
Business Finance 2003
IoD Policy Paper

Richard Wilson

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Contents

1	Introduction and summary	5
1.1	Introduction	5
1.2	The profile of respondents to our survey	6
1.3	Executive summary	7
2	Sources of business finance	13
3	Factors determining the choice of external finance	16
4	Information and advice	18
5	Accessibility of finance	20
6	Bank finance	22
6.1	Fixed term bank loans	22
6.2	Fixed and variable rate loans	22
6.3	Maturity of business loans	23
6.4	Date of most recent fixed term bank loans	24
6.5	Bank overdrafts	24
6.6	The cost of bank overdrafts	25
6.7	Lending conditions	26
6.8	Choice of bank finance	27
6.9	Business banking	28
6.10	Bank-firm relations	28
6.11	Customer loyalty	29
6.12	Switching banks	30
6.13	Reasons for not switching banks	31
6.14	Reasons for switching banks	32
6.15	Requests for bank finance	32
6.16	Reasons for the bank rejecting a request for finance	32
7	Cash deposits	34
7.1	The prevalence of cash deposits	34
7.2	The state of cash deposits	35
7.3	Reasons behind the increase in cash deposits	35
7.4	Plans for cash deposits	36

8	Equity Finance	37
8.1	Public equity markets	37
8.2	Stock market location	38
8.3	Propensity to raise equity finance through stock markets	38
8.4	Dates of rights issues	39
8.5	The propensity of IoD members to raise equity finance	39
8.6	Reasons for not wanting to raise equity finance	41
9	Conclusion	43

1 Introduction and summary

1.1 Introduction

As a generalisation, there does not appear to be much evidence to suggest that businesses are finding it difficult to raise finance. Certainly the economy faces a number of difficulties: manufacturing remains mired in recession¹; exporters are struggling as markets, especially in “euroland”, are weak²; and the build up of consumer debt has worrying implications for the economy.³ Nevertheless, the UK economy is still enjoying its longest period of continuous economic growth in the post-war period. Even in 2002 the economy is estimated to have grown by 1.7%.⁴ RPIX (Retail Price Index) Inflation, which excludes mortgage interest payments, may have been above the Government’s target of 2.5% at 2.7% in December 2002⁵, but it still remains subdued. Concomitantly, the Bank of England has been able to keep interest rates relatively low at 4% for fourteen months, before reducing them to 3.75% in February 2003. In these circumstances, it probably has not been too difficult for businesses to gain access to finance. Interestingly, a survey of 1,000 businesses with between 5-499 employees carried out by NOP in December 2002 revealed that just 19% considered that the issue of raising finance was preventing them from meeting their business objectives. The businesses surveyed were more concerned with the problems of economic uncertainty, recruiting and retaining staff, health and safety measures, training and development needs, European Community [sic] employment legislation, tax compliance, the threat of war/terrorism and other European Community [sic] legislation than they were with their ability to raise finance.⁶

Nevertheless, the provision of finance remains an important issue for consideration and is a matter of interest to the Institute of Directors (IoD). Accordingly, we commissioned NOP to conduct a survey of IoD members in order to ascertain their experiences and views on matters connected with business finance. The results of our survey are presented in this research paper.

¹ “Index of Production: December 2002” (London: National Statistics, February 7th 2003).

² See Richard Wilson, *The Foreign Markets, Business Performance and Trading Experiences of IoD Exporters in 2001-02* (Institute of Directors, January 2003) for a summary of some of these problems.

³ *United Kingdom. Country Report January 2003* (Economist Intelligence Unit, January 2003), p. 21.

⁴ “Gross Domestic Product. Preliminary Estimate - 4th Quarter 2002” (London: National Statistics, 24th January 2003).

⁵ “December Inflation Rate Up” (National Statistics, 10th February 2003).

⁶ *Quarterly Report on Entrepreneurial Britain. First Quarter 2003* (Tenon Forum, January 2003), p. 2.

1.2 The profile of respondents to our survey

NOP interviewed 500 IoD members on behalf of the IoD's Policy Unit in December 2002. The sample used and the number of interviews that took place were designed to reflect the composition of the IoD's membership in terms of firm size, economic sector and geographical location. The profile of those IoD members who took part in this survey is shown in Tables 1, 2 and 3.

1-20 employees	36% (180)
21-100 employees	32% (160)
101-200 employees	10% (50)
201 employees plus	22% (110)

Business and professional services	32% (160)
Manufacturing	21% (105)
Financial services	13% (65)
Government, education, health and personal services	12% (60)
Distribution	11% (55)
Other (including construction, mining and transport)	11% (55)

North	23% (115)
Midlands	19% (95)
South	58% (290)

Where important differences appear between the answers of IoD members in general and the answers of IoD members from a particular category of firm size, economic sector, or geographical location, these are highlighted.

The IoD Policy Unit previously commissioned NOP to conduct surveys of IoD members on the subject of business finance in December 2001 and in December 2002 and the results were published in the research papers, *Business Finance 2001* (Institute of Directors, March 2001) and *Business Finance 2002* (Institute of Directors, January 2002). Significant differences and similarities in the findings of this research paper and the findings published in *Business Finance 2001* and *Business Finance 2002* are noted at the appropriate points in the text.

⁷ Percentages are rounded throughout this research paper.

⁸ In this survey, the "North" covers respondents from Scotland, North/North West, Yorkshire & Humberside and Northern Ireland. The "Midlands" encompasses respondents from the East Midlands, East Anglia, the West Midlands and Wales. The "South" covers respondents from the South East, Greater London and the South West.

1.3 Executive summary

Sources of business finance

Retained profits/own finance/cash flow was used by 51% (251) of the directors in our survey to finance their business activities. The next most commonly used types of finance were bank overdrafts and fixed term bank loans, which were used by 50% (243) and 28% (136) of those surveyed, respectively.

Factors determining the choice of external finance

Unsurprisingly, 92% (262) of those directors in our survey who used external finance said that they regarded cost to be either a very important factor or an important factor when determining their choice of external capital. The same proportion of directors also considered that the maintenance of business control was either very important or important when selecting external finance.

Information and advice

56% (272) of IoD members in our survey contacted their banks for financial information and advice and 28% (137) looked to their accountant. 18% (90) of members also received advice on finance from personnel within their own business.

Accessibility of finance

69% (336) of the directors interviewed in our survey did not think that it was difficult to get access to finance for their business, 25% (123) thought that it was and 6% (29) did not know.

In *Business Finance 2002*, 74% of directors did not think that it was difficult to get access to finance for their business, 18% thought that it was and 8% did not know.

In *Business Finance 2001*, 78% of IoD members did not think that it was a problem to get access to finance, 17% thought that it was and 5% did not know.

Fixed term bank loans

28% (136) of the directors in our survey stated that their business had bank loans.

Fixed and variable rate loans

35% (48) of the IoD members in our survey who had fixed term loans from a bank only possessed loans with a fixed rate of interest and 34% (46) only had loans with variable rates of interest. 27% (37) used a mixture of fixed term bank loans with fixed rates and variable rates of interest.

Maturity of business loans

For 10% (14) of IoD members with fixed term bank loans, the length of maturity of their most recent loan when they originally took it out was less than three years and for 42% (57) of members the length of maturity was between three and five years.

Date of most recent fixed term bank loans

26% (35) of IoD members with fixed term bank loans took out their most recent loan between 1997 and 1999, while 55% (76) took out their most recent loan between 2000 and 2002.

Bank overdrafts

50% (243) of the businesses in our survey had a bank overdraft, 45% (219) did not and 5% (26) did not know.

The cost of bank overdrafts

29% (70) of businesses with a bank overdraft paid 2% over base rate for their bank overdrafts, 15% (37) of firms paid 1% over base rate and 10% (25) of enterprises paid 3%.

Lending conditions

61% (149) of IoD members stated that when they last renewed their overdraft facility, the terms that they agreed with their bank were about the same, 22% (53) said that they were more favourable and only 6% (53) said that they were less favourable. 10% (25) of members did not know whether the terms of their business's overdraft facility had changed or not.

Choice of bank finance

58% (282) of IoD members believe that, on the basis of their own experience, there is a good choice of bank finance, 30% (146) hold an opposite view and 12% (60) are unsure.

In ***Business Finance 2002***, 65% of IoD members considered that there was a good choice of bank finance, 24% disagreed and 11% did not know.

Business banking

31% (151) of the firms in our survey bank mainly with the Royal Bank of Scotland Group (including the Royal Bank of Scotland, NatWest and Ulster Bank), 23% (114) are with Barclays Bank, 13% (65) use HSBC Bank and 10% (50) have their main account with Lloyds TSB Bank.

Bank-firm relations

69% (338) of the directors in our survey described their firm's relationship with their bank as good, 24% (118) said that it was acceptable and just 3% (14) felt that it was poor. 4% (18) of directors said that they did not know.

In ***Business Finance 2002***, 73% of directors said that they had a good relationship with their bank, 18% described their relationship as acceptable and 5% thought it was poor.

In ***Business Finance 2001***, 76% of directors surveyed thought that they had a good relationship with their bank, 17% said that they had an acceptable relationship and 4% felt that the relationship was poor.

Customer loyalty

45% (218) of businesses in our survey had been with their present bank for more than ten years, while 23% (110) had been with their present bank for between five and ten years.

Switching banks

35% (57) of directors in our survey said that their firm had changed its main bank in the last five years, 53% (85) said that it had not and 12% (19) did not know.

Reasons for not switching

63% (259) of IoD members explained that they had not changed their bank in the last five years because they were happy with their existing bank. 14% (56) said that they not switched because they believed that it was important to have a long term relationship with their bank.

Reasons for switching

31% (18) of businesses who had changed their bank in the previous five years did so because they found an alternative bank offering better terms and conditions, while another 31% (17) left their last bank because it was providing them with a poor service.

Requests for bank finance

85% (417) of businesses in our survey had never had a request for finance turned down by their bank, 5% (26) said that they had and 9% (45) did not know.

Reasons for the bank rejecting a request for finance

28% (7) of directors said that the bank had dismissed their request for finance because they lacked sufficient collateral, while 22% (6) of directors reported that the bank had not given an explanation.

Cash deposits

67% (327) of IoD members in our survey reported that they had a cash deposit at their bank, 25% (123) stated that they had not and 6% (37) said that they did not know.

The state of cash deposits

Of those IoD members with cash deposits, 30% (98) had increased the amount over the last twelve months, 35% (116) kept it at the same level and 27% (89) reduced it.

Reasons behind the increase in cash deposits

17% (16) of those directors who had increased their cash deposits over the previous twelve months did so because they had managed to increase their trade and profits and were making more money. 16% (15) had built up their deposits in case of unforeseen

circumstances. 15% (14) had increased their deposits prior to withdrawing it from the business.

Plans for cash deposits

37% (179) of directors with cash deposits reported that they planned to keep them at their current levels during 2003, 37% (179) said that they meant to increase them and just 10% (50) commented that they intended to reduce them.

Public equity markets

11% (56) of the directors interviewed in our survey stated that their company was listed on a stock exchange.

Stock market location

45% (25) of directors of listed companies in our survey were listed on the New York stock exchange. The FTSE stock exchange had 43% (24) of directors of quoted companies in our survey listed on its exchange.

Propensity to raise equity finance through stock markets

Less than half of the businesses in our survey that were quoted on a stock market had raised further equity finance through a subsequent rights issue. However, the quality of this particular data is impaired because 48% (27) of directors whose businesses were listed on a stock market did not know whether their company had raised additional equity finance.

Dates of rights issues

33% (7) of businesses that had raised more equity finance since they were first listed did so during the period 1997-99 and 61% (12) did so in 2000-02. However, not too much weight should be attached to this data because of the small sample number.

The propensity of IoD members to raise equity finance

40% (195) of the IoD members in our survey reported that they would be prepared to consider using equity finance in order to fund the expansion of their business and 4% (18) said that they did already. 48% (232) of members stated that they would not be prepared to employ equity finance and 9% (42) did not know. The same proportion of IoD members surveyed for ***Business Finance 2001*** and for ***Business Finance 2002*** were also prepared to use equity finance.

Reasons for not wanting to raise equity finance

22% (61) of directors said that equity finance was not relevant to them because they ran small firms. Similarly, 16% (45) of members explained that equity finance was irrelevant to their needs because their business was a partnership/private company. Likewise, 6% (17) of businesses could not use equity finance because they were a subsidiary of a larger company and that the decision to raise this form of capital lay elsewhere. 15% (40) of members acknowledged that they were not interested in using equity finance because it could result in them losing control of their business.

2 Sources of business finance

As a general rule, start up enterprises and small businesses will typically rely on their own resources to finance their operations. In fact, even larger and older businesses will invariably rely to an important extent on internal sources of capital to finance their activities. However, as businesses grow they will usually have to seek external sources of finance to complement their internal revenues, as the latter are unlikely to be sufficient to meet their needs. In general terms, innovative and growing firms and larger and older businesses are most likely to seek external finance.⁹

In the first instance, the external provider of capital for most firms will probably be a bank. Bank finance in the form of overdrafts and term loans is the most significant form of exogenous finance for small enterprises.¹⁰ Small business owners are typically attracted to using bank finance because they are relatively well informed about how to raise this source of finance in comparison to some of the alternatives. Additionally, for some businessmen the use of bank finance has the added appeal of not diminishing their control over their enterprise, in contrast to the use of equity finance.¹¹

Small firms' dependence on external finance diminished during the 1990s, but their use of bank finance increased.¹² Our research confirms the importance of both internal sources of finance and bank finance to IoD members. Internal financial resources were the most popular source of finance for the participants in this survey. 35% (172) of members reported that they relied on their own money to finance their business, 10% (50) used their cash flow to fund their operations and 6% (29) relied on retained profits. Taken together, self-finance/cash flow/retained profits were used by 51% (251) of directors to fund their business activities. The next most commonly used types of finance were bank overdrafts¹³ and bank loans,¹⁴ which were used by 33% (159) and 24% (119) of members, respectively (see Table 4).¹⁵

⁹ Andy Cosh and Alan Hughes (eds), *British Enterprise in Transition* (ESRC Centre for Business Research, University of Cambridge, 2000), Chapter 5.

¹⁰ *Finance for Small Firms. A Seventh Report* (Bank of England, 2000), p. 15. See also *Finance for Small Firms – An Eighth Report* (Bank of England, March 2001), p. 23.

¹¹ *Finance for Small Firms. A Seventh Report*, p. 43.

¹² *Finance for Small Firms – An Eighth Report*, pp. 23-24.

¹³ A bank overdraft typically entails an arrangement fee for the facility and the customer pays interest on the overdraft in excess of the base rate set by the Bank of England. A business customer with an overdraft can be required to repay the loan at short notice by the bank.

¹⁴ A term loan provides a business customer with a more stable form of finance as the bank provides a loan for a set period. Customers typically pay an arrangement fee for the fixed term loan and may be charged either fixed or variable rates of interest on the loan.

¹⁵ The responses given by interviewees to the question “what sources of finance do you use to finance your business?” were unprompted. It is possible, therefore, that some interviewees forgot some of the

Table 4: what sources of finance do you use to finance your business? ¹⁶ (Interviewees could give more than one answer).	
Self-financing/own money	35% (172)
Bank overdraft	33% (159)
Bank loan	24% (119)
From our cash flow	10% (50)
Shareholders/shareholder loans	6% (30)
Retained profits	6% (29)
Leasing	3% (17)
Stock market (equity finance)	4% (19)
Parent company	4% (21)
Venture capital	3% (16)
Factoring or invoice discounting	5% (24)
Hire purchase	2% (11)
Partner investment	1% (5)
Small Firms Loan Guarantee Scheme	1% (5)
Government/EU grant	1% (5)
Bonds	1% (4)
Finance companies/loan providers	1% (3)
Family/friends	1% (4)
Mortgage/property loan	0% (2)
Business angel	0% (2)
Others	2% (11)
Refused to answer	0% (2)
No answer	3% (12)
Don't know	3% (15)

Size, sectoral and geographical variations

Larger firms were proportionately more likely to have bank loans than the smallest enterprises in our survey. Whereas 17% (31) of firms with 1-20 employees used bank loans to finance their operations, 27% (27) of companies with 201 or more employees relied on this form of finance. Conversely, the largest firms in our survey were proportionately less likely to have bank overdrafts in comparison to firms of all other sizes. For example, while 36% (66) of firms with 1-20 employees had bank overdrafts, just 20% (20) of companies with 201 or more employees used this form of finance to fund their operations. Self-financing/own money was an important source of finance for businesses of all sizes, but particularly so for the smallest firms in our survey. 42% (75) of enterprises with 1-20 employees were self-financing or used their own money to finance their operations, while the figures for firms

sources of finance that they used and failed to tell the interviewer. In Section 6.1, interviewees were directly asked whether their business had any fixed term loans and 28% (136) said that they had. In Section 6.5, interviewees were similarly asked whether their business had a bank overdraft and 50% (243) declared that they had. In the view of NOP, answers to direct questions in this survey are more likely to elicit accurate information than unprompted, open ended questions. Consequently, in the Executive Summary and Conclusion of this research paper it is assumed that 50% of those surveyed had a business overdraft and 28% had fixed term loans.

¹⁶ There were 488 replies to this question.

with 21-100 employees, 101-200 employees and 201 or more employees were 29% (46), 37% (18) and 32% (32), respectively.

The degree to which firms relied on a particular source of finance in some instances varied sharply depending on the economic sector within which they were based. For example, whereas 16% (11) of directors from the financial services sector employed bank overdrafts to finance their operations, 50% (28) of directors from the distribution sector used this form of finance. At the same time, while just 22% (11) of directors from the government, education, health and personal services sector were self-financing/used their own money, 48% (76) of directors from the business and professional services sector relied on this form of finance.

There were also some interesting differences between directors from different regions. While 43% (48) of directors from the North employed bank overdrafts, the figure for directors from the South was 27% (78). Similarly, whereas 39% (110) of firms in the South were self-financing/used their own money, just 25% (28) of businesses in the North did so.

3 Factors determining the choice of external finance

Firms take into account a number of considerations when raising external finance: the cost involved, how quickly it can be raised, the views of financial advisers and so on. Unsurprisingly, 92% (262) of IoD members in our survey who used external finance said that they regarded cost to be either a very important factor or an important factor when determining their choice of external capital. 92% (261) also considered that the maintenance of business control was either very important or important when choosing external finance. Availability was held by 89% (253) to be either very important or important when selecting a form of external finance. Knowledge of a source of finance (for example, how to acquire it) was seen by 83% (237) of members with external finance to be either a very important or an important matter.

Furthermore, 74% (212) of interviewees with external finance said that the speed with which it could be obtained was either a very important factor or an important factor when determining a type of external capital. The length of loan, no requirement for personal collateral, previous experience with a source of finance and advice were regarded as being either very important or important factors by 72% (204), 66% (187), 64% (183) and 60% (172) of members, respectively.

(See table next page)

Table 5: how important might you consider these factors when raising external finance?¹⁷						
	Very important	Important	Neither important nor unimportant	Not important	Not important at all	Don't know
Cost	54% (154)	38% (108)	2% (6)	4% (11)	0% (1)	2% (6)
Maintenance of business control	59% (169)	32% (92)	2% (6)	2% (6)	1% (3)	3% (9)
No requirement for personal collateral	30% (86)	36% (101)	8% (22)	13% (37)	6% (17)	8% (22)
The speed with which finance can be obtained	28% (79)	47% (133)	12% (33)	11% (32)	0% (1)	3% (7)
Previous experience with source of finance	15% (44)	49% (139)	14% (41)	16% (46)	1% (2)	5% (13)
Knowledge of source of finance (how to acquire it, etc)	31% (90)	52% (147)	7% (19)	6% (18)	0% (0)	4% (11)
Advice of bank/accountant/consultant	19% (53)	41% (118)	10% (28)	22% (64)	4% (13)	3% (9)
Length of loan	18% (51)	54% (153)	13% (37)	10% (28)	0% (1)	5% (15)
Availability	37% (104)	52% (149)	3% (9)	4% (10)	0% (0)	4% (12)

¹⁷ There were 285 responses to this question.

4 Information and advice

The most popular sources for information and advice about financial matters for IoD members in our survey were the banks and members of the accountancy profession. 56% (272) of interviewees contacted their bank for financial information and advice and 28% (137) looked to their accountant. 18% (90) of members surveyed also received advice on finance from personnel within their own business (see Table 6).

Bank	56% (272)
Accountant	28% (137)
Internal advice within the company	18% (90)
Financial advisers/consultants	12% (59)
Business Link	4% (21)
Business representative body (e.g. IoD)	4% (19)
Parent company/head office	4% (19)
Business contact	3% (17)
Venture capital or business angel investor	2% (11)
Finance companies/factoring companies	2% (8)
Financial press	1% (7)
Solicitors	1% (6)
Family/friends	1% (5)
Auditors	1% (5)
Government agencies/DTI	1% (5)
Internet	1% (4)
Investors/potential investors	1% (4)
My own expertise	1% (3)
Non-executive director	1% (3)
Trade association	0% (2)
Other	2% (11)
No answer	7% (33)
Don't know	5% (23)

Size, sectoral and geographical differences

Larger firms tended to use banks for advice and information rather less in comparison to smaller firms. While 65% (118) of enterprises with 1-20 employees, 63% (100) of firms with 21-100 employees and 46% (23) of businesses with 101-200 employees looked to banks for financial guidance, just 31% (31) of companies with 201 or more employees did so.

¹⁸ There were 488 responses to this question.

Similarly, there was a general correlation between the size of an enterprise and its propensity to approach an accountant for advice. 34% (61) of firms with 1-20 employees used accountants for financial advice, as did 36% (56) of businesses with 21-100 employees. However, only 20% (10) of firms with 101-200 employees and 10% (10) of firms with 201 or more employees looked to accountants for financial guidance.

5 Accessibility of finance

Although the fall in the stock market over the last three years has made it more difficult to raise finance¹⁹, generally speaking businesses should not find it too difficult to access capital. This is because the economy has continued to grow, the banks are willing to lend and inflation and interest rates are relatively low. Our survey confirmed this perception. 69% (336) of the IoD members interviewed by NOP did not think that it was difficult to get access to finance for their business. However, a quarter (25%) did believe that it was difficult to get access to finance for their business and 6% did not know (see Table 7).

Yes	25% (123)
No	69% (336)
Don't know	6% (29)

Size, sectoral and geographical differences

IoD members from smaller enterprises were more likely to consider that it was difficult to get access to finance compared to those IoD members from larger businesses. 34% (61) of directors from enterprises with 1-20 employees and 26% (42) of directors from firms with 21-100 employees thought that it was difficult to get access to finance. In contrast, only 9% (5) of employers with 101-200 employees and 16% (16) of employers with 201 or more employees held this view.

Respondents from the North were relatively gloomy about their ability to raise capital to finance their business in comparison to respondents from the other two areas. 31% (34) of directors from the North took the view that it was difficult to get access to finance compared to 25% (71) of directors from the South and 19% (18) of directors from the Midlands.

Annual change

Overall, a higher proportion of IoD members now consider that it is difficult to get access to finance for their business in comparison to a year ago. A survey of members published in

¹⁹ For example, fundraising by venture capitalists in 2002 was the lowest since 1995 and small companies are set to suffer from a decline in venture capital trust investments. See "Venture capitalists' fundraising hits a seven year low" (*The Times*, February 12th 2003) and "Venture capitalists warn Brown of threat to small companies" (*Financial Times*, February 14th 2003).

²⁰ There were 488 responses to this question.

Business Finance 2002 showed that 74% did not think that it was difficult to acquire finance for their business, just 18% did think that it was difficult and 8% did not know. Similarly, in ***Business Finance 2001***, 78% of directors did not think that it was a problem to raise finance, 17% thought that it was and 5% did not know.

Significantly, with the exception of respondents from firms with 101-200 employees, respondents from all other categories of firm size believe that it has become more difficult to get access to finance. For example, in ***Business Finance 2002***, only 24% (42) of directors from enterprises with 1-20 employees considered that it was difficult to acquire finance for their business, whereas now this is the position of 34% (61) of directors from firms of this size.

6 Bank finance

6.1 Fixed term bank loans

28% (136) of the directors who were interviewed by NOP stated that their business had bank loans (see Table 8).

Yes	28% (136)
No	66% (324)
Don't know	6% (27)

Size, sectoral and geographical differences

Our survey showed that the smallest category of firms were least likely to have any fixed term loans from a bank. 21% (38) of enterprises with 1-20 employees had fixed term bank loans compared, for example, to 42% (21) of firms with 101-200 employees.

6.2 Fixed and variable rate loans

A fixed term loan with a fixed rate of interest naturally provides an important element of certainty for a business owner and so it is naturally attractive to many entrepreneurs. However, many business owners and managers are drawn to taking out fixed term loans with a variable rate of interest because they hope that interest rates will fall, thereby reducing the cost of borrowing to their business.

Of those participants in our survey who had fixed term loans from a bank, 35% (48) said that they only had loans with a fixed rate of interest. 34% (46) reported that they only had loans with a variable rate of interest and 27% (37) had loans with both a fixed rate of interest and a variable rate of interest. 4% (5) did not know whether their fixed term bank loans had a variable or a fixed rate of interest, or both (see Table 9).

²¹ There were 488 responses to this question.

Table 9: do your fixed term bank loans generally have variable or fixed rate interest or both? ²²	
Fixed rate only	35% (48)
Variable rate only	34% (46)
Both fixed rate and variable rate	27% (37)
Don't know	4% (5)

Size, sectoral and regional differences

Our survey showed that IoD members from smaller businesses were more likely to only have fixed term bank loans at variable rates of interest compared to those members from larger businesses. 34% (13) of directors with 1-20 employees used only fixed term bank loans with variable rates of interest, as did 50% (25) of IoD members with 21-100 employees. In contrast, 32% (7) of directors with 101-200 employees and 5% (2) of employers with 201 or more staff only used fixed term bank loans with variable rates of interest.

Smaller firms in our survey were also likely to have just fixed term bank loans with fixed rates of interest in comparison to the largest category of firm size. 47% (18) of enterprises with 1-20 employees, 32% (16) of businesses with 21-100 employees and 36% (8) of firms with 101-200 employees used only fixed term bank loans with fixed rates of interest. By way of contrast, 26% (7) of companies with 201 or more employees had fixed term bank loans with fixed rates of interest alone.

Directors from larger companies were more likely to have a mix of loans in comparison to directors from smaller concerns. Whereas 32% (7) of directors from businesses with 101-200 employees and 56% (16) of directors with 201 or more employees had both fixed rate and variable rate fixed term bank loans, the figure for respondents from firms with 1-20 and 21-100 employees was 17% (6) and 16% (8), respectively.

6.3 Maturity of business loans

Most IoD members with fixed term bank loans were borrowing for five years or less. For 10% (14) of members the length of maturity of their most recent fixed term bank loan when they originally took it out was less than three years and for 42% (57) of members the length of its maturity was three to five years (see Table 10).

Table 10: thinking about your most recent fixed term loan, what was the length of its maturity when you originally took it out? ²³	
Less than three years	10% (14)
Three to five years	42% (57)
Six to ten years	18% (25)
More than ten years	13% (18)
Don't know	17% (23)

²² There were 136 responses to this question.

²³ There were 136 responses to this question.

6.4 Date of most recent fixed term bank loans

In view of the preceding findings, it was unsurprising to discover that most IoD members with fixed term loans negotiated them with their bank after 1997. 26% (35) took out their most recent fixed term bank loan between 1997 and 1999 and 55% (76) did so between 2000 and 2002 (see Table 11).

1979-81	0% (1)
1985-87	0% (1)
1988-90	1% (1)
1991-93	1% (5)
1994-96	4% (5)
1997-99	26% (35)
2000-02	55% (76)
Don't know	12% (16)

6.5 Bank overdrafts

Bank overdrafts remain a popular form of finance for many IoD members' businesses. 50% (243) of the businesses in our survey had a bank overdraft, 45% (219) did not and 5% (26) did not know (see Table 12).

Yes	50% (243)
No	45% (219)
Don't know	5% (26)

Size, sectoral and geographical differences

The smallest and largest categories of firm size in our survey were less likely to have bank overdrafts in comparison to the other two categories of business size. 42% (76) of enterprises with 1-20 employees and 44% (44) of businesses with 201 or more employees had bank overdrafts, whereas 59% (94) of firms with 21-100 employees and 59% (29) of businesses with 101-200 employees did so. Smaller enterprises may be less enthusiastic about having a bank overdraft, while the largest businesses in our survey probably have access to a greater range of financial options and so are less dependent on bank overdrafts as a source of finance.

Businesses in the North were proportionately more likely to have a bank overdraft than businesses elsewhere in our survey. 62% (68) of businesses in the North had an overdraft, compared to 46% (131) in the South and 46% (43) in the Midlands.

²⁴ There were 136 responses to this question.

²⁵ There were 488 responses to this question.

67% (37) IoD members in the distribution sector had bank overdrafts, compared to just 32% (21) of members in the financial services sector. Otherwise, there were no significant variations between businesses in different economic sectors with regards to their propensity to have bank overdrafts.

6.6 The cost of bank overdrafts

Of those businesses with a bank overdraft, the majority paid 3% or less on top of base rates for this form of finance. The largest single category were the 29% (70) of businesses who paid 2% over base rate for their bank overdrafts. For 15% (37) of firms, the margin over base rate for their bank overdraft was 1%, while for 10% (25) the margin was 3% (see Table 13).

0%	2% (6)
1%	15% (37)
2%	29% (70)
3%	10% (25)
4%	6% (14)
5% plus	3% (6)
Don't know	35% (84)

Size, sectoral and geographical differences

Intuitively, one might think that larger businesses with a longer track record, a greater range of customers and stronger financial and managerial resources in comparison to SMEs would pay a smaller margin over base rate than these businesses. Unfortunately, the quality of our data was impaired as a consequence of the fact that a disproportionate number of directors from big businesses did not know what margin they paid over base rate. Whereas 30% (23) of directors with 1-20 employees, 23% (21) of directors with 21-100 employees and 37% (11) of directors with 101-200 employees did not know what margin over base rate they paid, the figure for directors from businesses with 201 or more employees was 66% (29). The smaller enterprises in our survey are more likely to be run by an owner or manager or have a small managerial team in comparison to the larger firms. Concomitantly, the interviewees from smaller enterprises are more likely to know the intricacies of their business's financial arrangements compared to interviewees from larger firms, who may well rely upon a Finance Director for information of this kind.

Our survey did show that whereas just 1% (1) of businesses with 201 or more employees paid 4% over base rate on bank overdrafts, the corresponding figure for firms with 1-20 employees was 11% (8). However, most businesses with 1-20 employees were paying a smaller margin than this: 5% (3) paid nothing over base rate, 7% (5) paid 1%, 28% (21) paid 2%, 12% (9) paid 3%, 11% (8) as we have seen paid 4% and 8% (6) paid 5% or more.

Most businesses with 21-100 employees paid a margin of 2% or less over base rates: 20% (19) paid 1% and 38% (35) paid 2%. Similarly, most firms with 101-200 employees paid a margin of 2% or less: 28% (8) paid 1% and 27% (8) paid 2%.

²⁶ There were 243 responses to this question.

6.7 Lending conditions

As observed earlier, interest rates in the UK were stable at 4% for fourteen months before being reduced to 3.75% in February 2003. At the same time, British banks do not appear to have poor balance sheets. In this environment it would be surprising to find any strong evidence that lending conditions have become more restrictive in recent months. The results of our survey do not suggest that lending conditions have become more restrictive. 61% (149) of IoD members reported that when they last renewed their overdraft facility, the terms that they agreed with their bank were about the same, 22% (53) said that they were more favourable and only 6% (15) said that they were less favourable. 10% (25) of members did not know whether the terms of their business's overdraft facility had changed or not (see Table 14).

More favourable	22% (53)
Less favourable	6% (15)
About the same	61% (149)
Don't know	10% (25)

Size, sectoral and geographical differences

Larger businesses did not appear to be receiving more favourable treatment than their smaller counterparts when renewing their overdraft facility. 26% (19) of businesses with 1-20 employees, 21% (20) of firms with 21-100 employees and 18% (5) of businesses with 101-200 employees gained more favourable terms when they last renewed their overdraft facility, compared to 19% (9) of enterprises with 201 or more employees. Having said that, once again a disproportionate number of IoD members from businesses with 201 or more employees – 32% (14) – did not know anything about their overdraft facility. By way of contrast, just 2% (1) of members from businesses with 1-20 employees did not have any information about their overdraft facility. As noted earlier, IoD members from smaller firms are more likely to be the business's only director or one of a small team of managers and so they are much more likely to be aware of the financial circumstances of the business. In contrast, IoD members from businesses with 201 or more employees may well be part of a larger management team and unless they hold the position of Finance Director, they are unlikely to know a great deal about their firm's overdraft facility.

Interestingly, businesses from the South appeared to receive more favourable terms when they renewed their overdraft facility compared to businesses elsewhere in the country. Almost a third – 30% (39) – of firms in the South gained more favourable conditions when they last renewed the terms of their overdraft facility with their bank, compared to 17% (7) of businesses in the Midlands and 10% (7) of enterprises in the North.

²⁷ There were 243 responses to this question.

A higher proportion of businesses in the North – 71% (48) – and in the Midlands – 68% (29) – received the same terms and conditions when they last renewed their overdraft facility compared to the South, where the proportion was 54% (71).

6.8 Choice of bank finance

The majority of employers in our survey believe that, on the basis of their own experience, there is a good choice of bank finance. 58% (282) of employers hold this optimistic view, compared to 30% (146) of employers who do not (see Table 15).

Yes	58% (282)
No	30% (146)
Don't know	12% (60)

Size, sectoral and geographical differences

48% (87) of IoD members from firms with 1-20 employees thought that there was a good choice of bank finance, while 42% (75) disagreed. Higher proportions of directors from other categories of firm size were convinced that there was a good choice of bank finance: 57% (90) from businesses with 1-20 employees, 73% (36) from businesses with 101-200 employees and 70% (69) of businesses with 201 or more employees took this view.

At least half of IoD members from all business sectors thought that there was a good choice of bank finance, ranging from 50% (52) of members in manufacturing to 60% (33) of members in the distribution sector.

Annual change

In ***Business Finance 2002***, 65% of the IoD members surveyed considered that there was a good choice of bank finance, 24% disagreed and 11% did not know. Similarly in ***Business Finance 2001***, 62% of the members interviewed thought there was a good choice of bank finance, 26% disagreed and 12% did not know. Clearly, a smaller proportion of IoD members now thinks that there is a good choice of bank finance than was the case in the previous two surveys. It is conceivable that the critical conclusions reached by the Competition Commission following its inquiry into the supply of banking services afforded to SMEs has influenced the views of some IoD members and has had the effect of making them less satisfied with the banking market.²⁹

²⁸ There were 488 responses to this question.

²⁹ ***The Supply of Banking Services by Clearing Banks to Small and Medium-sized Enterprises*** (Competition Commission, Cm 5319, March 14th 2002).

6.9 Business banking

Over half of the firms in our survey banked mainly with either the Royal Bank of Scotland Group (31%) or with Barclays Bank (23%). HSBC Bank plc and Lloyds TSB Bank plc – the other two principal high street banks – had a relatively small proportion of the IoD business market (see Table 16).

The Royal Bank of Scotland Group (including RBS, NatWest and Ulster Bank)	31% (151)
Barclays Bank plc	23% (114)
HSBC Bank plc	13% (65)
Lloyds TSB Bank plc	10% (50)
Bank of Scotland	6% (28)
National Australia Bank (including Clydsdale and Northern)	2% (10)
Bank of Ireland	1% (7)
Nationwide Building Society	1% (6)
Yorkshire Bank	1% (5)
Abbey National	0% (2)
The Co-operative Bank plc	0% (2)
Fortis	0% (2)
Girobank plc	0% (1)
Other	3% (17)
Don't know	6% (27)

6.10 Bank-firm relations

The overwhelming majority of IoD members who participated in our survey have a good working relationship with their bank. 69% (338) of the directors who were interviewed by NOP stated that their firm's relationship with its bank was good, 24% (118) described their relationship as acceptable and just 3% (14) considered that they had a bad relationship with their bank (see Table 17). The generally cordial atmosphere that prevails between businesses and their banks is partly a consequence of the relatively stable economic environment that currently exists, particularly with regards to interest rates. Additionally, bank-firm relations have improved as a result of measures introduced by the banks to address some of the criticisms that were levelled at them during the last recession.³¹ Significantly, small enterprises have become less dependent on bank finance in comparison to the early 1990s and so the potential for a serious collapse in bank-firm relations is unlikely in the near future.³²

³⁰ There were 488 responses to this question.

³¹ *Finance for Small Firms. A Seventh Report*, p. 24.

³² *Ibid*, Section Three. See also *Finance for Small Firms. A Sixth Report* (Bank of England, January 1999) and *Finance for Small Firms – An Eighth Report*, pp. 36-41.

Good	69% (338)
Acceptable	24% (118)
Poor	3% (14)
Don't know	4% (18)

There were no significant differences between respondents from different geographical sectors, different economic sectors or different categories of firm size.

Annual change

In ***Business Finance 2002***, 73% of IoD members said that they had a good relationship with their bank, 18% stated that it was acceptable and 5% reported that it was poor. In ***Business Finance 2001***, 76% of directors described their relationship with their bank as good, 17% considered that they had an acceptable relationship and 3% described their relationship as poor. Consequently, there has been a fall over the last three years in the proportion of IoD members who feel able to say that they have a good relationship with their bank. However, the fall is hardly precipitous and most members continue to have a good relationship with their bank.

6.11 Customer loyalty

A significant proportion of IoD members has had a long term relationship with their bank. 45% (218) of employers in our survey had banked with their present bank for more than ten years and 23% (110) had been with their present bank for between five and ten years (see Table 18).

Less than three years	14% (70)
Three to five years	12% (60)
Five to ten years	23% (110)
More than ten years	45% (218)
Don't know	6% (30)

Size, sectoral and geographical differences

Directors from smaller firms tended to have been with their present bank for a shorter period of time in comparison to directors from larger businesses. This may simply be due to the fact that smaller businesses have been operating for a shorter period of time than larger businesses. For example, 18% (33) of firms with 1-20 employees, 13% (21) of firms with 21-100 employees and 15% (7) of firms with 101-200 employees had been with their present bank for less than three years, compared to 8% (8) of firms with 201 or more employees.

³³ There were 488 responses to this question.

³⁴ There were 488 responses to this question.

Interestingly, though, 44% (79) of businesses with 1-20 employees had been with their present firm for ten years or more, as had 43% (69) of businesses with 21-100 employees, 51% (25) of firms with 101-200 employees and 45% (45) of companies with 201 or more employees. Irrespective of firm size, therefore, an important proportion of businesses in our survey has had a long term relationship with their bank.

6.12 Switching banks

In 2001 the Competition Commission concluded that it had found a complex monopoly³⁵ in the supply of banking services to SMEs and it published a list of possible hypothetical remedies.³⁶ The Government accepted the recommendations of the Competition Commission in March 2002 when it published the Commission's final report on the subject.³⁷

Although the Competition Commission declared that there were significant restraints on SMEs switching from one bank to another, a large proportion of IoD members have clearly been able to surmount these obstacles. Our survey shows that 35% (57) of firms have changed their main bank in the last five years (see Table 19). This does not seem to support the view that there is a lack of competition in the banking market. Nor does it confirm the notion that businesses are overly reluctant to change their bank if the need should arise.

Yes	35% (57)
No	53% (85)
Don't know	12% (19)

Size, sectoral and geographical differences

54% (26) of firms with 21-100 employees had changed their bank over the past five years, compared to 35% (5) of firms with 101-200 employees, 31% (18) of firms with 1-20 employees, and 19% (7) of businesses with 201 or more employees.

Manufacturing firms were more likely to have changed their bank within the previous five years than firms were from any other sector. 46% (16) of manufacturing firms had taken this action compared to just 11% (1) of firms in the distribution sector.

³⁵ *Supply of Banking Services by Clearing Banks to Small and Medium-sized Enterprises (SMEs): Statement of Provisional Conclusions on Complex Monopoly* (Competition Commission, March 6th 2001).

³⁶ *Banking Services by Clearing Banks to Small and Medium-sized Enterprises (SMEs). Statement of Hypothetical Remedies* (Competition Commission, March 21st 2001, news release).

³⁷ *The Supply of Banking Services by Clearing Banks to Small and Medium-sized Enterprises* (Competition Commission, Cm 5319, March 14th 2002).

³⁸ There were 160 responses to this question. IoD members who have banked with their present bank for more than five years did not answer this question. See Table 18 for details.

6.13 Reasons for not switching banks

There is a tendency amongst some individuals to substitute complicated or devious explanations for what are in actuality the obvious facts. For example, many commentators prefer to assume that America's apparent preparedness to go to war against Iraq is motivated by a Machiavellian plot to gain control of Iraq's oil supplies, rather than accept the more obvious reason that America wants to prevent Saddam Hussein from acquiring weapons of mass destruction. Similarly, many commentators choose to assume that the reason why most businesses do not change their bank regularly is because there is a lack of competition in the market. The more obvious explanation – that businesses do not switch from one bank to another on a regular basis because they are happy with the quality of service that they get from their existing bank – sometimes struggles to get a fair hearing. However, our survey shows that this is precisely the reason why many businesses stay with their existing bank. 63% (259) of directors in our survey explained that they had not switched banks because they were happy with their existing bank. 7% (28) said that they had not changed banks because although their current bank was not perfect, it was certainly not bad enough to make it worth changing. Additionally, 14% (56) stated that they had not changed their bank because they believed that it was important to have a long term relationship with a bank. Only 10% (41) said that they had not changed their bank because all the banks were the same and only small proportions of directors explained that it was too difficult or expensive to change banks (see Table 20).

You are happy with your existing bank	63% (259)
You believe that it is better to have a long term relationship with a bank	14% (56)
There is no point because all the banks are the same	10% (41)
Your bank may not be perfect, but it is not bad enough to make it worth changing	7% (28)
It is too difficult	6% (25)
We are a new business/we have not been operating long	3% (12)
It is too expensive	2% (7)
Not our decision – it's up to H.Q.	1% (6)
Don't use the bank much/don't borrow/so it's not that important	1% (5)
Too much work/too time consuming/no time to do it	1% (5)
Looking into it now/planning to change	1% (4)
No one has approached us with a better offer	1% (4)
We are the bank	1% (3)
Apathy	0% (2)
Other	2% (9)
Don't know	6% (24)

³⁹ There were 412 responses to this question. The directors who answered this question had all been with a bank for more than five years.

6.14 Reasons for switching banks

Of those directors who did switch their banks over the previous five years, 31% (18) did so because they found another bank offering better terms or conditions and another 31% (17) left their previous bank because it was providing them with a poor service. 12% (7) left their old bank because its service was deemed to be inflexible (see Table 21).

Table 21: why have you changed your bank? ⁴⁰ (Interviewees could give more than one answer.)	
You found another bank offering better terms or service	31% (18)
Poor service	31% (17)
Inflexibility on the part of the old bank	12% (7)
Change of company ownership	11% (6)
Poor relationship with bank manager	10% (6)
You were approached by another bank offering better terms or service	6% (4)
High rate of interest	6% (3)
High charges	4% (2)
Result of mergers/acquisitions	4% (2)
Request for loan rejected	2% (1)
Mistakes made by old bank	2% (1)
Other	11% (6)
Don't know	4% (2)

6.15 Requests for bank finance

85% (417) of businesses in our survey said that they had never had a request for finance turned down by their bank, 9% (45) did not know and 5% (26) had had a request for money rejected (see Table 22). No doubt this experience helps to underpin the view of IoD members that access to capital is not a problem for most businesses.

Table 22: has your current bank ever turned down a request for finance by your firm? ⁴¹	
Yes	5% (26)
No	85% (417)
Don't know	9% (45)

6.16 Reasons for the bank rejecting a request for finance

A bank's decision on whether to lend capital to a firm depends on a variety of factors. The state of the economic cycle and the financial health of the bank itself will be important considerations. Additionally, the bank's willingness to lend will be affected by whether the

⁴⁰ There were 57 responses to this question. The IoD members who answered this question had all changed their bank within the last five years.

⁴¹ There were 488 responses to this question.

prospective borrower can offer security for the loan, the competence of the firm's management, the plausibility of the firm's business plan, its market positioning and its financial state, amongst other determinants.

Of those directors who acknowledged that their firm's application for bank finance had been rejected in the past, 28% (7) said that the bank's decision was due to the fact that they lacked sufficient collateral. 22% (6) of directors said that their bank did not give a reason for dismissing their request for finance (see Table 23). However, the numbers involved in this section of the survey were so small that not too much weight can be placed on the data.

Lack of collateral	28% (7)
Bank did not give a reason	22% (6)
Bank did not agree with your business plan	14% (4)
Bank doubted that a market existed for the venture in question	10% (3)
Bank did not have confidence in firm's management	5% (1)
Change of bank policy or bank manager	4% (1)
Other	20% (5)
Don't know	12% (3)

⁴² There were 26 responses to this question.

7 Cash deposits

7.1 The prevalence of cash deposits

Not only have SMEs reduced their dependence on bank finance in recent years, but since 1992 they have also built up significant deposits at their banks.⁴³ Our survey echoed this fact, with 67% (327) of the IoD members who were interviewed reporting that they had a cash deposit at the bank (see Table 24).

Yes	67% (327)
No	25% (123)
Don't know	6% (37)

Size, sectoral and geographical differences

This year's survey did not show that smaller enterprises were significantly more likely to have cash deposits than larger firms. 68% (122) of enterprises with 1-20 employees, 67% (106) of firms with 21-100 employees, 72% (35) of businesses with 101-200 employees and 64% (64) of companies with 201 or more employees all had cash deposits at the bank.

Annual change

By way of contrast, *Business Finance 2002* showed that respondents from smaller firms were comparatively more likely to have cash deposits at the bank compared to those from larger businesses. For example, 71% (126) of IoD members with between 1-20 employees had cash deposits at the bank, compared to 63% (66) of those with over 201 employees.

⁴³ *Finance for Small Firms – An Eighth Report*, p. 24. See also *Finance for Small Firms – A Ninth Report* (Bank of England, April 2002), pp. 13-15.

⁴⁴ There were 488 responses to this question.

7.2 The state of cash deposits

Of those IoD members with cash deposits, over the last twelve months 30% (98) increased the amount, 35% (116) kept the amount the same and 27% (89) decreased the amount (see Table 25).

Increased the amount	30% (98)
Kept the amount the same	35% (116)
Decreased the amount	27% (89)
Don't know	7% (24)

Annual change

In contrast, *Business Finance 2002* revealed that of those IoD members with a cash deposit at the bank, 40% increased the amount, 39% kept the amount the same and 21% reduced the amount in the course of 2001. Consequently, a smaller proportion of directors increased their cash deposits at the bank in 2002 in comparison to 2001.

7.3 Reasons behind the increase in cash deposits

A diverse set of reasons appears to be behind directors' propensity to increase their cash deposits. Of those IoD members who had increased their cash deposits at their banks over the last twelve months, 17% (16) had done so because they had managed to increase their trade and profits and were making more money. 15% (14) had increased their deposits prior to withdrawing it from a business. 16% (15) added to their cash deposits because they wanted to be prepared for any unforeseen circumstances (see Table 26).

Increased trade/profits/making more money	17% (16)
To build up cash in case of unforeseen difficulties	16% (15)
Build up cash prior to withdrawing it from a business	15% (14)
Just had more cash available/larger cash flow/bigger trading surplus	12% (12)
To finance an investment project	8% (8)
To build up cash in case there is an economic downturn	8% (8)
To take advantage of a good financial product (e.g. high interest account)	8% (8)
Raised more finance/equity finance	4% (4)
Not investing at the moment/nowhere more useful to put it	3% (3)
Other	13% (13)
Don't know	3% (3)

⁴⁵ There were 327 responses to this question.

⁴⁶ There were 98 responses to this question.

Size, sectoral and geographical differences

There were few noteworthy differences behind the decisions of IoD members' to increase their cash deposits over the last twelve months according to the economic sector within which they were based or according to the category of firm size. However, it was relatively interesting to learn that 25% (15) of directors from the South increased their cash deposits in case of unforeseen circumstances, compared to just 4% (1) of directors in the North; no directors from the Midlands added to their cash deposits in case of unforeseen circumstances.

7.4 Plans for cash deposits

43% (211) of directors with cash deposits plan to keep them at their current levels in 2003, 37% (179) intend to increase them still more and just 10% (50) said that they were going to reduced them (see Table 27).

Increase	37% (179)
Decrease	10% (50)
Stay about the same	43% (211)
Don't know	10% (47)

Size, sectoral and geographical differences

IoD members from smaller enterprises were comparatively more likely to say that they would be increasing their cash deposits in 2003 than directors from larger businesses. 44% (80) of directors with 1-20 employees and 35% (56) of directors with 21-100 employees planned to add to their cash deposits this year compared to 24% (12) of directors with 101-200 employees and 32% (31) of directors with 201 or more employees.

⁴⁷ There were 488 responses to this question.

8 Equity finance

8.1 Public equity markets

Acquiring public equity finance involves the flotation of a business on a stock market. A flotation allows a business to raise significant financial resources from a wide pool of investors. It also provides a private equity investor, such as a venture capital firm, with an exit route. In simple terms, the UK has a three tier public equity market. At the summit is the official list on the London Stock Exchange (LSE). The official list of the LSE is segmented by market capitalisation. For example, smaller companies are segmented in the FTSE SmallCap or FTSE Fledgling. There are stringent entry requirements to the Official List and it is tightly regulated. The second tier consists of the Alternative Investment Market (AIM). This was established in 1995 to attract small or young companies whose shares were not publicly traded. There are less demanding entry requirements to AIM and the regulatory requirements are less burdensome than that for the Official List. The third tier is provided by OFEX, an off exchange unregulated trading facility offered by JP Jenkins, a market/agency broker. It was set up in 1995 for companies that did not want to join AIM or the Official List. It is not regulated, but it abides by the London Stock Exchange rules. It acts as a staging post to companies that wish to join AIM or the Official List, although some prefer to stay with OFEX to avoid having to meet the regulatory requirements.⁴⁸

11% (56) of the directors interviewed in our survey reported that their company was listed on a stock exchange (see Table 29).

Table 29: is your company listed on a stock market? ⁴⁹	
Yes	11% (56)
No	89% (432)

Size, sectoral and geographical differences

Our survey showed that businesses in the financial services sector were more likely to be listed on a stock market than businesses from any other sectors. 24% (16) of directors from the financial services stated that their business was listed on a stock market. By way of

⁴⁸ *Finance for Small Firms. A Seventh Report*, pp. 59-61 and *Finance for Small Firms – An Eighth Report*, Section 4, pp. 43-62. See also www.ofex.com.

⁴⁹ There were 488 responses to this question.

contrast, just 4% (7) of directors from the business and professional services sector said that their business was listed on a stock market.

Small businesses are less likely to be listed on a stock market in comparison with larger companies. The owner managers of SMEs are typically antipathetic towards the idea of public equity finance because it diminishes their control over their business. Additionally, small businesses may be deterred by the regulatory requirements that listed companies face. Also, businesses have to meet minimum levels of capitalisation to join the Official List: this precludes most small companies from a listing. Just 1% (1) of directors with 1-20 employees, 4% (7) of directors with 21-100 employees were listed on a stock market. In contrast, 19% (9) of directors with 101-200 employees and 39% (38) of employers from companies with over 201 employees were listed on a stock market.

Annual change

Business Finance 2002 reported that 13% (65) of directors interviewed were listed on a stock market. Evidently, there has been a slight fall in the number of IoD members whose businesses are listed on a stock market over the last year.

8.2 Stock market location

The most popular stock market for listed companies in our survey was the New York stock exchange. 45% (25) of directors of listed companies were listed in the 'Big Apple's' stock exchange. The London stock exchange had 43% (24) of directors of quoted companies in our survey listed on its exchange (see Table 30).

New York stock exchange	45% (25)
London stock exchange/FTSE	43% (24)
Hong Kong	10% (5)
Paris stock exchange	8% (5)
German stock exchange	8% (5)
Alternative Investment Market	5% (3)
NASDAQ	3% (2)
Others	16% (9)
Don't know	6% (3)

8.3 Propensity to raise equity finance through stock markets

Less than half of the businesses that were quoted on a stock market had raised further equity finance through a stock market since first being listed. However, the quality of the data was impaired because 48% (27) of IoD members whose businesses were listed on a

⁵⁰ There were 56 responses to this question.

stock market simply did not know when they had raised further equity finance (see Table 31).

Table 31: since listing, how many times have you raised further equity finance through a stock market? ⁵¹	
Once	14% (8)
Twice	11% (6)
Four or more times	12% (7)
Have not raised further equity finance	16% (9)
Don't know	48% (27)

8.4 Dates of rights issues

The majority of those directors who had raised further equity finance since first being listed on a stock market did so in the last six years. 33% (7) raised additional equity finance in the period between 1997 and 1999, when stock markets in the USA, the UK and most of Europe were booming. 61% (12) raised more equity finance during the period between 2000 and 2002, when markets had generally peaked and were declining in value (see Table 32). However, the number of directors participating in this aspect of the survey was very small in number and so it would probably be a mistake to put too much weight on these particular findings.

Table 32: which years did you raise further equity finance through a stock market? ⁵²	
Prior to 1978	4% (1)
1979-81	11% (2)
1982-84	14% (3)
1985-87	11% (2)
1988-90	15% (3)
1991-93	11% (2)
1994-96	14% (3)
1997-99	33% (7)
2000-02	61% (12)
Don't know	16% (3)

8.5 The propensity of IoD members to raise equity finance

Raising equity finance, whether it is public or private in nature, can bring substantive benefits to a firm. In the first instance, it provides a business with a fresh stream of finance. A stock market listing also enables a business to raise capital to finance acquisitions. Additionally, a flotation provides a business with an exit route for private investors. A stock market listing also allows a company to attract and retain skilled and talented staff through

⁵¹ There were 56 responses to this question.

⁵² There were 21 responses to this question.

the use of stock options.⁵³ Finally, the very process of raising equity capital often brings the owner of the firm into contact with people who can provide valuable business and managerial advice. It is probably the combination of these factors that help to explain the evidence which indicates that businesses that embrace equity funding are more likely to grow than those organisations that shun external equity finance.⁵⁴

However, the adoption of equity finance can result in the owner-manager losing control over his business. Venture capitalists not only inject money into a small enterprise, they also typically take a 30-40% equity stake and a seat on the business's board.⁵⁵ A public flotation invariably entails an even more dramatic diminution of the owner-manager's equity stake. Undoubtedly, one of the principal incentives for an individual to start his own business is a desire to reap financial rewards. Additionally, though, many entrepreneurs are animated by a desire for independence to set up their own firm.⁵⁶ Consequently, many owner-managers are deterred from raising equity finance because they believe it will result in them losing control of their business.⁵⁷ Despite these fears, 40% of those IoD members who took part in our survey were prepared to raise equity finance to pay for the expansion of their business (see Table 33).

Yes	40% (195)
No	48% (232)
I already do (to some extent)	4% (18)
Don't know	9% (42)

Size, sectoral and geographical differences

Of the various categories of firm size, businesses with 101-200 employees were least inclined to use equity finance. Just 16% (8) said that they would be prepared to use equity finance, compared to 40% (72) of firms with 1-20, 52% (82) of firms with 21-100 and 33% (33) of firms with 201 or more.

Annual change

IoD members have been extraordinarily consistent in their willingness to use equity finance over the last three years. In *Business Finance 2001*, *Business Finance 2002* and *Business Finance 2003*, 40% of the directors surveyed have been prepared to raise equity finance to fund the expansion of their business.

⁵³ P. Poutziouris, F. Chittenden and N. Michaelas, *The Financial Development of Smaller Private & Public Ltd Companies (SMEs)*, p. 24.

⁵⁴ D.J. Storey, *Understanding the Small Business Sector* (Routledge, 1994), p. 146. See also D. Smith, "Dilemma of Outside Equity", *Sunday Times*, 13th October 1996.

⁵⁵ *Finance for Small Firms. A Seventh Report*, p. 43.

⁵⁶ Poutziouris et al, *The Financial Development of Smaller Private & Public Ltd Companies (SMEs)*, pp. 2, 7 and 25-26, and *Finance for Small Firms. A Seventh Report*, pp. 43-44.

⁵⁷ *Finance for Small Firms. A Seventh Report*, p. 43.

⁵⁸ There were 488 responses to this question.

8.6 Reasons for not wanting to raise equity finance

Of those IoD members who were not prepared to raise equity finance to fund their operations, a considerable proportion explained that this was due to the nature of their business. 22% (61) stated that equity finance was inappropriate because they ran a small business and 16% (45) explained that their business was either a private company or a partnership. A further 6% (17) said that they were simply a subsidiary of a larger company and so the decision to use equity finance was not theirs to make. 8% (21) of businesses felt that they had no need for equity finance and 7% (18) said that they could raise the finance that they needed in the form of debt, rather than equity. Just 15% (40) of members who were not prepared to use equity finance explained that they were afraid that use of it could result in them losing control of their business (see Table 34).

Not applicable as you are a small company	22% (61)
Private company/partnership	16% (45)
Equity finance could result in you losing control of your firm	15% (40)
No need for it/we're OK as we are	8% (21)
Can raise all the finance that you need by taking on debt rather than new equity	7% (18)
Raising equity finance is too expensive	7% (18)
We have a parent company/we are just a division of a large company/not our decision	6% (17)
Dominant shareholder would oppose rights issue	4% (12)
Not a good time for equity finance/market conditions	4% (12)
Lack of knowledge about equity finance	3% (7)
City/institutions/market would not be interested because amount would be too small for them to bother with	3% (7)
Not appropriate for us	2% (6)
No need to raise money/we are well funded	2% (6)
Not company policy	2% (4)
We are not allowed to because we are a charity/not for profit company/publicly owned company	2% (6)
Other	4% (11)
Don't know	13% (34)

⁵⁹ There were 274 responses to this question.

Size, sectoral and geographical differences

IoD members from the smallest category of firm size in our survey who did not want to use equity finance were much more likely to justify this decision on the grounds that they were a small firm. 42% (43) of firms with 1-20 employees said that they were not prepared to use equity finance because they were a small business compared to just 4% (3) of businesses with 201 or more employees.

9 Conclusion

For the majority of IoD members, access to finance is not a problem. Over two-thirds (69%) of the directors in our survey did not think that it was difficult to get access to finance for their business (see Section 5). However, over the last three years there has been a decline in the proportion of members thinking that it is not difficult to get access to finance and a corresponding increase in the proportion believing that it is a problem. This almost certainly reflects the changes in economic fortune that have taken place during this period. The UK has moved from a position at the end of the 1990s when the economy was growing quite strongly, the stock market was booming and access to finance was relatively easy to obtain, to a situation today where the economy has slowed and the stock market has slumped, with the result that it is comparatively harder to raise capital. Significantly, the more challenging economic environment has been accompanied by a fall in the number of start-up businesses in 2001.⁶⁰

Most IoD members continue to believe that there is a good choice of bank finance. This view is held by just under three-fifths (58%) of members in our most recent survey (see Section 6.8). Nevertheless, as mentioned previously, a smaller proportion of IoD members now consider that there is a good choice of bank finance in comparison to our previous surveys of members, published in *Business Finance 2001* and *Business Finance 2002*

Bank-firm relations remain good, with 69% of the directors in our survey describing their firm's relationship with their bank as good and just 3% of directors depicting them as poor (see Section 6.10). The survey of IoD members published in *Business Finance 2001* showed that 76% of directors believed that they had a good relationship with their bank and 4% considered that they had a poor relationship. While a smaller proportion of members are effusive about their relationship with their bank today in contrast to three years ago, an even smaller proportion consider that their relationship with their bank is bad.

Although most businesses in our most recent survey have a good relationship with their bank, IoD members are prepared to switch banks if necessary. 35% of members who use bank finance have switched their bank in the past five years (see Section 6.12). This result is consonant with the findings published in *Business Finance 2001* and *Business Finance 2002*. The fact that such a large proportion of members have been able to change their bank in the past not only indicates that the hurdles to switching banks can be surmounted but also that the banking market for SMEs is relatively competitive.

A significant proportion of IoD members continues to be well disposed in principle to using equity finance to fund their business's expansion. 40% of the directors in our most recent

⁶⁰ *Finance for Small Firms - A Ninth Report*, pp. 7-8.

survey stated that they were prepared to use this form of finance (see Section 8.5), exactly the same proportion as in *Business Finance 2001*.

The economic climate has become chillier for businesses over the last three years, but most are still able to get access to finance to fund their operations and bank-firm relations remain generally good.