2016 |
|---|---|---|---|---|---|---|---|---|---|
| *Unweighted base:* | *5008* | *5023* | *5024* | *5038* | *5001* | *5004* | *5003* | *4500* | *4500* |
| Inject personal funds – you chose to do to help the business grow and develop | 15% | 13% | 14% | 14% | 13% | 15% | 15% | 17% | 14% |
| Inject personal funds – you felt you had no choice about this, that you had to do it | 15% | 15% | 15% | 11% | 13% | 15% | 14% | 13% | 11% |
| *Any personal funds* | *30%* | *28%* | *29%* | *26%* | *26%* | *30%* | *29%* | *30%* | *25%* |
| Not something you have done | 70% | 72% | 71% | 74% | 74% | 70% | 71% | 70% | 75% |

Q15d All SMEs

The more detailed analysis below is based on the combined results YEQ2 2016 to provide robust base sizes for key sub-groups. Smaller SMEs, with fewer than 10 employees, were much more likely to have received an injection of personal funds:

| **Personal funds in last 12 months**<br>YEQ2 16 – all SMEs | Total | 0 emp | 1-9 emps | 10-49 emps | 50-249 emps |
|---|---|---|---|---|---|
| *Unweighted base:* | *19,007* | *3800* | *6203* | *6103* | *2901* |
| Inject personal funds – you chose to do to help the business grow and develop | 15% | 16% | 15% | 8% | 6% |
| Inject personal funds – you felt you had no choice about this, that you had to do it | 13% | 14% | 12% | 7% | 2% |
| *Any personal funds* | *28%* | *30%* | *27%* | *15%* | *8%* |
| Not something you have done | 72% | 70% | 73% | 85% | 92% |

Q15d All SMEs from Q2 2012

Amongst SMEs with employees, 25% reported any injection of personal funds – 14% because they chose to do so and 11% who felt that they had no choice.

Analysis by external risk rating showed that those with a worse than average external risk rating were more than twice as likely to have seen an injection of personal funds (36%), as those with a minimal external risk rating (14%). Around half of all SMEs making *any* injection of funds reported that they had felt that they had no choice, and this proportion did not vary much by risk rating:

| **Personal funds in last 12 months**<br>YEQ2 16 – all SMEs | Total | Min | Low | Avge | Worse/ Avge |
|---|---|---|---|---|---|
| *Unweighted base:* | *19,007* | *2965* | *5907* | *4231* | *4276* |
| Inject personal funds – you chose to do to help the business grow and develop | 15% | 7% | 9% | 13% | 20% |
| Inject personal funds – you felt you had no choice about, that you had to do | 13% | 8% | 9% | 12% | 16% |
| *Any personal funds* | *28%* | *14%* | *18%* | *25%* | *36%* |
| Not something you have done | 72% | 86% | 82% | 75% | 64% |

Q15d All SMEs from Q2 2012

Analysis by sector showed relatively little variation in terms of *any* injection of funds, experienced by 25-33% of SMEs in each sector:

**Personal funds in last 12 months**

| YEQ2 16 – all SMEs | Agric | Mfg | Constr | Whle Retail | Hotel Rest | Trans | Prop/ Bus | Hlth SWrk | Other Comm |
|---|---|---|---|---|---|---|---|---|---|
| *Unweighted base:* | *1350* | *1790* | *3349* | *1912* | *1500* | *1909* | *3550* | *1645* | *2002* |
| Chose to inject | 15% | 14% | 13% | 15% | 17% | 16% | 17% | 15% | 17% |
| Had to inject | 12% | 15% | 13% | 14% | 15% | 14% | 12% | 11% | 15% |
| *Any funds* | *27%* | *29%* | *26%* | *29%* | *33%* | *30%* | *28%* | *25%* | *32%* |
| Not done | 73% | 71% | 74% | 71% | 67% | 70% | 72% | 75% | 68% |

Q15d All SMEs from Q2 2012

A longer term look at the injection of personal funds shows how this became less likely between 2012 and 2014. When the question was first asked in 2012, 43% reported an injection of personal funds, declining to 29% for 2014 and stable since. This is due predominantly to a drop in the proportion feeling that they had to inject funds (from 25% in 2012 to 12% in H1 2016) :

| **Personal funds in last 12 months**<br>Over time – all SMEs | 2012* | 2013 | 2014 | 2015 | H1 2016 |
|---|---|---|---|---|---|
| *Unweighted base:* | *15,032* | *20,036* | *20,055* | *20,046* | *9000* |
| Inject personal funds – you chose to do to help the business grow and develop | 17% | 19% | 14% | 14% | 15% |
| Inject personal funds – you felt you had no choice about this, that you had to do it | 25% | 20% | 15% | 13% | 12% |
| *Any personal funds* | *43%* | *38%* | *29%* | *28%* | *27%* |
| Not something you have done | 57% | 62% | 71% | 72% | 73% |

Q15d All SMEs from Q2 2012

The table below looks at the long term changes in injections of any personal funds, whether through choice or necessity, by key business demographics. It shows that larger SMEs, those with a minimal risk rating and those who meet the definition of a Permanent non-borrower have always been less likely to report an injection of funds:

| **Any personal funds in last 12 months**<br>Over time – all SMEs<br>Row percentages | 2012* | 2013 | 2014 | 2015 | H1 2016 |
|---|---|---|---|---|---|
| All | 43% | 38% | 29% | 28% | 27% |
| 0 emp | 45% | 40% | 30% | 29% | 29% |
| 1-9 emps | 39% | 36% | 29% | 26% | 26% |
| 10-49 emps | 22% | 19% | 17% | 16% | 14% |
| 50-249 emps | 13% | 11% | 9% | 8% | 9% |
| Minimal external risk rating | 20% | 16% | 17% | 17% | 11% |
| Low | 29% | 22% | 21% | 19% | 17% |
| Average | 36% | 33% | 25% | 24% | 23% |
| Worse than average | 51% | 46% | 36% | 33% | 34% |
| Agriculture | 41% | 38% | 27% | 26% | 27% |
| Manufacturing | 42% | 31% | 30% | 27% | 26% |
| Construction | 44% | 38% | 29% | 25% | 25% |
| Wholesale/Retail | 43% | 37% | 27% | 27% | 28% |
| Hotels & Restaurants | 47% | 41% | 33% | 29% | 33% |
| Transport | 44% | 40% | 30% | 31% | 30% |
| Property/ Business Services | 42% | 41% | 29% | 27% | 28% |
| Health | 43% | 37% | 29% | 27% | 23% |
| Other | 41% | 37% | 31% | 34% | 28% |
| PNBs | 33% | 29% | 19% | 19% | 20% |
| All excl PNBs | 48% | 44% | 37% | 35% | 34% |

Q15d All SMEs from Q2 2012

Returning to the current period, analysis by age of SME for YEQ2 2016 showed that it was the youngest, start-up businesses that were most likely to have had an injection of personal funds (47%), and that this was more likely to have been a choice (28%) than a necessity (19%). For older businesses, an injection of personal funds was less likely to have happened at all but where it had, a higher proportion of these injections were felt to have been a necessity:

| **Personal funds in last 12 months**<br>YEQ2 16 – all SMEs | Starts | 2-5 yrs | 6-9 yrs | 10-15 yrs | 15 yrs+ |
|---|---|---|---|---|---|
| *Unweighted base:* | *1909* | *2062* | *2207* | *3130* | *9699* |
| Inject personal funds – you chose to do to help the business grow and develop | 28% | 19% | 14% | 10% | 9% |
| Inject personal funds – you felt you had no choice about this, that you had to do it | 19% | 15% | 9% | 13% | 10% |
| *Any personal funds* | *47%* | *34%* | *23%* | *23%* | *19%* |
| Not something you have done | 53% | 66% | 77% | 77% | 81% |

Q15d All SMEs from Q2 2012

Starts have always been more likely to report an injection of funds than older businesses but the proportion has declined somewhat over time. In 2012, 68% of Starts reported receiving an injection of funds, compared to 43% in 2015. The 47% reported for YEQ2 2016 shows a slight increase in that figure, across both those choosing to inject funds and those feeling they had to.

Those using a *personal* account for their business banking were somewhat more likely to have put personal funds in at all (37% v 26% of those with a business account) and to have felt that they had to do so (16% of SMEs with a personal account, 12% with a business account).

SMEs currently using external finance were more likely to have received an injection of personal funds (35% YEQ2 2016) than those not currently using external finance (25%) and were also more likely to say they had felt that there had been no choice (19% v 10%).

Analysed by their overall financial behaviour in the previous 12 months, the Would-be seekers (who had wanted to apply for loan or overdraft finance but felt that something had stopped them) remained clearly more likely to have received an injection of personal funds (and to have felt that they had no choice):

| **Personal funds in last 12 months**<br>YEQ2 16 – all SMEs | Total | Had an event | Would-be seeker | Happy non-seeker |
|---|---|---|---|---|
| *Unweighted base:* | *19,007* | *3956* | *450* | *14,601* |
| Inject personal funds – you chose to do to help the business grow and develop | 15% | 17% | 23% | 15% |
| Inject personal funds – you felt you had no choice about, that you had to do | 13% | 23% | 38% | 10% |
| *Any personal funds* | *28%* | *40%* | *61%* | *25%* |
| Not something you have done | 72% | 60% | 39% | 75% |

Q15d All SMEs

As already reported, the proportion of SMEs that had seen an injection of funds has declined overall, from 43% when the question was first asked in 2012 to 27% for YEQ2 2016.

- This was also true amongst those that have had a borrowing event (from 52% to 40% for YEQ2 2016) and amongst Happy non-seekers (37% to 25%)
- However, there has been no such decline amongst the small group of Would-be seekers of finance, from 62% in 2012 to 61% YEQ2 2016 and this group is now much more likely than SMEs generally to have seen an injection of personal funds.

Additional data on whether these SMEs had been turned down by a bank (or thought that they would be), the amount of funds injected and whether this was a long or short term investment is not currently being gathered.

## Use of personal accounts and accounts at other banks

Most SMEs used a business bank account (80% excluding DK answers).

Of the 20% that used a personal account, almost all (94%) were 0 employee businesses. Excluding those with 0 employees reduces the proportion of remaining SMEs with a personal account to 5%.

SMEs more likely to be using a personal account included those in the Health sector (30%), Starts (27%) and those with a worse than average risk rating (27%).

In most years around 1 in 5 SMEs has used a personal account, the exception being 2014 when 14% of SMEs used them, compared to 20% YEQ2 2016. This latest increase was primarily due to an increase in 0 employee SMEs using such accounts (18% to 25%). Amongst those with employees, usage remained low (3% to 5%).

YEQ2 2016, SMEs using a personal account were:

- less likely to be using external finance (27% used external finance, compared to 39% using a business account) and less likely to have applied for new or renewed facilities (4% versus 7%)
- more likely to have put personal funds into the business (37% v 26% of those with a business account) and to be a Permanent non-borrower (54% v 44%)

In H1 2016, 98% of SMEs reported that they only used one bank for their business banking, with little difference by size. Multi-banking remains rare in this market:

| **Use one bank**<br>Over time - row percentages | 2012 | 2013 | 2014 | 2015 | H1 2016 |
|---|---|---|---|---|---|
| All | 99% | 99% | 99% | 98% | 98% |
| 0 emps | 99% | 99% | 99% | 99% | 99% |
| 1-9 emps | 98% | 99% | 98% | 98% | 98% |
| 10-49 emps | 97% | 98% | 97% | 97% | 97% |
| 50-249 emps | 97% | 98% | 97% | 98% | 98% |

## The ‘interweaving’ of business and personal funds

A number of questions explore the use of personal funds and/or personal borrowing by SMEs and details are provided in the relevant chapters. For YEQ2 2016, 4 in 10 SMEs (44%) reported having one or more of these personal ‘elements’ to their business. This is in line with 2014 and 2015 (both 42%) but lower than in 2012 (54%) and 2013 (53%), as fewer smaller SMEs with less than 10 employees say that they have any personal element to their business. The table below shows how smaller SMEs, those with a worse than average risk rating and those in the Health sector remaining the most likely to have a personal element to their business:

| **Had any personal element**<br>Row percentages | YEQ2 16 |
|---|---|
| All SMEs | **44%** |
| 0 employee | 48% |
| 1-9 employees | 33% |
| 10-49 employees | 18% |
| 50-249 employees | 10% |
| Minimal external risk rating | 26% |
| Low external risk rating | 27% |
| Average external risk rating | 41% |
| Worse than average external risk rating | 52% |
| Agriculture | 41% |
| Manufacturing | 38% |
| Construction | 46% |
| Wholesale/Retail | 38% |
| Hotels & Restaurants | 43% |
| Transport | 44% |
| Property/Business Services etc. | 43% |
| Health | 47% |
| Other Community | 48% |

Excluding SMEs with no employees reduces the proportion of remaining SMEs with a personal element to their business to 30%.

## Recent applications for other forms of finance

The majority of this report focuses on activity around loans and overdrafts. For a complete picture of external finance applications in the 12 months prior to interview, an overview is provided below of applications for other forms of funding and the extent to which these were successful.

As reported elsewhere, amendments were made to the answer codes for Q1 2014, splitting the loans/equity codes into loans from friends and family/directors and equity from friends and family/directors. These can now be reported as the new codes.

Overall a small minority of SMEs had applied for other forms of finance and this is stable over time, with larger SMEs more likely to have applied, notably for leasing:

| **Other finance applied for** | Total | | Applied for | | | |
|---|---|---|---|---|---|---|
| YEQ2 16 – all SMEs | Applied | % success | 0 emp | 1-9 emps | 10-49 emps | 50-249 emps |
| *Unweighted base:* | *19,007* | *varies* | *3800* | *6203* | *6103* | *2901* |
| Leasing/Hire purchase/vehicle finance | 5% | 94% | 3% | 7% | 13% | 13% |
| Credit cards | 3% | 89% | 3% | 4% | 7% | 6% |
| Loans from family/friends or directors | 3% | 90% | 2% | 5% | 4% | 2% |
| Grants | 2% | 65% | 2% | 3% | 5% | 5% |
| Equity from family/friends or directors | 1% | 79% | 1% | 2% | 2% | 2% |
| Invoice finance | 1% | 80% | 1% | 2% | 4% | 5% |
| Loans from other 3rd parties | 1% | 67% | 1% | 2% | 2% | 2% |
| *Any of these* | *12%* | - | *9%* | *17%* | *24%* | *23%* |

Q222 All SMEs

Most applicants for most types of funding were successful, with larger SMEs (10-249 employees) that applied generally more likely to be successful. Success rates in 2015 have typically been somewhat higher that in 2014.

SMEs that are companies were also asked about equity from other third parties. 1% had applied for such finance.

In a series of questions asked for the first time in 2015 respondents were asked in more detail about these other forms of finance:

Applications for other forms of finance YEQ2 2016

| | |
|---|---|
| Net applications for facilities | 12% reported an application for one or more of these other forms of finance. As the next chapter reports, 6% of SMEs interviewed YEQ2 2016 reported that they had made an application for a new or renewed loan or overdraft facility (not including any automatically renewed facility).<br>Putting the two together increases the proportion making *any* application to 16% (30% when the PNBs are excluded).<br>This has declined from 21% in 2012 due to fewer loan and overdraft applications – applications for these other forms of finance have been more stable (14% in 2012, 13% in both 2014 and 2015). |
| Other applications | For YEQ2 2016, <1% of SMEs said that they had applied for some other form of finance not listed, half successfully and half unsuccessfully. The type of finance applied for is not recorded. |
| Identifying additional Would-be seekers of other forms of finance | From Q3 2015, SMEs who had not sought any of these forms of finance (whether from the list specified or any other source as above) were asked whether they had wanted to apply for any of them but had felt that something had stopped them.<br>88% of SMEs *qualified* for this question for YEQ2 2016 because they had not applied for any additional form of external finance (90% of those with 0 employees to 75% of those with 10-49 or 50-249 employees). |
| Would-be seekers of other forms of finance | 2% of these SMEs went on to say that something had stopped them applying for an additional form of finance (3% for 0 employee SMEs, 1% for those with 10-49 or 50-249 employees).<br>This is the equivalent of 2% of all SMEs – the potential impact on the proportion of Would-be seekers overall is explored in Chapter 11. |
| Net users of finance | Taking all loan/overdraft events (including automatic renewal of overdrafts) and the applications for these other types of finance together for YEQ2 2016 showed that:<br>- Most SMEs (77%), reported neither a loan/overdraft 'event' nor an application for any of the types of finance listed above<br>- 12% reported a loan/overdraft event, but had not applied for other forms of finance<br>- 8% had applied for other forms of finance but did not report a loan/overdraft event<br>- 3% reported both a loan/overdraft event and applying for one of these forms of finance |

## Use of trade credit

Data has been gathered on the extent to which SMEs use trade credit from their suppliers and the impact it has on their use of, or need for, external finance.

YEQ2 2016, 32% of SMEs regularly purchased products or services from other businesses on credit and this has changed very little over time. Use of trade credit increased by size of SME:

- 26% of those with 0 employees regularly purchased on credit
- 45% of those with 1-9 employees
- 59% of those with 10-49 employees
- 58% of those with 50-249 employees

Those using external finance (loans, overdrafts etc) were more likely to be using trade credit (43%) than those who were not using any external finance (24%).

From Q3 2014 to Q4 2015 questions were also included to explore the extent to which SMEs offered trade credit to their customers but these no longer form part of the questionnaire. When this was last asked for YEQ4 2015, 32% said that they did so, again with variation by size of SME:

- 28% of those with 0 employees offer trade credit to their customers
- 42% of those with 1-9 employees
- 59% of those with 10-49 employees
- 62% of those with 50-249 employees

SMEs that received trade credit were asked whether having this trade credit meant that they had a reduced need for other forms of external finance. Two thirds of them did and this is the equivalent of 22% of all SMEs needing less external finance, as the table below shows:

| **Impact of receiving trade credit**<br>YEQ2 16 – all SMEs | Total | 0 emp | 1-9 emps | 10-49 emps | 50-249 emps |
|---|---|---|---|---|---|
| *Unweighted base:* | *19,007* | *3800* | *6203* | *6103* | *2901* |
| Receive trade credit | 32% | 26% | 45% | 59% | 58% |
| *Have less of a need for external finance* | *22%* | *18%* | *30%* | *40%* | *37%* |
| *Do not have less of a need for external finance* | *9%* | *7%* | *13%* | *15%* | *16%* |
| *Not sure* | *1%* | *1%* | *2%* | *4%* | *5%* |
| Do not receive trade credit | 68% | 74% | 55% | 41% | 42% |
| *% of those with TC where it reduces need* | *69%* | *69%* | *67%* | *68%* | *64%* |

Q14y/y4 All SMEs from Q3 2014

YEQ2 2016, SMEs currently using external finance (who are more likely to be using trade credit) were also more likely to say that they had less of a need for external finance as a result (31%) than those not using external finance (16%) or SMEs overall (22%).

SMEs with a minimal or low external risk rating were more likely to receive trade credit. Around two thirds of those receiving trade credit in each risk rating band said that it reduced their need for external finance:

| **Impact of receiving trade credit**<br>YEQ2 16 – all SMEs | Total | Min | Low | Avge | Worse/ Avge |
|---|---|---|---|---|---|
| *Unweighted base:* | *19,007* | *2965* | *5907* | *4231* | *4276* |
| Receive trade credit | 32% | 43% | 46% | 34% | 26% |
| *Have less of a need for external finance* | *22%* | *29%* | *31%* | *24%* | *18%* |
| *Do not have less of a need for external finance* | *9%* | *12%* | *13%* | *9%* | *7%* |
| *Not sure* | *1%* | *2%* | *1%* | *1%* | *1%* |
| Do not receive trade credit | 68% | 57% | 54% | 66% | 74% |
| *% of those with TC where it reduces need* | *69%* | *67%* | *67%* | *71%* | *69%* |

Q14y/y4 All SMEs from Q3 2014

Older SMEs were also more likely to be receiving trade credit and overall a quarter said it reduced their need for trade credit:

| **Impact of receiving trade credit**<br>YEQ2 16 – all SMEs | Starts | 2-5 yrs | 6-9 yrs | 10-15 yrs | 15 yrs+ |
|---|---|---|---|---|---|
| *Unweighted base:* | *1909* | *2062* | *2207* | *3130* | *9699* |
| Receive trade credit | 22% | 27% | 27% | 35% | 39% |
| *Have less of a need for external finance* | *14%* | *19%* | *21%* | *25%* | *26%* |
| *Do not have less of a need for external finance* | *7%* | *7%* | *6%* | *9%* | *12%* |
| *Not sure* | *1%* | *1%* | *1%* | *1%* | *2%* |
| Do not receive trade credit | 78% | 73% | 73% | 65% | 61% |
| *% of those with TC where it reduces need* | *64%* | *70%* | *78%* | *71%* | *67%* |

Q14y/y4 All SMEs from Q3 2014

SMEs in the Manufacturing or Wholesale/Retail sectors were the most likely to receive trade credit:

**Trade credit in last 12 months**

| YEQ2 16 – all SMEs | Agric | Mfg | Constr | Whle Retail | Hotel Rest | Trans | Prop/ Bus | Hlth SWrk | Other Comm |
|---|---|---|---|---|---|---|---|---|---|
| *Unweighted base:* | *1350* | *1790* | *3349* | *1912* | *1500* | *1909* | *3550* | *1645* | *2002* |
| Receive TC | 35% | 47% | 40% | 46% | 33% | 22% | 25% | 18% | 24% |
| *Have less of a need for external finance* | *23%* | *34%* | *30%* | *31%* | *21%* | *13%* | *16%* | *12%* | *15%* |
| *Do not have less of a need for external finance* | *11%* | *11%* | *8%* | *13%* | *11%* | *7%* | *8%* | *5%* | *8%* |
| *Not sure* | *1%* | *2%* | *1%* | *2%* | *2%* | *2%* | *1%* | *** | *1%* |
| Do not receive TC | 65% | 53% | 60% | 54% | 67% | 78% | 75% | 82% | 76% |
| *% where TC reduces need* | *66%* | *72%* | *75%* | *67%* | *64%* | *59%* | *64%* | *67%* | *63%* |

Q14y/y4 All SMEs from Q3 2014

## The non-borrowing SME

As this chapter has already reported, just over a third of SMEs (36% YEQ2 2016) currently use external finance. Other data from this report allows for identification of those SMEs who seem firmly disinclined to borrow, defined as those that meet **all** of the following conditions:

- Are not currently using external finance
- Have not used external finance in the past 5 years
- Have had no loan or overdraft borrowing events in the past 12 months
- Have not applied for any other forms of finance in the last 12 months
- Said that they had had no desire to borrow in the past 12 months
- Reported no inclination to borrow in the next 3 months

These Permanent non-borrowers make up 46% of SMEs (YEQ2 2016), and were more likely to be found amongst the smaller SMEs:

- 50% of 0 employee SMEs met this non-borrowing definition
- 36% of 1-9 employee SMEs
- 29% of 10-49 employee SMEs
- 27% of 50-249 employee SMEs

Amongst SMEs with employees, 35% met the definition of a Permanent non-borrower.

Half of SMEs in the Health (55%) or Property/Business Services (51%) sectors met the definition of a Permanent non-borrower. Those with an above average risk rating (49%) or using a personal account for their business banking (54%) were also somewhat more likely to meet the definition. This means that the equivalent of 11% of all SMEs are Permanent non-borrowers who use a personal account.

In the second half of 2015, the proportion meeting the definition of a PNB declined slightly due to fewer of the smaller SMEs meeting the definition, but this trend has not been maintained into 2016. Amongst larger SMEs the proportion of PNBs is lower and more stable over time:

**Permanent non-borrowers**

| Over time – all SMEs<br>Row percentages | Q2 2014 | Q3 2014 | Q4 2014 | Q1 2015 | Q2 2015 | Q3 2015 | Q4 2015 | Q1 2016 | Q2 2016 |
|---|---|---|---|---|---|---|---|---|---|
| *All SMEs* | *39%* | *40%* | *47%* | *48%* | *49%* | *46%* | *43%* | *49%* | *47%* |
| 0 employee | 42% | 44% | 51% | 53% | 53% | 50% | 47% | 52% | 52% |
| 1-9 employees | 31% | 29% | 39% | 36% | 38% | 36% | 33% | 42% | 34% |
| 10-49 employees | 27% | 23% | 31% | 29% | 28% | 30% | 29% | 28% | 28% |
| 50-249 employees | 23% | 22% | 28% | 29% | 26% | 29% | 28% | 27% | 24% |

If these PNBs are excluded from the 'use of external finance' table, the proportion using external finance increases to 7 in 10 of the remaining SMEs:

**Use of external finance in last 5 years**

| Over time – all SMEs excl PNBs<br>By date of interview | Q2 2014 | Q3 2014 | Q4 2014 | Q1 2015 | Q2 2015 | Q3 2015 | Q4 2015 | Q1 2016 | Q2 2016 |
|---|---|---|---|---|---|---|---|---|---|
| *Unweighted base:* | *3514* | *3576* | *3153* | *3220* | *3195* | *3258* | *3338* | *2854* | *3008* |
| Use now | 64% | 66% | 68% | 70% | 71% | 66% | 71% | 64% | 69% |
| Used in past but not now | 5% | 4% | 5% | 5% | 6% | 7% | 4% | 5% | 5% |
| Not used at all | 31% | 29% | 27% | 25% | 23% | 27% | 24% | 31% | 26% |

Q14/15 All SMEs

The table below looks at the long term changes in the proportion of SMEs meeting the definition of a PNB by key business demographics. Between 2012 and 2015 the proportion of PNBs increased from a third to a half of all SMEs. Smaller SMEs have always been more likely to meet the definition of a PNB but the proportion of the largest SMEs that are PNBs has almost doubled since 2012:

| **Permanent non-borrowers**<br>Over time – all SMEs<br>Row percentages | 2012 | 2013 | 2014 | 2015 | H1 2016 |
|---|---|---|---|---|---|
| All | 34% | 40% | 43% | 47% | 48% |
| 0 emp | 37% | 44% | 48% | 51% | 52% |
| 1-9 emps | 25% | 28% | 33% | 36% | 38% |
| 10-49 emps | 18% | 22% | 26% | 29% | 28% |
| 50-249 emps | 15% | 17% | 26% | 28% | 26% |
| Minimal external risk rating | 31% | 37% | 41% | 41% | 42% |
| Low | 29% | 35% | 44% | 38% | 43% |
| Average | 36% | 40% | 45% | 45% | 48% |
| Worse than average | 34% | 40% | 43% | 51% | 50% |
| Agriculture | 26% | 37% | 40% | 41% | 42% |
| Manufacturing | 32% | 41% | 42% | 43% | 46% |
| Construction | 33% | 41% | 45% | 52% | 45% |
| Wholesale/Retail | 26% | 32% | 34% | 38% | 41% |
| Hotels & Restaurants | 28% | 33% | 39% | 40% | 42% |
| Transport | 29% | 33% | 40% | 44% | 45% |
| Property/ Business Services | 38% | 43% | 46% | 48% | 55% |
| Health | 47% | 52% | 54% | 51% | 59% |
| Other | 37% | 38% | 46% | 47% | 45% |

All SMEs

As already reported, the proportion of all SMEs using external finance has decreased over time, while the proportion that meet the definition of a PNB has increased. The table below shows that the relationship between these two elements is different over time for those with employees to those without:

**Use of external finance and PNBs**

| Over time<br>Row percentages | 2012 | 2013 | 2014 | 2015 | H1<br>2016 |
|---|---|---|---|---|---|
| 0 employees: | | | | | |
| • Use external finance | 38% | 35% | 32% | 32% | 29% |
| • Permanent non-borrower | 37% | 44% | 48% | 51% | 52% |
| All with employees | | | | | |
| • Use external finance | 59% | 57% | 51% | 51% | 49% |
| • Permanent non-borrower | 24% | 27% | 32% | 35% | 36% |

All SMEs from 2012

Amongst 0 employee SMEs, the proportion using external finance and the proportion that met the definition of a PNB were the same in 2012. Since then, use of external finance has decreased, and the proportion meeting the definition of a PNB has increased such that in 2015 there was a 19 percentage point gap between the two figures (32% were using external finance while 51% met the definition of a PNB). Early indications for 2016 are that the gap has increased slightly again to 23 points as use of external finance reduced.

For SMEs with employees, in 2012 twice as many were using external finance (59%) as met the definition of a PNB (24%). Since then there has been a decline in the proportion using external finance, and an increase in those meeting the definition of a PNB. As a result, the gap reduced from 35 to 16 percentage points by the end of 2015 and early indications for 2016 are that the gap has narrowed again to 13 points as use of external finance reduced.

PNBs are now a major influence on the overall position of SMEs on access to finance. Additional analysis has therefore been conducted, to understand the types of SME that fit the PNB definition.

The table below summarises the differences between PNBs and other SMEs on a range of key measures. PNBs are as likely to be profitable and almost as likely to hold £10,000 or more in credit balances. However, they remain less likely to be international, to innovate or to be planning to grow:

| **PNBs** | Further analysis YEQ2 2016 |
|---|---|
| Made a profit | PNBs were slightly more likely to have made a profit in the previous 12 months (82%) than non-PNBs (79%). Over time the proportion making a profit has increased in both groups – in 2012 74% of PNBs reported making a profit compared to 66% of non-PNBs – but the gap between them has narrowed. |
| Hold £10k+ in credit balances | 21% of PNBs held more than £10,000 in credit balances, compared to 25% of those who were not PNBs. Over time the proportion holding £10,000 or more has increased in both groups – in 2012 17% of PNBs reported holding such a sum compared to 16% of non-PNBs. |
| Minimal/Low external risk rating | 20% of PNBs were rated a minimal or low risk, compared to 25% of non-PNBs. Over time the proportion with a minimal or low risk rating has increased in both groups – in 2012 14% of PNBs had such a rating compared to 17% of non-PNBs. |
| International | PNBs were less likely to import and/or export. 13% were international compared to 20% of non-PNBs. This proportion has increased more slowly over time for PNBs (7% were international in 2012) compared to non-PNBs (12% in 2012). |
| Innovation | PNBs were less likely to have innovated (32%) than non-PNBs (42%). Neither group has changed much over time. In 2012, 33% of PNBs and 43% of non-PNBs innovated. |
| Ambition | 38% of PNBs planned to grow in the coming 12 months compared to 52% of non-PNBs. Since 2012, the proportion of PNBs planning to grow has varied between 37% and 43% with no clear pattern over time. For non-PNBs, 47% were planning to grow in 2012 but since then 51-52% have planned to grow each year. |
| Mentors | In a question asked for the first time in 2016, 10% of PNBs said they had a mentor to help the business, slightly lower than the 13% of non-PNBs with a mentor. |

To explore this further, and to understand which factors in combination predicted a PNB, further detailed (CHAID) analysis was undertaken for the Q2 2015 report. All the usual business demographic variables (size, sector, region, growth, profitability etc) were included.

In summary, this showed that the best predictor of being a PNB was turnover. Other common themes seen across size bands, showed that SMEs were more likely to be a PNB if:

- ‘Access to Finance’ was not seen as a barrier
- They had not had a self-reported credit issue (such as a bounced cheque)
- They did not receive trade credit
- They had not put personal funds into the business
- They had not experienced a previous decline from a bank
- They held higher credit balances
- ‘Cash flow and late payment’ was not rated as a barrier

This highlights that being a PNB is linked to already having enough funds within the business. These PNBs are not using external finance but neither are they likely to be using trade credit or to have injected personal funds (which are outside the PNB definition) and nor is cash flow or late payment causing them issues.

These PNBs have indicated that they are unlikely to be interested in borrowing, based on their current views. At various stages in this report, therefore, we have provided an alternative to the ‘All SME’ figure, which excludes these Permanent non-borrowers and provided an alternative figure that might be described as ‘All SMEs with a *potential* interest in external finance’.

## A wider definition of 'Total business funding'

The Permanent non-borrowers described in the previous section are defined by their non-use of, or appetite for, external finance (loans, overdrafts etc), and that definition will be maintained to provide consistent analysis over time.

The addition of the questions on trade credit does, though, allow for an analysis of the use of 'total business funding' by SMEs in a wider sense, i.e. including both trade credit received and injections of personal funds. Note that the amount of trade credit received is not recorded, and that when last asked, the typical injection of personal funds was for a relatively small amount (often less than £5,000).

For YEQ2 2016:

- 36% of SMEs were using **external finance** as defined earlier in this chapter (i.e. loans, overdrafts, invoice finance etc).
- An additional 15% of SMEs were not using external finance but were receiving **trade credit**
- And finally, a further 12% of SMEs were using neither external finance, nor trade credit, but had seen an **injection of personal funds** into the business

Widening the definition of external funding to include not only finance but also trade credit and personal funds thus increases the proportion of SMEs using business funding from 36% to 63% and this has changed very little for the period for which this data is available, as the table below shows:

| **Use of business funding**<br>Over time – all SMEs | 2014 | 2015 | H1 2016 |
|---|---|---|---|
| *Unweighted base:* | *20,055* | *20,046* | *9000* |
| Use external finance | 37% | 37% | 34% |
| Do not use finance but do use trade credit | 15% | 16% | 16% |
| Do not use the above but injected personal funds | 12% | 11% | 12% |
| *Total business funding* | *63%* | *64%* | *62%* |

Q15d All SMEs from Q2 2012

Looking specifically at YEQ2 2016 in more detail, there remained a bigger 'uplift' amongst smaller SMEs when this wider business funding definition was applied:

| **Wider definition of business funding**<br>YEQ2 16 – all SMEs | Total | 0 emp | 1-9 emps | 10-49 emps | 50-249 emps |
|---|---|---|---|---|---|
| *Unweighted base:* | *19,007* | *3800* | *6203* | *6103* | *2901* |
| Use external finance | 36% | 31% | 49% | 60% | 62% |
| Do not use finance but do use trade credit | 15% | 15% | 18% | 18% | 16% |
| Do not use the above but injected personal funds | 12% | 14% | 7% | 1% | 1% |
| *Total business funding* | *63%* | *60%* | *74%* | *80%* | *79%* |

Q14y/y4 All SMEs from Q3 2014

The proportion using business funding did not vary as much by age of business (56-67%) as by size of business (60-79%). Whilst 0 employee SMEs were the least likely to be using business funding, analysis by age of business showed that Starts were somewhat more likely to be using business funding than older SMEs and saw a much greater uplift between use of external finance and total business funding (28% to 67%).

By sector, the proportion using business funding varied from 53% of those in the Health sector to 73% of those in Manufacturing.

PNBs by their very definition are not currently using external finance. Adding use of trade credit and injections of personal funds results in 37% of PNBs using any business funding. If those who had injected personal funds and/or used trade credit were excluded from the PNB definition, the proportion of PNBs would reduce from 47% to 29% of all SMEs.

For those that do not meet the definition of a PNB, the uplift is from 68% of these SMEs using external finance to 86% using business funding.

## Attitudes to finance

Since Q3 2014 an increasing number of attitudinal statements have been included in the SME Finance Monitor to explore demand for finance amongst SMEs. Most recently, two statements were added in Q1 2016 and are reported for the first time here.

The first two statements below have been asked consistently since Q3 2014. In the latest period, YEQ2 2016, 7 in 10 SMEs agreed that their aim was to pay down debt and then remain debt free if possible, with little variation by size:

**"Our aim as a business is to repay any existing finance (eg on loan or overdraft) and then remain debt free if possible"**

| YEQ2 16 – all SMEs | Total | 0 emp | 1-9 emps | 10-49 emps | 50-249 emps |
|---|---|---|---|---|---|
| *Unweighted base:* | *19,007* | *3800* | *6203* | *6103* | *2901* |
| Strongly agree | 38% | 38% | 39% | 34% | 30% |
| Agree | 33% | 32% | 35% | 38% | 39% |
| Neither/nor | 20% | 21% | 17% | 18% | 20% |
| Disagree | 6% | 6% | 6% | 7% | 8% |
| Strongly disagree | 3% | 3% | 3% | 3% | 3% |
| *Total 'Agree'* | *71%* | *70%* | *74%* | *72%* | *69%* |

Q238a5 All SMEs from Q3 2014

Amongst those with employees, agreement with this statement was 74%. Amongst those currently using external finance it was 79% (v 66% amongst those not using external finance).

By sector the most likely to agree with the statement were those in Agriculture or Wholesale/Retail (both 75%) while the least likely to agree were those in the Health or Transport sectors (both 66%). There was little variation in levels of agreement by external risk rating or age of business.

The second long-standing statement (from Q3 2014) saw just under half of SMEs agreeing that they were happy to use external finance to help the business grow, increasing by size of SME:

**"As a business we are happy to use external finance to help the business grow and develop"**

| YEQ2 16 – all SMEs | Total | 0 emp | 1-9 emps | 10-49 emps | 50-249 emps |
|---|---|---|---|---|---|
| *Unweighted base:* | *19,007* | *3800* | *6203* | *6103* | *2901* |
| Strongly agree | 11% | 11% | 13% | 14% | 13% |
| Agree | 33% | 31% | 37% | 41% | 41% |
| Neither/nor | 20% | 19% | 19% | 23% | 27% |
| Disagree | 25% | 26% | 21% | 18% | 14% |
| Strongly disagree | 11% | 13% | 9% | 5% | 4% |
| *Total 'Agree'* | *44%* | *42%* | *50%* | *55%* | *54%* |

Q238a5 All SMEs from Q3 2014

Willingness to use external finance was higher amongst larger SMEs overall. Amongst those with any employees, agreement with this statement was 51%. Other groups more likely to agree included those in the Agricultural sector (51%). Previous analysis revealed that a key predictor of being prepared to use finance to grow was to be already using external finance and amongst those using finance, 57% agreed with this statement, compared to 37% of those not currently using external finance.

Those planning to grow were more likely to agree with this statement (52%) than those not planning to grow (38%).

To understand this willingness to use external finance in more detail, additional analysis has been undertaken on this question.

The table below allocates all SMEs to one of four categories, depending on whether they are currently using external finance and whether they agreed that they would be willing to use external finance in future to help the business develop and grow:

**Combined analysis: Use of external finance and willingness to use in future**

| YEQ2 16 – all SMEs | Total | 0 emp | 1-9 emps | 10-49 emps | 50-249 emps |
|---|---|---|---|---|---|
| *Unweighted base:* | *19,007* | *3800* | *6203* | *6103* | *2901* |
| Use external finance and willing to use in future | 20% | 17% | 30% | 37% | 42% |
| Use external finance but not willing to use in future | 16% | 14% | 19% | 22% | 25% |
| Do not use it but willing to | 24% | 25% | 21% | 16% | 17% |
| Do not use it and not willing to | 40% | 44% | 30% | 23% | 25% |

Q15/Q238a5 All SMEs

It shows that:

- 1 in 5 SMEs (20%) were currently using finance and agreed that they would be willing to use it in future, increasing by size of SME to 42% of those with 50-249 employees.
- The remaining users of finance (16% of all SMEs) did not agree that they would be willing to use finance in future (the equivalent of 44% of all users of finance).
- A quarter of all SMEs (24%) were not using external finance but agreed that they would be willing to use it to help the business develop and grow.
- The remainder, 4 in 10 SMEs, were non-users who would not be willing to use finance and this was more common amongst 0 employee SMEs (44% compared to 25% of those with 50-249 employees). Three quarters of this group met the definition of a PNB.

As has already been stated, analysis in Q4 2015 showed that use of external finance was a key predictor of willingness to use finance in the future.

- Amongst those using external finance, willingness to use it again increased further if they were planning to grow and/or they had the characteristics of larger SMEs (a limited company, 50-249 employees or turnover £2-25m).
- Amongst those not currently using external finance, willingness to use it in future increased if the owner/MD was aged under 30 and they were planning to grow by 20% or more.

From Q3 2015 another statement explored demand for finance further: "Our current plans for the business are based entirely on what we can afford to fund ourselves". As the table below shows, 8 in 10 SMEs agreed with this statement, decreasing by size:

**"Our current plans for the business are based entirely on what we can afford to fund ourselves"**

| YEQ2 16 – all SMEs | Total | 0 emp | 1-9 emps | 10-49 emps | 50-249 emps |
|---|---|---|---|---|---|
| *Unweighted base:* | *19,007* | *3800* | *6203* | *6103* | *2901* |
| Strongly agree | 40% | 42% | 37% | 28% | 24% |
| Agree | 40% | 39% | 42% | 42% | 41% |
| Neither/nor | 11% | 11% | 12% | 16% | 21% |
| Disagree | 7% | 6% | 8% | 11% | 13% |
| Strongly disagree | 2% | 2% | 2% | 2% | 2% |
| *Total 'Agree'* | *80%* | *81%* | *79%* | *70%* | *65%* |

Q238a5 All SMEs from Q3 2015

Amongst those with employees, 77% agreed with this statement. Agreement with this statement did not vary much by whether the SME was currently using external finance or not (79% v 81%). There was little variation by age of business (79-82%) and only a slight increase by risk rating (77% if have a minimal risk rating to 82% if have a worse than average risk rating).

Two further demand related statements were added from Q1 2016 and are reported for the first time here. Both show levels of agreement declining slightly by size:

**"We never think about whether we could/should use more external finance"**

| H1 16 – all SMEs | Total | 0 emp | 1-9 emps | 10-49 emps | 50-249 emps |
|---|---|---|---|---|---|
| *Unweighted base:* | *9000* | *1800* | *2900* | *2900* | *1400* |
| Strongly agree | 15% | 15% | 13% | 11% | 7% |
| Agree | 32% | 33% | 31% | 25% | 22% |
| Neither/nor | 23% | 23% | 24% | 29% | 35% |
| Disagree | 23% | 21% | 25% | 28% | 27% |
| Strongly disagree | 7% | 7% | 7% | 7% | 8% |
| *Total 'Agree'* | *47%* | *48%* | *44%* | *36%* | *29%* |

Q238a5 All SMEs from Q1 2016

**"We will accept a slower growth rate rather than borrowing to grow faster"**

| H1 16 – all SMEs | Total | 0 emp | 1-9 emps | 10-49 emps | 50-249 emps |
|---|---|---|---|---|---|
| *Unweighted base:* | *9000* | *1800* | *2900* | *2900* | *1400* |
| Strongly agree | 27% | 28% | 26% | 21% | 15% |
| Agree | 44% | 44% | 43% | 42% | 37% |
| Neither/nor | 19% | 19% | 20% | 23% | 33% |
| Disagree | 8% | 7% | 10% | 12% | 13% |
| Strongly disagree | 2% | 2% | 1% | 2% | 2% |
| *Total 'Agree'* | *71%* | *72%* | *69%* | *63%* | *52%* |

Q238a5 All SMEs from Q1 2016

Half of SMEs didn't think about using (more) finance in the business while 7 in 10 were prepared to accept slower growth that was self-funded. Amongst those with employees, 41% agreed that they never thought about using (more) external finance and 68% that they would accept a slower self-funded growth rate.

Those not currently using external finance were more likely to agree that they never thought about finance (50%) than those who were using finance (41%). However they were only slightly more likely (72%) than those who were using finance (69%) to agree about preferring self-funded growth.

Agreement with both statements was higher if the SMEs met the definition of a PNB (51% never thought about finance and 74% were prepared to accept slower self-funded growth).

There were no clear patterns by age or risk rating and those planning to grow in the next 12 months were just as likely to agree with these statements as their peers.

With the changes and additions made to these statements, analysis over time is somewhat limited, but is shown here for half year periods from H2 2014 where available for each statement:

| **Attitudes to finance**<br>Over time – all SMEs<br>All agreeing – row percentages | H2 2014 | H1 2015 | H2 2015 | H1 2016 |
|---|---|---|---|---|
| Repay existing finance and remain debt free | 71% | 74% | 75% | 67% |
| Happy to use finance to help business grow | 42% | 45% | 45% | 43% |
| Plans based on what can afford ourselves | - | - | 80% | 80% |
| Accept slower growth rather than borrow | - | - | - | 71% |
| Never think about using more external finance | - | - | - | 47% |

Q238a5 All SMEs from H214

This shows that a consistent 4 in 10 have agreed that they are happy to use external finance to help the business grow, but that more, around 7 in 10, would prefer to be debt free and/or would accept a slower growth rather than borrowing to grow faster.

Two final attitude statements cover other aspects of using external finance.

The second of the statements added in Q3 2015 was "If our bank were unable to help us with the finance we needed, we would be happy for them to pass on our request to an alternative lender". As the table below shows, 4 in 10 SMEs agreed with this statement, with relatively little variation by size:

**"If unable to help, happy for bank to pass on our request to an alternative lender"**

| YEQ2 16 – all SMEs | Total | 0 emp | 1-9 emps | 10-49 emps | 50-249 emps |
|---|---|---|---|---|---|
| *Unweighted base:* | *19,007* | *3800* | *6203* | *6103* | *2901* |
| Strongly agree | 10% | 9% | 11% | 9% | 8% |
| Agree | 30% | 28% | 33% | 34% | 32% |
| Neither/nor | 20% | 20% | 20% | 23% | 29% |
| Disagree | 26% | 27% | 25% | 24% | 23% |
| Strongly disagree | 14% | 15% | 12% | 9% | 9% |
| *Total 'Agree'* | *40%* | *37%* | *44%* | *43%* | *40%* |

Q238a5 All SMEs from Q3 2015

Amongst those with employees, 43% agreed with this statement. Those currently using external finance were more likely to agree with this statement (48%) than those who were not (34%).

Starts were the most willing to have their details passed on (46%), with agreement then declining by age of business to 35% for those trading for more than 15 years. There was less of a difference by external risk rating (37% if have a minimal risk rating to 41% if have a worse than average risk rating).

Finally, a statement amended in Q3 2015 concerning interest rates. Previously, 3 in 10 SMEs agreed that they would struggle if interest rates were to rise by 2% or more. The new statement asked whether they would struggle if their *cost of borrowing* were to increase by this amount. To reflect this, the table below is based just on those SMEs that are currently using external finance:

**"If our cost of borrowing were to increase by 2% or more, the business would be struggling"**

| YEQ2 16 – all SMEs using external finance | Total | 0 emp | 1-9 emps | 10-49 emps | 50-249 emps |
|---|---|---|---|---|---|
| *Unweighted base:* | *9876* | *1207* | *3101* | *3719* | *1849* |
| Strongly agree | 11% | 12% | 11% | 7% | 5% |
| Agree | 19% | 18% | 23% | 20% | 15% |
| Neither/nor | 22% | 22% | 21% | 23% | 24% |
| Disagree | 35% | 36% | 34% | 38% | 42% |
| Strongly disagree | 12% | 12% | 11% | 12% | 15% |
| *Total 'Agree'* | *30%* | *30%* | *34%* | *27%* | *20%* |

Q238a5 All SMEs from Q3 2015 using external finance

Amongst those using external finance 3 in 10 (30%) felt they would struggle if the cost of borrowing were to rise by 2% or more, declining slightly by size of SME to 20% of those with 50-249 employees.