

**POLICY BRIEFING PAPER**  
**March 2006**

## **Improving Access to Finance for Ethnic Minority Businesses**

### **THE ISSUE**

Ethnic minority businesses (EMBs) account for 6% of all Small and Medium-sized Enterprises (SMEs) in England and one in ten employing SMEs are owned and managed by individuals of ethnic origin.<sup>i</sup> They provide 7% of total employment and are a growing sector of the economy.<sup>ii</sup> Ethnic minority sole traders have similar characteristics to non-ethnic minority sole traders but employing EMBs are more likely to be classified as ‘micro’ businesses (employing between 1-9 people) than non-ethnic minority businesses, which are more likely to be classified as small (10 – 49 employees) or medium-sized (50 – 249 employees).<sup>iii</sup> EMBs with employees are more likely to be based in the services sector than non-ethnic minority businesses, 90.4% compared to 69.9%,<sup>iv</sup> and their financial turnover tends to be lower.<sup>v</sup> 40% of employing EMBs are based in the 15% most deprived wards, compared with 23.9% of non-ethnic minority employing businesses.<sup>vi</sup>

The public policy rationale for supporting and promoting EMBs is encompassed by public service agreement 6; *‘Help to build an enterprise society in which small firms of all kinds thrive and achieve their potential, with (i) an increase in the number of people considering going into business, (ii) an improvement in the overall productivity of small firms, and (iii) more enterprise in disadvantaged communities.’*<sup>vii</sup> Given the prevalence of EMBs in deprived areas and the differences between the levels of entrepreneurial activity between ethnic minority groups and non-ethnic minority groups, it is of importance to understand, and offer solutions to the problems faced by EMBs.

Research has suggested that one of the problems facing EMBs is that of accessing finance. Whilst it is widely recognised that the process of accessing external finance is a problem for many small businesses, indeed ACCA has produced leading research into the issue, research has suggested that ethnic minorities face additional barriers when accessing finance.

## RECOMMENDATIONS TO IMPROVE ACCESS TO FINANCE FOR ETHNIC MINORITY BUSINESSES

1. It is important that policymakers consider the heterogeneity of the ethnic minority business community. Evidence shows that African/Caribbean entrepreneurs are more likely to be rejected when applying for bank loans, and once established are more likely to fail when trying to access external finance than other ethnic minority businesses or white controlled firms.<sup>viii</sup>
2. Previous policy instruments that have sought to improve the access to and use of finance by ethnic minority businesses have largely been unsuccessful. They were relatively unsuccessful due to a failure to deliver interventions through the existing business support mechanisms and the existing financial institutions. All future intervention should be delivered through the mainstream financial community and existing business advisory institutions. This will help improve outcomes and coverage, whilst also improving perceptions as it will reduce the schism between the mainstream and the public sector interventions.
3. Research suggests that the outcomes and experiences of ethnic minority businesses in their financial relationships may not be being met due to a number of factors, including their weak market power and language and cultural issues.<sup>ix</sup> Whilst many institutions are making an effort to employ greater number of ethnic minority banking staff – in some institutions up to a third of graduate recruits are from an ethnic minority. The overall percentage of ethnic minority staff, particularly those of Black African or African-Caribbean origin, is still low. Institutions should be encouraged to represent and understand the customers they seek to serve.
4. The latest research shows that there is often a difficulty disaggregating between the cause and effect for ethnic minorities accessing finance. In many cases the businesses' and owners' characteristics could explain the variations in outcomes and experience – although it is clear that ethnicity would still have a residual role in the financial gaps and loan margins experienced.<sup>x</sup> The wide divergence of some ethnic groups from favourable outcomes leads to a perception of systematic discrimination. This perception leads to a disengagement of ethnic minority businesses from the financial system and poorer outcomes. Work must be done to reduce these negative perceptions.

5. Ethnic minority businesses in deprived areas suffer greater problems when accessing finance due to a number of factors including a scarcity of collateral and a more fragile local economy. There is a problem in the provision of bank lending given the high unit cost of making small loans and the comparatively high credit risk associated with some of these businesses. Micro-credit schemes and Community Development Finance Institutions (CDFIs) often represent the best source of lending for these entrepreneurs. However CDFIs have not attracted the scale of investment originally envisaged; only £38 million of a £1 billion target in five years. We therefore recommend that the Community Investment Tax Relief (CITR) which provides 5% relief per year over 5 years is raised to 8% per year over 7 years, in order to better meet the needs of SMEs in deprived communities.
6. The provision of, and access to, impartial and expert financial advice greatly increases the chances of entrepreneurs securing appropriate and affordable finance. Accountants are in an excellent position to provide this advice.<sup>xi</sup> The Government should consider subsidising accountancy advice for specific communities or sections of society, including businesses in deprived areas, the financially excluded and specific ethnic minorities.
7. Low levels of financial literacy can impact the degree to which entrepreneurs access formal sources of finance. Many positive steps have been taken to ensure that entrepreneurs are aware of the forms of finance available, including the publication of the two 'no-nonsense' guides to finance.<sup>xii</sup> The Government should continue its efforts to ensure that a high level of financial literacy is universal to entrepreneurs.
8. Ethnic minority firms, in particular groups specific ethnic minorities,<sup>xiii</sup> perceive the problem of accessing formal finance as harder than it actually is.<sup>xiv</sup> As a result finance is not sought and, consequently, businesses suffer from being under capitalised. Financial institutions, the Government and relevant organisations should get involved with, and create, networks targeting these groups to dispel the myths and share best practice.
9. There should be closer co-operation between business support organisations, banks and African/Caribbean entrepreneurs to support these businesses when accessing finance and ensure that they are aware of

opportunities that exist for small businesses to operate in other sectors of the economy.

10. Black owned businesses face a significant shortfall when accessing finance. This shortfall is between 40 and 60 pence per £1 of business assets. They are also up to six times more likely to experience out right rejection. As Fraser states “*these are big differences*”<sup>xv</sup> and demands serious consideration and action from Government. Therefore, the newly instigated Ethnic-Minority Business Forum must be resourced and supported from the highest level and its recommendations adhered to.

### ACCA'S INVOLVEMENT

ACCA (the Association of Chartered Certified Accountants) is the largest and fastest growing global professional accountancy body, with over 105,000 members and 245,000 students in 170 countries. Independent research shows consistently that accountants are the first choice advisors of small businesses. In the UK, 56% of ACCA members work in or for SMEs, and provide professional advice to clients on access to finance and the mix of finance. We conduct research on this topic which can be found at [www.accaglobal.com/research](http://www.accaglobal.com/research).

At the ACCA UK Small Business Committee meeting in December 2006 Dr Stuart Frasser, Warwick Business School gave evidence and discussed the issue of access to finance for ethnic minority businesses.

ACCA's UK Small Business Committee is a unique voice on small business issues. It has a wide membership including accountants, leading academics and representatives from the main small business organisations.

## ACCA'S UK SMALL BUSINESS COMMITTEE

**Chair: Professor Francis Chittenden, ACCA Professor of Small Business Finance, Manchester Business School**

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## REFERENCES

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<sup>ii</sup> Page 14, Fraser S. (2007), *Finance for Small and Medium-Sized Enterprises: Comparisons of Ethnic Minority and White Owned Business*, Department of Trade and Industry, London

<sup>iii</sup> Page 21, Whitehead, S. et al (2006), *Ethnic Minority Businesses in England; Report on the Annual Small Business Survey 2003 Ethnic Boost*, (Small Business Service, London).

<sup>iv</sup>Page 23, Whitehead, S. et al (2006), *Ethnic Minority Businesses in England; Report on the Annual Small Business Survey 2003 Ethnic Boost*, Small Business Service, London.

<sup>v</sup>Page 25, Whitehead, S. et al (2006), *Ethnic Minority Businesses in England; Report on the Annual Small Business Survey 2003 Ethnic Boost*, Small Business Service, London.

<sup>vi</sup>Page 28, Whitehead, S. et al (2006), *Ethnic Minority Businesses in England; Report on the Annual Small Business Survey 2003 Ethnic Boost*, Small Business Service, London.

<sup>vii</sup>Department of Trade and Industry (2004), *DTI Public Service Agreement Targets for 2005 – 2008 Technical Notes for: PSA 6* [<http://www.dti.gov.uk/files/file14297.pdf>] accessed 6 March 2007.

<sup>viii</sup> Smallbone, D., Ram M., Deakins, D. and Baldock, R. (2003), *ibid*.

<sup>ix</sup> Page 145, Fraser S. (2007), *Finance for Small and Medium-Sized Enterprises: Comparisons of Ethnic Minority and White Owned Business*, Department of Trade and Industry, London

<sup>x</sup> Page 203, Fraser S. (2007), *Ibid*

<sup>xi</sup> Federation of Small Business (2002), *Lifting the Barriers to Growth in UK Small Businesses* (London).

<sup>xii</sup> Business Link (2005), *The No-Nonsense Guide to Finance for High Growth Companies* and *The No-Nonsense Guide to Small Business Funding*, (Department of Trade and Industry, London).

<sup>xiii</sup> Ram, M. and Deakins, D. (1995) 'African-Caribbean Entrepreneurship in Britain', University of Central England Business School, Birmingham.

<sup>xiv</sup> Marlow, S. and Carter, S. (2005), *ibid*.

<sup>xv</sup> Page 202, Fraser S. (2007) *Ibid*