



## banks, SMEs and accountants

RESEARCH REPORT NO. 95



# Banks, SMEs and accountants: an international study of SMEs' banking relationships

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## Executive summary

The issue of small business finance, the relationship between SMEs and their bankers and the role of accountants as advisers of SMEs have been subjects of considerable research over a long period in the UK and in other countries. Most of the evidence from that work establishes the importance of the banking relationship and the accountants' role in providing advice to SMEs. The research evidence does, however, show variations in the levels of SME satisfaction with their banking relationships. This, together with evidence from other countries with different banking structures, has led to suggestions that banking structures may be an important determinant of SMEs' levels of satisfaction with their banks.

Although research studies from different countries exist, each study differs in terms of aims, the questions asked and the method of data collection. To date no research has been carried out that uses the same research instrument to collect data from SMEs in different countries. This research addresses that gap in the literature and provides data that are comparable from country to country.

As well as providing comparable data the research also highlighted country-specific factors that needed further investigation. This was undertaken during the second phase of this research through a series of focus groups and interviews. Some of the findings warrant additional work.

The analysis provides some interesting and important insights into SMEs' relationships with their banks and the effects of differing banking regimes and industry structures. It identifies some potential gaps in the provision of small business finance and advice and provides more understanding of the role of accountants as a source of financial and general business advice. The cross-country comparison provides insights into the effects of structural differences in the accounting profession and an indication of the potential impact of the separation of the audit, tax, preparation of accounts and advice functions on the future relationships between SMEs and their accountants.

### EMPIRICAL EVIDENCE

#### Quantitative

1. Telephone interviews among SMEs.
  - 1,004 SMEs were interviewed.
  - All sizes of SMEs were represented in each country.
  - A wide range of industry sectors were covered.
  - The continents represented were Europe, America and Asia.
  - Countries covered were Germany, Hong Kong, Spain, United Kingdom, United States of America.
2. An online survey among ACCA members in the UK elicited 377 responses.
3. An online survey among ACCA members in Hong Kong elicited 127 responses.

#### Qualitative

There were face-to-face interviews with:

- six practising accountants in the US.
- a focus group with five practising accountants in Spain.
- a focus group with six practising accountants in Germany.

Research conducted Winter 2005 to Summer 2006.

## **SMEs AND THEIR BANKING RELATIONSHIPS**

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### **Relationships**

- There is a wide variation in the number of banking relationships SMEs sustain, from an average of 1.4 relationships in the UK to around 4 relationships in Spain.
- The variation in the number of relationships is primarily related to the country in which the SME resides.
- The structure of the banking industry in a country is a significant determinant of the number of relationships an SME has.
- Consolidation of banks may lead to an increase in the number of relationships SMEs have, as accountants advise them to spread their banking risk.

### **Services used**

- The banking services and methods of finance used by SMEs vary with size but the primary determinant of the variation is the country of residence.
- SMEs tend to have more banking relationships where a combination of different types of bank provide different services and compete for SME business.
- Cultural norms and attitudes within countries may have an effect on SMEs' choice of financial service.

### **Raising finance**

- SMEs wishing to raise finance are generally able to do so in full or in part.
- Banks are either the sole source or one of several sources of finance for SMEs in all countries studied.
- Accountants from all countries identify a lack of collateral or security as a frequent reason for refusals to provide finance.

- Although for German SMEs lack of collateral is an important factor, the primary reason for refusal of finance is lack of equity resulting from the impact of tax laws on German SMEs.
- In the UK banks are used less as the main source of finance than in the other countries surveyed.

## **COMMUNICATION AND SATISFACTION WITH BANKS**

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### **Communication**

- For smaller SMEs, visiting the bank is very important, with nearly 75% of the smallest SMEs visiting their bank.
- The larger SMEs tend to use more remote communication methods, such as telephones, writing and electronic communication, with 86% of the large SMEs using electronic communication.

### **Satisfaction**

- In general SMEs are satisfied or very satisfied with the services they get from their banks.
- SMEs in the £50,000 to £1million turnover range are generally less satisfied with their banks than SMEs outside this turnover range.
- SMEs are less satisfied with their banks' charges and tariffs.
- SMEs are also less satisfied with their banks' level of understanding of their business.
- Accountants are also critical of the level of charges and bankers' level of understanding of their clients' businesses, although the extent of the criticism varies from country to country.



- The 'centralisation' of decision making in banks as a result of consolidation of the industry appears to lengthen the decision-making process and to decrease the level of communication between the decision maker and the SME, leading to reduced levels of understanding of the business and the environment in which it operates.
- Country variations on satisfaction are present in the data but these are likely to reflect cultural factors rather than being related to the banking structures in each country.

#### **Benefits and propensity to change**

- The benefits received by SMEs in the form of free transactions and interest on current accounts vary according to size, with the smallest businesses most likely to get no benefits.
- The benefits are, however, more affected by the country in which the SME resides; SMEs in Spain and Hong Kong are least likely to receive 'no benefits' and those in the UK are most likely to receive 'no benefits'.
- SMEs in continental Europe are much more willing to change bankers than their counterparts in Hong Kong, the UK and the US.

#### **CHALLENGES FACED BY SMES**

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##### **General issues**

- Obtaining new business and general finance-related issues are the biggest challenges facing SMEs.
- Future planning is high on the list of challenges facing SMEs.
- Public sector bodies are identified by accountants in a number of countries as prime examples of slow payers.

#### **Country-specific issues**

- In the US, recruiting and retaining employees is identified as an issue by SMEs and this is confirmed by the accountants interviewed.
- The cost of employees is an issue for Germany, with the accountants' focus group suggesting that with new EU employment legislation this will become more important.
- SMEs in Spain identify competition as an issue. The focus group suggested that this is due to competition from low-wage economies such as the accession states, now that Spain is no longer a low-wage economy.
- German SMEs identified slow payment as an important issue whereas although this is an issue in Spain the use of factoring by SMEs offsets its effects.
- Red tape and regulation is more of an issue in the UK and Germany than in any of the other countries surveyed.

#### **ADVICE, ADVISERS AND THE ROLE OF THE ACCOUNTANT**

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##### **Sources of advice**

- Accountants, lawyers and banks are the most frequently used sources of advice.
- SMEs' use of advisers is correlated to the size of their business, with 75% of the largest SMEs seeking advice compared with 43% of the smallest.
- Country variations exist in the ordering of accountants and lawyers, some of which are role related, eg the split between tax advisers and accountants in Germany and the role of lawyers in Spain.

- Country-related differences are also apparent in the use of business colleagues. From the explanations provided by the SMEs' accountants, this is related to issues of attitude and trust.
- Government and public agencies are ranked lowest as a source of advice; explanations for this included lack of expertise, trust and commitment.

#### **Role of accountants**

- Accountants are the most frequently used source of advice across the whole sample.
- They are used most for tax, audit and accounts preparation work.
- Fewer than 40% of SMEs claim to use their accountants for business planning, general advice or as management consultants.
- Similarly, fewer than 40% claim to use their accountants for advice on finance.
- The accountants' results on these areas differ – discussions suggest that advice is often sought in a less formal way and sometimes after the first approach to a financier.
- The use of accountants for advice on finance varies from country to country, with Spanish SMEs using their accountants almost twice as much as their UK counterparts.

#### **Influencing factors**

- The effects of variations in regulations covering SMEs' financial reporting make inter-country comparisons difficult without further in-depth research.

- The acceptance by bankers in the US of annual accounts prepared for tax purposes, using tax-related rules rather than generally accepted accounting practice, appears to be a sensible way of reducing burdens on SMEs.
- The separation of accountants' roles to comply with professional guidelines on auditor independence may inhibit the use of accountants for both finance and business-related advice.

#### **CONCLUSIONS**

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The findings from the study show that SMEs' levels of satisfaction with their banking arrangements are generally very high, although there are areas where this could be improved. The inter-country comparison shows that there are vastly different 'norms' for the number of banking relationships an SME might have. Nonetheless, there does not appear to be a significant negative or positive correlation between the number of banking relationships and levels of satisfaction.

Although the size of the SME and the complexity of its financing needs may be a contributory factor in determining the number of relationships an SME has, the primary factor is the country in which it operates. This may be because the number of such relationships may depend in part on the different historical structures of the banking industry in different countries. For example in the US, Germany and Spain there are more banks operating than in the other countries studied, and there is a longer tradition of small localised and specialised banks. This affects the number of providers a business may have to use to meet its financing needs. The existence of a localised banking structure may also affect the expectations of bankers and their knowledge, not only of the business but also of the environment in which it operates.

The indications are that consolidation in the banking industry in Germany, Spain and the US is providing new and unexpected challenges for SMEs as the potential for a bank's policies to change after consolidation may leave them without a source of finance. This in turn is encouraging accountants to advise clients to have multiple banking relationships to reduce the risk arising from changes in banks' policies. It is also clear that differences in size and function of banks in different countries, as well as increased competition, lead to differences in the number of banking relationships that SMEs have. The overall conclusion to be drawn here is that there is no one right way of setting up a banking structure to support SMEs. Indeed, it would appear that the different systems have worked in the past but that some of the changes that are currently occurring, perhaps influenced by global competition or by regulatory changes such as Basel II, are having unintended consequences some of which are detrimental to SMEs' established banking relationships.

There appears to be a gap in the provision of finance for SMEs with an annual turnover of up to £1 million, which leads to lower satisfaction ratings by this group of SMEs. The reasons for this are not immediately apparent although respondents have suggested that the cost of providing a fuller service is such that banks are reluctant to do so. On the other hand, if the services demanded were only those based upon the services these SMEs currently use, meeting their needs would not be a problem nor would there be a lower satisfaction rating. It would appear, therefore, that the supply does not match the demand or expectations of this group of SMEs. It is possible that the explanation here may lie in the fact that, because of their reliance on collateral, their aspirational needs are not being met and this, as suggested by some accountants interviewed, is acting as a barrier to further growth among SMEs within this size range.

The main issues faced by SMEs tend to be business issues such as competition and getting new business. These are difficult issues for SMEs to address and they are likely to get worse as a result of the impact of the accession states coming into the EU and increasing competition from China and India. Some issues were very country-specific, eg the problems of recruiting and retaining employees in the US and the cost of employees in Germany, but when considered together with the effects of competition these may also provide some indications for the future of SMEs in other advanced countries, especially those within the EU.

Although there is considerable evidence from other research that accountants, lawyers and bankers are the most frequently used source of advice and this is confirmed by this survey, there are factors identified within this research which may warrant further consideration. In the case of accountants, the changing structure of the profession and the impact of regulation and self-regulation to protect audit independence, although unlikely to affect tax- and accounting-related advice, may lead to problems for SMEs in accessing appropriate advice on financial and business matters. Similarly the shifts within the banking industry away from localised banking services are having an impact upon the SME sector and are likely to have an even greater effect in future.

## RECOMMENDATIONS

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### The banking industry

Although in general the banking industry is providing a service that satisfies its SME customers, there are areas that warrant further consideration and research:

- the possible gap between the aspirations of SMEs with turnover up to £1 million and the services provided
- the level of satisfaction with charges, tariffs and benefits and the impact of this upon banking relationships
- the effects of moving from localised decision making to more centralised decision making in terms of banks' understanding of an SME's business and the business environment in which it operates, and the apparent remoteness of the decision makers from the SME.

### The accounting profession

The survey results show very high levels of SME satisfaction with their accountants, but they also highlight some areas for concern:

- the relatively low use of accountants for advice on matters relating to finances, which, with an ever-increasing range of financial products becoming available, must raise the question of the sources of advice that SMEs are currently using and the adequacy and appropriateness of that advice
- the effects of regulatory and self-regulatory regimes relating to audit independence on access to accountants as a source of advice
- the question of whether accountants should be taking a proactive rather than reactive role in assisting their SME clients with finance-related advice

- the extent to which accountants can play a positive role in identifying simpler structures for accounting to meet the needs of the various users, eg to what extent the needs of the owner, the tax authorities and financiers can be met by one single form of reporting.

### Policy makers and government

The findings show that the effects of regulation and red tape are not universal problems and lessons can therefore be learned from other countries. Some other issues thrown up by this work that may be worthy of consideration include:

- whether there are lessons to be learned from the issues of the cost of employment and the difficulties in recruitment being faced by SMEs in Germany and the US
- how to improve the take-up of government sources of advice to SMEs
- how to encourage smaller SMEs to access the advice that is clearly available to them
- whether to encourage more use of business colleagues as a source of advice, as occurs in Germany and the US, and how to achieve the change.

# 1. Introduction

Small businesses have been seen as an important source of employment and growth in the economy. It is widely appreciated that banks are the main, if not the sole, source of finance for these small businesses (SMEs). The importance of the accounting profession as advisers to SMEs is also widely recognised. Most research to date on banking relationships with SMEs and SME relationships with accountants has been one sided and country specific. Where comparisons have been drawn between countries this has tended to be based on different data sets from each country. The present work aims to provide a basis for inter-country comparisons by collecting a common data set from each of the five countries included in the survey. These countries are Germany, Spain, Hong Kong, the UK and the US. They include three countries where an Anglo-centric approach is dominant, namely the UK and the US and to a lesser extent Hong Kong, which is clearly heavily influenced by its past. By contrast, Germany is a European country where the banking structure and the structure of the accounting profession differ markedly from those in the UK, hence Germany is often held up as an example of how SME banking can be done differently. Lastly, Spain has been one of the 'tiger' economies of Europe and has a highly competitive industrial sector as well as a banking structure with a greater number of banks than is the case in the UK. Many of these banks are regionally based and provide limited or specialist services that affect the SME–banking relationship.

## 1.1 EARLIER RESEARCH

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The issue of small business finance has been a topic of discussion and debate for many years. Taking the UK as an example<sup>1</sup> we find that there have been numerous

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<sup>1</sup> It is possible to trace a similar pattern of literature in the United States of America, and later in this report we refer to work by the US Small Business Administration. Similarly, it is possible to find some work on this topic relating to Germany, eg A. Mullineux (1994).

government commissions addressing the topic (Bolton 1971; Macmillan 1931; Radcliffe 1959; Wilson 1979). This has been matched by considerable research effort over the years. Studies concerned specifically with banks as a source of small business finance include the Warwick study (Fraser 2004) but can be traced back over a number of years (see, for example, Berry et al. 1993; Binks et al. 1992a; Binks and Ennew 1996; Cosh et al. 1996; Cruickshank 2000; ESRC Centre for Business Research Cambridge 2000; Keasey and Watson 1994). A further strand of publications is concerned with the relationship between banks and SMEs. Here the work carried out for the Forum of Private Business (Binks 1991; Binks et al. 1992b; Binks and Ennew 1997; and the Forum of Private Business 2004) consistently identifies SMEs' relatively low levels of satisfaction with their banking relationships. A counter view is provided by the results of the Institute of Directors' survey (2000) that showed only 9% of respondents had a 'bad' relationship with their bank, 25% had an 'acceptable' relationship and the remainder were satisfied. Similarly, the Federation of Small Businesses' report (2000) found 72% of respondents were neutral, satisfied or very satisfied with their bank relationship. The Bank of England's survey (2004) suggested that there were improvements in the relationships as a result of an improvement in the banks' understanding of SMEs, and better communication. The latest survey by the Federation of Small Businesses (2006), however, suggests a lowering in SMEs' satisfaction with banks as a source of advice.

To date, the research and other work published in the area of banking and SMEs tends not to attempt to make any comparisons between countries. Where this is done, the comparisons tend to rely on different data sources. This report addresses that gap in the literature by reporting on data collected through the use of the same research instrument in five different countries. It provides an analysis that enables the survey results to be viewed in a comparative context.

In addition to providing a comparative analysis of the five countries the report also draws upon independent and parallel research with accountants and upon confirmatory and explanatory research carried out with accountants dealing with SMEs in each of the five countries.

## 1.2 THE CURRENT PROJECT

For this work the data was collected from SMEs, and from accountants dealing with SMEs, in each of the five countries. This data provide different perspectives on SMEs' banking relationships, their relationships with accountants as advisers, and on the accountants' views of banks as providers of finance and banking services to SMEs. The data were collected by using the same research questions for SMEs in each of the five countries and by asking similar questions of the accountants.

### **Aims and objectives**

This study is intended to shed light on the gap in the literature by providing comparative rather than country-specific information. In particular, the aim is to provide an inter-country comparison of SMEs' relationships with their banks and advisers and an insight into the issues faced by SMEs in five different countries. The study draws upon the views of SMEs in each of the countries and upon the views of accountants working with SMEs in each of those countries. The report contrasts the views of SMEs and accountants, highlights country- and size-based differences and relates these to the banking structural arrangement and cultural contexts of each of the countries.

In order to be able to compare results from the different countries it is important to understand that the banking structures differ in each of the countries and that these differences may affect the results and the interpretation of those results. For this reason, Chapter 2 describes the banking structure in each of the countries surveyed.

Chapter 3 discusses the accounting profession and the regulatory regime in each of the countries concerned. This provides the background and context for the interpretation of the results relating to SMEs' relationships with their accountants and the accountants' relationships with SMEs' banks.

Chapter 4 is concerned with providing the reader with an overview of the research methods used. The respondents and their characteristics are explored and information is provided to enable the reader to understand the structure of the samples, including the industry base, the markets in which the SMEs operate and the size characteristics of the SMEs surveyed and of the accountants' client bases.

The main body of the report is divided into three chapters. The first of these, Chapter 5, deals with banking relationships, the next (Chapter 6) with challenges facing SMEs, and then Chapter 7 discusses their use of advisers. In each of these chapters the analysis covers three perspectives. The first two of these take the data from the SME survey and analyse these from both a country-based perspective and a size-based perspective and then identify which of the two aspects is the driving factor in the responses obtained. The third perspective is that of the accountants in each of the countries, and here the results are interwoven into the analysis in order to provide either contrasting or confirmatory evidence or to provide possible explanations for the differences identified in the SME data sets. Where appropriate, the reader is referred back to the introductory sections on country-based differences in the banking and accounting profession structures.

Chapter 8 brings together the results of the analysis and presents conclusions, putting these into the context of the countries concerned. It identifies areas for further research and issues for consideration by the banking industry, the accounting profession and policy makers.

## 2. Banking structure and characteristics

In any inter-country research it is important to recognise that the context of each country will have an effect on the answers obtained from the participants in the research. This overview does not claim to be comprehensive nor are any claims made about the precise accuracy of any of the percentages quoted, as the sector is dynamic and changing to a greater or lesser extent in each of the countries included in this report. The intention is to provide the reader with a broad overview of the banking structures and the context in which small business finance operates within each of the countries.

### 2.1 GERMANY

#### **The structure of the banking industry – overview**

The German banking system has a decentralised composition and relatively low concentration. The structure of the German banking industry is fragmented, comprising the large commercial banks, the savings banks, the cooperatives and the development banks. One distinctive characteristic of the German banking market is the significant presence of non-commercial banks. The public-sector banks occupy the largest market share in terms of total assets; the Sparkassen (savings banks) and Landesbanken (regional state banks) enjoy over 34%, while the inclusion of state-owned mortgage banks, special purpose banks and development banks brings the public sector influence to 45%. The non-commercial Genossenschaftsbanken (cooperative banks) also hold a considerable market share of approximately 15%, leaving the commercial banks with 28% in terms of total assets (Audretsch and Elston, 1997). The large commercial banks tend to serve German public companies (AGs) and make a significant proportion of total loans to banks nationally and internationally (Weber 2002). The non-commercial banks as a whole are particularly dominant in the Mittelstand (small and medium-sized firms) sector and are noted for their prevailing presence on the high

street (Rushton 2004). The situation in Germany is undergoing considerable change, with an increasing presence of foreign banks and the abolition of state guarantees for its public sector banks, making it an even more attractive market for foreign banks.

#### **SME banking providers**

The need for financing of this sector has mainly been satisfied by the Sparkassen and Genossenschaftsbanken. Vitols (1998) suggests a three-tier structure of both the savings and cooperative banks.

- The savings banks consist of a bottom tier of local banks typically owned by the city in which they are situated, where both the bank and the local government are mutually dependent.
- The middle institutional tier comprises financial intermediaries, including Landesbanken (regional state banks), with the main function of accessing national capital markets and offering consultancy to the savings banks.
- The third tier serves on a national level and offers access to national and international capital markets.

The cooperative banks, which originated from craft societies and agriculture, also display a three-tier structure; the bottom tier consists of local banks that are mostly owned by SMEs themselves (always a large number of shareholders with basically no significant influence on the bank's commercial direction). The middle-tier offers regional services, including training, to the bottom tier, and the top tier adds general structure.

#### **Government support and banking**

Government support in financing the Mittelstand is delivered through the banking system. A network of subsidised loans and loan guarantees are made available to the SME's main bank, which is commonly

referred to as the Hausbank, by referring qualifying applications to guarantee banks (Burgschaftsbanken) or development banks such as the Kreditanstalt für Wiederaufbau (KfW) (Mullineux 1994). Government-backed subsidised loans and grant funding are offered in wide-ranging formats depending on regional locality, size of business, age of business and industry. The KfW is partly state funded and, by virtue of their state backing, the development banks such as KfW enjoy positive credit ratings and can raise finance cheaply (Mullineux 1994). The Hausbank forwards successful loan applications to the KfW, which then supplies the finance in return for a guarantee (up to 85%). The Hausbank retains the default risk and receives a premium of approximately 1% of the total loan amount per annum to cover running costs. The relationship is mutually reinforcing, as the KfW requires the bank guarantee to make funding available and the bank is able to 'refinance' the principle instead of using the deposit base.

#### **Banking and SMEs – other factors**

It is important to note that references are frequently made to the Mittelstand rather than to SMEs. The Mittelstand refers to family-owned and managed businesses with a turnover of up to a few hundred million Euro. This is larger than the definition of small firms in other countries.

In Germany, the cost of loan finance is reported to be relatively cheap compared with countries such as the UK and the US. This feature is intrinsic to an economic environment noted for stability and a low failure rate of small firms. There are several possible explanations for this. First, the prevalence of non-profit making banks in the SME market results in cheaper financing costs than their counterparts in, for example, the UK and US (where commercial banks cater for SME financing requirements). Secondly, German banks have a greater propensity to offer long-term loans at fixed rates, the outcome of which is reflected in lending costs. Thirdly,

the competition between the Sparkassen and Genossenschaftsbanken on one side and the commercial banks on the other historically resulted in lower borrowing costs compared to other countries. Another possible explanation concerns the acceptable risk levels of proposals. A study by Midland Bank plc (1994) suggested that German banks whittle out riskier proposals early on in the decision process, thus lending only to sound propositions. Furthermore, the sharing of risk between institutions reduces the vulnerability of one individual loan provider and thereby allows a lower risk premium to be included in the cost of borrowing.

## **2.2 HONG KONG**

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### **The structure of the banking industry – overview**

The Hong Kong banking industry is highly competitive and decentralised. Hong Kong operates a free market economy with minimal government intervention and bureaucracy. The tax system in Hong Kong is also exceptionally favourable and simple. This has encouraged substantial investment from international banks and significant growth opportunities. International banks from over 30 countries operate in Hong Kong, including 71 of the 100 largest banks in the world ([www.tdctrade.com](http://www.tdctrade.com)). The structure of the Hong Kong banking industry is organised in three tiers; licensed banks, restricted licence banks and deposit taking institutions ([www.tdctrade.com](http://www.tdctrade.com)); branches of foreign banks are also significant to the market. Only licensed banks are permitted to offer savings and current accounts, and there are 24 such banks in Hong Kong. The KPMG Banking Survey Report (2004) found that in terms of market share by net assets the licensed banks held the greatest proportion (57.4%), followed by foreign bank branches (40.9%), restricted licence banks (1.3%) and then deposit-taking companies (0.4%). In 2006 there are 208 authorised institutions (AIs) which are regulated by the Hong Kong Monetary Authority (HKMA). The top five largest banks in terms of net assets are Hong Kong Shanghai Bank (HSBC),



Bank of China (Hong Kong), Hang Seng Bank Ltd, Standard Chartered Bank and Bank of East Asia.

### **SME banking providers**

Because of the highly competitive structure of the banking industry, SMEs in Hong Kong have a large choice of potential providers. It is not clear to what extent foreign banks participate in the SME market. If experience in the UK (Berry et al. 2003) is mirrored in Hong Kong they are unlikely to play a significant role in banking for SMEs, leaving this to the local banks with the branch networks and infrastructure to support this type of banking relationship.

### **Government support and banking**

The Hong Kong government offers significant assistance by way of funding and business advice. Many of the government-funded services are offered to all firms regardless of size or origin. Because SMEs constitute 98% of private sector organisations, however, such schemes are used mainly by SMEs. There are four main schemes offered by the Trade and Industry department: the loan guarantee scheme, the export marketing fund, the training fund, and the development fund. The loan guarantee scheme is divided into three separate initiatives according to purpose: Business Installation and Equipment Loans, Associated Working Capital Loans and Accounts Receivable Loans. The maximum loan per SME for the Business Installation Loan scheme is HK\$2 million for a period of five years; Working Capital Loans are available for up to HK\$1 million for up to two years. The export marketing fund requires the SME to match government grant funding with a maximum of HK\$40,000 and the training fund offers grant funding up to HK\$30,000. The development fund is available only to not-for-profit organisations and research institutes that fulfil certain criteria.

### **Banking and SMEs – other factors**

In 2004 the Hong Kong Monetary Authority launched the Commercial Credit Reference Agency (CCRA) to

collate information on the financing structure of small firms. The aim of the CCRA is to give SMEs better access to finance and to reduce risk for the banks. This would seem to indicate that there is some concern with the current situation from both an SME and a banking perspective.

## **2.3 SPAIN**

### **The structure of the banking industry – overview**

The Spanish banking structure is highly concentrated within the retail banking market, with the two largest operatives maintaining 80% of commercial banking assets (Economist Intelligence Unit 2005). Despite the concentration and dominance of the two largest retail banks, a strong network of regionally based savings banks (Cajas) and smaller specialised commercial banks has ensured a competitive environment. Geographically, Spain is strongly regional, and the regions have fostered a specialised banking environment according to location. The 17 regions maintain autonomous control over local banks, as well as funds allocated by central government, and are protected from takeover.

The commercial banking sector is dominated by the two most significant retail banks: Banco Bilbao Vizcaya Argentaria (BBVA) and Banco Santander Central Hispano (BSCH), although 78 retail banks exist (Crowley 2004). The commercial banks have traditionally focused on large corporate customers, leaving personal banking and smaller-firm facilities mainly to the savings banks. Despite a tradition of oligopolistic dominance by the commercial banks, deregulation over the past decade has created a competitive environment. The effect of deregulation has been an increase in the domestic branch networks of the savings banks while the commercial banks have followed strategies of diversifying into international markets and merging with competitors (Kumbhakar et al. 2001). Despite the deregulation and consolidation

of the industry, the dense branch network may still be a significant barrier to entry from international competition unless, like Barclays,<sup>2</sup> they are prepared to invest heavily in a branch network.

### **SME banking providers**

A system of mainly state-owned and specialised savings banks facilitates finance through a variety of schemes, including some part state-securitised guarantees. These savings banks have historically been, and remain, the main provider of finance for SMEs. Since 2000, however, commercial banks such as Banco Popular have successfully sought to serve this market by bundling services at competitive rates and offering an alternative to the regional savings banks.

The savings banks sector originated in the nineteenth century to serve the general public. The banks have traditionally been owned by the state and run by local committees and thus they have avoided pressures from shareholders to pursue profits. The deregulation of the banking structure at the turn of the present century has allowed the savings banks to restructure their capital and issue 'participating stakes' to private investors (without voting rights) to raise finance (The Economist (US) 2002). The introduction of such participating stakes and the opportunity to raise finance through the stock market may strengthen the position of the savings banks but may also result in a more profit-oriented approach to lending. The implications for lending to the SME sector (their core business) are yet to be seen.

The savings bank market currently consists of approximately 47 banks (Kirkman 2003), with the two largest being La Caixa and Caja Madrid (Economist Intelligence Unit 2005). The savings bank network controls 50% of all banking deposits and thus holds significant importance; furthermore, the savings banks

account for 46% of non-corporate lending (Wise 2005) and are self-financed.

### **Government support and banking**

As noted above, the savings bank network is the main supplier of finance to the SME market through loans and government funding, as well as benefiting from federal loan guarantee schemes. Specifically, loans to SMEs can be guaranteed through the Instituto de Crédito Oficial (ICO), which is the state-owned credit agency. The ICO funds support and investment in SMEs to promote innovation and technological advance, mainly in regions where state assistance is prevalent. The finance is guaranteed in some cases by the Kingdom of Spain and in others by the European Investment Bank (depending on the purpose of funding and loan structure). Valid comparisons with other countries are problematic, although it appears that the structure of guarantee schemes is less complex than that of those found in Germany, for example, and such schemes are more common than in the UK.

### **Banking and SMEs – other factors**

Evidence from the Spanish banking literature suggests that the existence of long-term banking relationships increases the availability of debt finance but does not result in reduced costs (Cardone et al. 2005). SMEs in Spain have an average of 4.5 banking relationships with an average duration of six to ten years' duration for small and medium-sized firms and three to five years for micro-firms (Cardone et al. 2005). The core banking needs of SMEs appear to be satisfied by the savings banks' dense branch networks (exceptions to this include specialised mortgage banks and banks supplying finance to agriculture). The result of increasing competition has been the continuous pursuit of new products to maintain customer loyalty (Crowley 2004).

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<sup>2</sup> Barclays has established a branch network of more than 5,000 branches in Spain.

## 2.4 UNITED KINGDOM

### The structure of the banking industry – overview

The structure of the UK banking industry was seen as segmented up until the mid 1990s. Traditionally, the banking industry could be split according to its functions; for example retail,<sup>3</sup> merchant banking and building societies. In 2006, although the market is dominated by four large 'retail' banks, each of these banks conducts many of the main banking functions under one organisation (Howells and Bain 2004). Therefore, to understand the structure of the UK banking industry it must be noted that the large banking groups perform more than one activity and the industry is characterised by a small number of heterogeneous suppliers (Buckle and Thomson, 1998). The most prominent players in UK banking are the 'big four': Barclays, HSBC, RBoS-NatWest, and Lloyds-TSB (Howells and Bain 2004), all of which are commercial, profit-making organisations. Each of these banks offers a wide range of services, from retail banking to investment banking, for both businesses and personal customers. The 'big four' banks hold around 84% of market share between them with roughly equal distribution (Lund and Wright 1999). The current banking structure has evolved from a number of mergers and acquisitions; one criticism of the industry is a lack of competition due to aggressive merger activity and an oligopolistic environment.

### SME banking providers

Because of the dominance of the 'big four' it is hardly surprising that the SME sector is largely banked by these banks. Since the mid 1980s, building societies and, to a lesser extent, Internet-based banking providers have been active in the SME market. In the case of building societies and ex building societies, the main area of finance offered initially was commercial mortgages, although some have now extended the range of services offered. Despite these changes the big four are still dominant, with a market share of around 80% (Cruickshank 2000; Fraser 2004).

### Government support and banking

The government has taken steps to support the SME sector through organisations such as the Small Business Service (SBS). One of the key issues for the SBS is the availability of finance. As an attempt to encourage banks to lend to SMEs, the SBS offers a small-firm loan guarantee scheme where a loan is applied for through the retail banks and 75% is guaranteed by the government. The scheme enables firms with insufficient security to obtain bank loan finance. Other forms of finance available to SMEs include grant schemes. Grant schemes are available from a range of sources and are intended for a specific purpose, although they tend to be concentrated in certain key sectors and usually require the firm to 'match' funds given.

### Banking and SMEs – other factors

A wealth of research suggests dissatisfaction within the small firm community with the availability of finance (Bolton 1971; Cruickshank 2000). In the UK, SMEs have found difficulty in obtaining finance because of information asymmetry;<sup>4</sup> the firm owner generally has better performance information than the bank when seeking finance (Lund and Wright 1999). Furthermore, bank lending criteria have been seen as incongruous with SMEs' specific circumstances and often unachievable. A body of evidence suggests that this climate is now changing. The Bank of England report (2004) suggests that there is a greater awareness by the banks of the unique set of problems faced by SMEs, and better communication, and it indicates that past difficulties are gradually improving. This is in line with the finding of general satisfaction (Fraser 2004).

<sup>3</sup> Retail includes banking for SMEs.

<sup>4</sup> As will be seen later in this report, it is worth noting that because SMEs outside the UK tend to have more banking relationships the problems of information asymmetry are likely to be more pronounced elsewhere.

Fraser (2004) shows that nearly 60% of UK SMEs have a single banking relationship. This may be explained in part by the range of financial products offered by the main banks, either directly or through their associated non-bank subsidiaries. Services such as asset finance and factoring have seen significant growth since the mid 1990s, and this has been matched by a decline in traditional bank finance from around 60% in the late 1980s (Lund and Wright 1999) to around 50% in 2006.

## **2.5 UNITED STATES OF AMERICA**

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### **The structure of the banking industry – overview**

The structure of the US banking industry is a product of continual reform and the fear of centralised governmental control and domination of monetary interest (Howells and Bain 2004). The market-based banking system is dominated by the commercial banks, but a large number of savings associations, mutuals and credit unions also operate within the market. The large numbers of banks that characterise the US banking industry are the result of locational restrictions placed upon banks until 1994. In 2000, 8,315 commercial banks operated in the sector, despite a large reduction due to mergers and acquisitions around the turn of the present century (Howells and Bain 2004). Mishkin (2002) also estimates that 1,200 savings and loan associations, 400 mutual savings banks and 12,000 credit unions are present in the sector. Although the commercial banks as a group are the largest in terms of deposits, the top ten banks account for just under 60% of the total assets of the industry (Mishkin 2002). The five largest commercial banks are Citicorp, Chase, Bank of America, Wachovia/First Union, and Wells Fargo (Mishkin 2002).

The US has a dual banking system; banks are either chartered by individual states or by federal government. Until 1994 few states permitted banks that operated in other states to open branches. This led to a situation

where a multiplicity of banks operated in the US but not across the US. The rationale for this was rooted in a fear of central governmental control. One of the perceived advantages of the large number of banks was greater competition. The counter argument was that inefficient banks remained in business owing to a lack of effective competition. In some areas, the lack of competition created localised oligopolies and even monopolies. The Interstate Banking and Branching Efficiency Act (IBBEA) passed in 1994 permitted banks to form interstate branch networks. The passing of the Act marked a significant shift in the US banking industry, with a trend towards mergers and acquisitions, particularly in the commercial banks. This trend towards merger continues today. Deregulation has achieved the aim of greater competition but economies of scale and larger numbers of banking relationships appear to have had a negative effect on credit availability to small firms (Strahan and Weston 1998).

### **SME banking providers**

The providers of most finance are the local and regional banking organisations that provide a more personalised service than the national-level banks. The sector is continually changing, with local banks being merged or bought out to form larger regional banks, and new local banks entering the market. It would appear to be the case that as an SME grows it is likely to need to change banks in order to access the increased finance required by its growth.

### **Government support and banking**

Small firms in the US can also access finance from grant schemes and favourable rate loans. Although the federal government does not offer any grant schemes, individual states operate differing schemes depending on industry and purpose. The Small Business Administration offers a loan guarantee scheme through the commercial banks for small firms that cannot raise finance by themselves. The scheme will lend up to \$2 million with a maximum guarantee of \$1 million. Other

small-firm loans include the Certified Development Company scheme, which offers fixed interest rate borrowing with up to 100% guaranteed, and the Microloan programme for newly established firms. In addition, there are specific schemes to support start-ups among ethnic minorities and female entrepreneurs.

**Banking and SMEs – other factors**

Debt finance is the primary source of funding for small firms. Research by Small Business Administration (2005) found that in 1998 there was a total of \$700 million of outstanding credit to small firms. Of this, 57% originated from the commercial banks, 12% from owners' loans and 11% from other finance companies. Contextually, the commercial banks lend the most significant amounts of money to small firms. Research also suggests that small firms in the US engage in few banking relationships, often with only one bank supplying finance (Strahan and Weston 1998). Small firms build long-term relationships with their banks and thus overcome difficulties of information asymmetry. Peterson and Rajan (1994) suggest that the banking relationship is vital to securing lower interest rates and assessing credit worthiness. The banking relationship appears to have been a casualty of consolidation within the industry, in that harmonising practice across branch networks has resulted in an increase in the number of relationships and increased risk exposure. Previously, bank managers were able to monitor portfolios of small firms more closely and potentially offer tailored finance. It is now more likely that standard packages are offered and centrally controlled and monitored.



## 3. The accounting profession and its role

Although accountants and lawyers exist in all countries included in the study there are subtle differences in the organisation of the professions, the rules and ethics governing their work and the roles they traditionally undertake. This chapter provides a brief overview of the differences that are pertinent to this study and the interpretation of the results contained herein.

### 3.1 GERMANY

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#### **The profession**

For simplicity, the German professional area can be characterised as having two distinct parts; the auditing profession (Wirtschaftsprüfer) and the tax advisers (Steuerberater). This broad characterisation covers such subtleties as taking the exams to become a tax adviser part way through the training to be an auditor. Most, if not all, auditors could therefore practise as tax advisers but tax advisers cannot do audits. In practice, for the purposes of discussing SMEs, the broad categorisation generally works because although one can be a tax adviser and accountant to a business one cannot also be an auditor. The audit function has to be clearly separated. In Germany, as in other EU countries, the requirement for audit has been removed from all companies that fit within the EU definition of a small business.

All businesses, irrespective of size, have to produce accounts for tax purposes and a further set as required under EU company law, although the level of compliance by small businesses with the latter requirement is still very low in Germany; our focus group (see Chapter 4, Research method) put it at around 5%. This, they argued, was related to competition and sensitivity around financial information, especially where firms were producing only a single product.

The tax accounts are not generally available to the public but may be used by the banks. They are prepared by tax advisers/accountants owing to the

complexity of the taxation regulations. One has to be a qualified accountant to produce the accounts and must sign the accounts with a declaration. These declarations range from a statement saying that the accounts were prepared from the information provided through to a partial audit.

In effect, this means that for most small businesses preparation of these accounts is outsourced to a qualified tax advisor (mostly) or accountant (sometimes).

The small business market is essentially served by local and regional accounting firms; the 'big four' are interested only in the top end of the Mittelstand market.

#### **Definitions of small businesses**

In Germany, although the EU definitions of small and medium-sized firms are adopted, there are issues around the use of these definitions. Traditionally in Germany there has been a distinction made between businesses based upon ownership and access to and use of external capital. Thus the public companies (AGs) would raise money on the capital markets whereas the Mittelstand, which range in size from very small to very large, do not. This has led to issues in Germany in relation to the adoption of common definitions. These are exacerbated by tradition on one hand and access to EU funding and grants, where EU definitions prevail, on the other.

### 3.2 HONG KONG

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#### **The profession**

The profession in Hong Kong largely reflects that found in the UK, with accountants being members of a recognised professional body. The Hong Kong Institute of Certified Public Accountants (HKICPA) regulates the profession and in order to carry out audit work an accountant requires a practising certificate. This is issued by the HKICPA. As is the case in the UK, the professional bodies have a code of ethics covering accountants' services to clients and the extent to which

they can provide audit. These ethical guidelines are less formal and clear cut than in Germany but still comply with the same basic premise that in order for the audit report to have value there is a need to establish the independence of the audit function from the work of accounts preparation and tax work.

All companies incorporated under the Companies Ordinance are required to produce accounts with an auditors' report. There is no audit threshold exempting small audits.

For tax purposes, there is a concession to small corporations where the total gross income of the business does not exceed \$HK500,000 for the basis period: it is not necessary to submit the supporting documents when lodging the Tax Return. These supporting documents include the audited accounts, although the companies still need to prepare these documents upon completion of the Tax Return and the Inland Revenue Department may request the companies to submit these documents.

#### **Definitions of small businesses**

Small firms are defined by the Trade and Industry Department as manufacturing firms with fewer than 100 employees and non-manufacturing firms with fewer than 50 employees.

### **3.3 SPAIN**

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#### **The profession**

Spain has three professional accountancy bodies and separate from these is the audit profession, which is regulated through the Institute of Auditors. The latter comes under the Ministry of Trade.

Accountants cannot prepare the accounts and audit a company. A single accountant cannot provide tax, accounting and audit services to a company so the profession is organised into separate entities for each of these functions.

All businesses have to produce accounts in line with EU law and these have to be prepared by qualified accountants. In accordance with EU law, the content and the extent of disclosure in the accounts vary according to the size of the business. In general, small companies are not subject to audit although this may be required for their own purposes or for tax purposes. In addition, banks may require audited accounts as a condition of a loan.

The structure of the profession mirrors that found elsewhere, ranging from a sole practitioner through to the 'big four'. In Spain the 'big four' are active in every market, including SMEs.

#### **Definitions of small businesses**

Spain has adopted the EU definitions, which are probably the definitions most widely used by accountants and bankers.

### **3.4 UNITED KINGDOM**

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#### **The profession**

The UK has a number of professional bodies with three, the Institute of Chartered Accountants in England and Wales, the Institute of Chartered Accountants in Scotland and the Association of Chartered Certified Accountants, being involved as 'public accountants' providing services to the business community as external accountants.

As is the case elsewhere, there are clear professional guidelines on the separation and independence of the audit function from other advisory and preparation functions, although as mentioned with respect to Hong Kong these are somewhat less formalised in law than is the case in Germany and Spain.

The profession ranges from sole practitioner through small and medium-sized practices to the 'big four'. The majority of work at the smaller end of the SME market is provided by the smaller accounting practices, with



the national practices targeting the medium to large firms and the 'big four' targeting listed companies and global businesses.

All businesses, irrespective of size, have to produce accounts for tax purposes and a further set, as required under EU company law, has to be lodged at Companies House. As is the case in the rest of the EU, small businesses as defined by EU law are exempt from the requirement to produce audited accounts.

#### **Definitions of small businesses**

Although legally the EU definitions of small and medium-sized firms are adopted for financial reporting purposes it is doubtful that they have been universally adopted, especially in the case of small firms, where a plethora of differing definitions and classifications exist. For medium-sized firms the EU definition of up to 250 employees has gained more general acceptance.

### **3.5 UNITED STATES OF AMERICA**

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#### **The profession**

The accounting profession in the US is dominated by Chartered Public Accountants (CPA). In order to practise as an auditor one has to be a CPA. The profession has very clear rules, to which all CPAs have to adhere, on the separation of work. Hence preparation (compiling) of accounts has to be done by a different CPA from the one who does the audit.

There is a clear distinction in the US between three levels of professional accounting work for clients. The first, and simplest, level is compilation, whereby the accountant compiles the accounts on an 'Other statutorily accepted basis'. Generally, this is the one accepted for tax purposes. Above this level there is a review of accounts where the accounts are compared with previous years' figures and industry norms but no formal audit work is carried out. The final level is a full audit.

Small companies are exempt from any formal requirement for audit or for producing a set of financial statements, although they must all produce a set of financial statements for tax purposes.

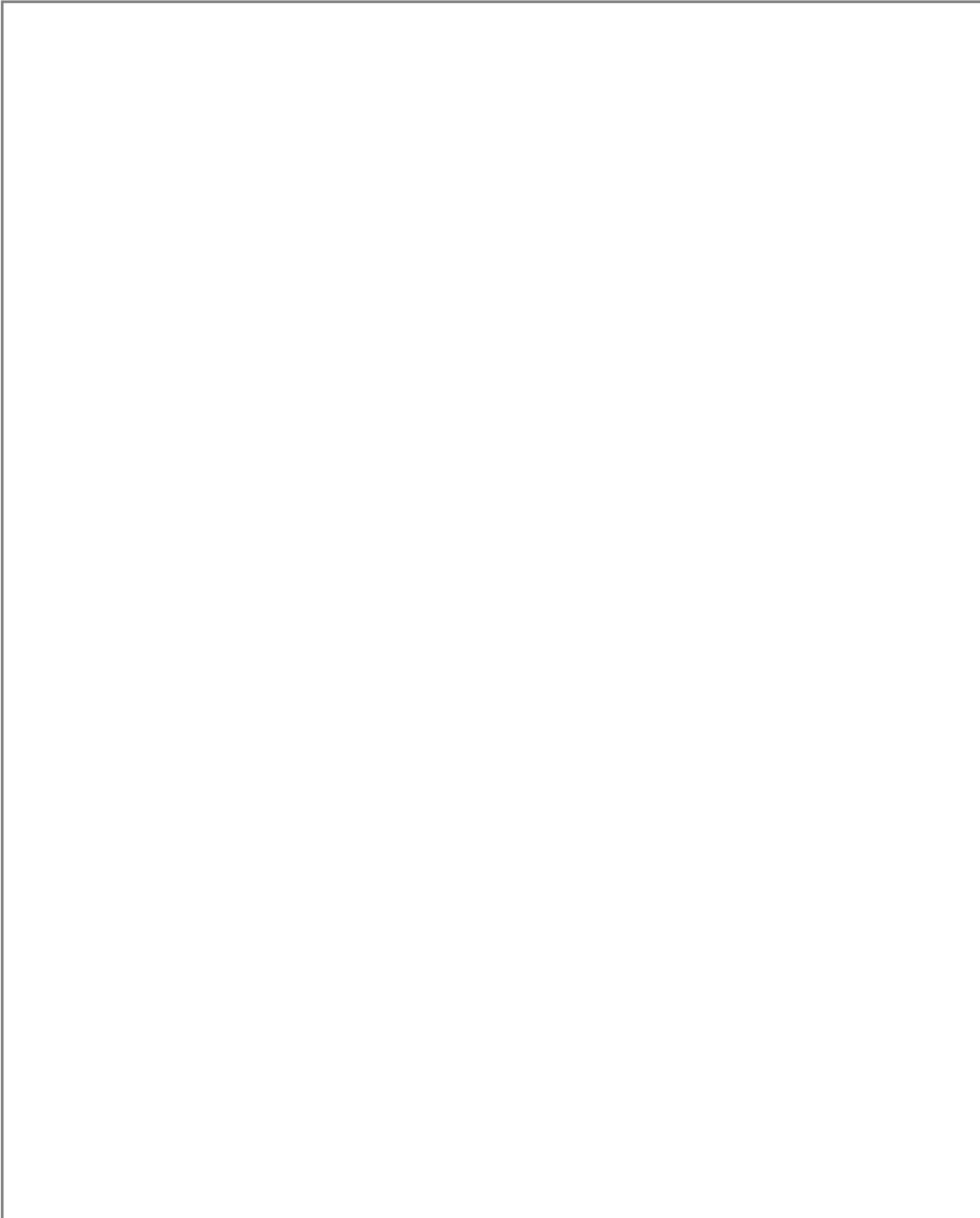
The profession consists of a range of firms of different sizes, ranging from the sole practitioner, through local firms, regional firms to national firms and international firms right through to the 'big four' accounting firms. As is the case elsewhere, the small business market tends to be the preserve of local firms, with national and international firms targeting large and very large corporations.

#### **Definitions of small businesses**

It would appear that there is little agreement on a common definition of a small or medium-sized business as it is argued that this varies by industry. Interviewees (see Chapter 4) offered the following definitions of an SME:

- a company that is not publicly traded
- a company with fewer than 100 employees
- a company with fewer than 50 employees
- it varies from industry to industry, but anything with less than a \$100 million turnover is probably an SME.

In its survey of small businesses, the NFIB (2004) includes all those businesses with fewer than 250 employees.



## 4. Research method

The study consists of three components. The first concerns the background to the banking industry, the accounting profession and the country-specific context within which the SME is domiciled. The second part covers SME responses from five countries to a standardised questionnaire and the third looks at the views of accountants in those countries on issues related to SMEs and their banking and accounting relationships.

The background contextual data (See Chapters 1 and 2) were collected using desk-based research of a wide range of banking texts, refereed journal articles and the professional press. This work was then confirmed and supplemented in discussions with members of the accounting profession in the countries concerned. These chapters cannot and do not claim to be comprehensive. Instead they offer an overview of pertinent issues within banking and the accounting profession in each of the countries.

The second tranche of data is based upon a survey of SMEs carried out by telephone interviews using a standardised questionnaire. The questions posed in the questionnaire were drawn from other survey work such as that mentioned in Chapter 1 above and from issues identified in the small business literature, in particular that relating to SMEs and their banking relationships and the role of accountants for SMEs.

Dunn and Bradstreet were asked to provide details of 2000 businesses that were representative of the SME population in each country. The SMEs included in this sample were then contacted by telephone and asked to take part in the survey. The survey company was required to obtain 200 responses from each country using the Dunn and Bradstreet sample as the base population. The respondents were the main financial decision makers within the organisations. In total, 1,004 responses were obtained from SMEs in five countries, Germany, Hong Kong, Spain, the UK and the US, with approximately 200 respondents from each

country. As would be expected from such a data collection technique, the sample obtained is not fully representative of that population. Small business owners are often far too busy with running the business to take part in this type of work whereas a bigger SME with more employees is more likely to be willing and able to spend the time required to respond. The sample is therefore biased away from the smaller end of the SME spectrum. Hence it is not claimed that the sample is representative of the SME population in each of the countries surveyed. The objective here was to provide an inter-country comparison rather than to replicate other country-specific work such as that carried out by the Centre for Small and Medium-Sized Enterprises in the UK (Fraser 2004).

The analysis of the data was carried out using SPSS (Statistical Package for the Social Sciences). Where appropriate, comparisons are made with other work, but because of the differences in underlying samples these comparisons should be treated with caution.

The final stage was to collect data in each of the five countries from accountants who work directly with SMEs and can therefore claim some expertise in the area of the challenges and opportunities faced by their business clients. In this area there are considerable difficulties obtaining access to 'professional' accountants as they are represented by different professional bodies in each country and in many cases by more than one professional body. As a result, the approach taken here was to collect independent data using a similar research instrument with comparable questions where access to a large number of accountants was feasible. This was the case in the UK and Hong Kong, where access to members of ACCA was provided. The data collected from these countries were independently analysed and then compared with the data from the SME survey to provide confirmatory or complementary evidence and views. These data were analysed using a combination of SPSS and Excel.

In the other three countries, because of difficulties in accessing a large enough population of qualified accountants to make survey work valid, it was decided to adopt a different but complementary approach whereby interviews and focus groups were undertaken with five or six accountants. In Germany, Spain and the US, accountants concerned with SMEs were identified through representatives of the accounting professions in each of these countries who are concerned with international bodies focusing on SMEs and accounting reports. In Germany and Spain a focus group consisting of accountants dealing directly with SMEs and those concerned with accounting regulation and SMEs was set up. The focus group meeting in each country was organised around a set of focusing questions and issues, including a discussion of the findings of the SME survey. In the US it was not possible to find a convenient time to bring together a focus group so here the approach adopted was to interview the prospective members of the focus group individually. The aim of the focus groups and interviews was partly similar to that for the accountants' surveys in the UK and Hong Kong, in so far as a part of the discussion was concerned with collecting confirmatory evidence. Because of the timing of the data collection, however, it was also possible to explore, in some depth, the reasons for differences between countries that had been highlighted in the initial analysis of the SME data (Berry 2006).

The focus groups in Germany and Spain were taped and analysed against the original set of targeted questions and issues. During the focus group discussions, as would be expected, contrasting views were expressed and in some cases a consensus was reached while in others differing views still existed. This is reflected in the analysis and the commentary in the report. In the US, the approach adopted was to use the interviews in a similar way to the focus groups by checking out contrasting responses with subsequent interviewees to provide explanations of differences between the participants. The interviews were then

analysed and the results reported in the same way as for the focus groups. In this way these results can be seen as providing confirmatory evidence of the SME data and insights into different views within countries as well as insights into the reasons for the SME responses from different countries.

#### 4.1 THE SME RESPONDENTS

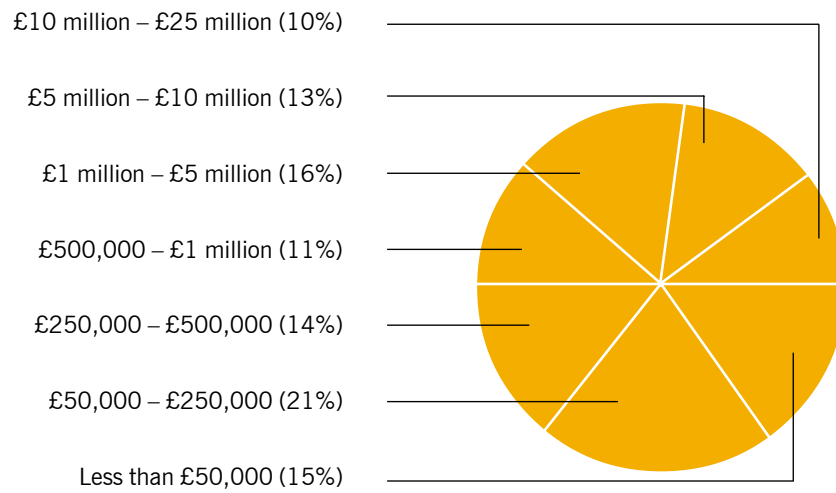
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The paragraphs below set out the main characteristics of the respondents. Fig. 4.1 provides an overview of the total population as measured by turnover.

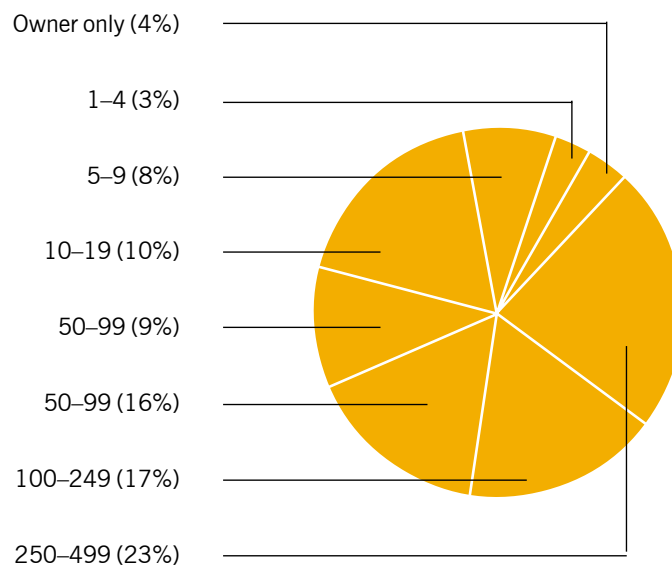
A breakdown of the turnover categories analysed by country is shown in Table 4.1 (see page 26). As can be seen from that table, there are differences in the size profile of different countries' respondents. For example, the US and Spain at 20% and 22% respectively have more micro businesses (ie those with turnover of less than £50,000 equivalent) included in the respondent sample than other countries. Similarly, Germany has a lower percentage of respondents with businesses in the £10 million to £25 million category than the other countries. Nonetheless, taking the percentages with turnover of less than £500,000 or equivalent compared with those with more than £500,000, each country has approximately the same split, at around 50%.

Fig. 4.2 provides an analysis of the total population of respondents by number of employees as an alternative proxy for size. This is then broken down on a country-by-country basis in Table 4.2. As one might expect, there is a strong relationship between turnover and number of employees. About 80% of micro businesses, ie those having turnover under £500,000, have fewer than 10 employees, while those with greater turnover generate more employment. The crossover point from being essentially a micro business in terms of employment would appear to be in the £500,000 to £1,000,000, or equivalent turnover, range.

**Figure 4.1: SME sample by turnover**



**Figure 4.2: SME sample by number of employees**



**Table 4.1: SME respondent size measured by turnover**

<b>Size</b>	<b>Total sample</b>	<b>UK</b>	<b>Germany</b>	<b>Spain</b>	<b>Hong Kong</b>	<b>US</b>
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
Less than £50,000	15	4	12	22	16	20
£50,000–£250,000	21	26	22	18	16	23
£250,000–£500,000	14	18	18	9	17	8
£500,000–£1 million	11	7	13	8	17	8
£1 million–£5 million	16	19	13	18	11	23
£5 million–£10 million	13	12	17	14	10	11
£10 million–£25 million	10	14	5	11	13	7
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
<b>Less than £500,000</b>	<b>50</b>	<b>48</b>	<b>52</b>	<b>49</b>	<b>49</b>	<b>51</b>
<b>More than £500,000</b>	<b>50</b>	<b>52</b>	<b>48</b>	<b>51</b>	<b>51</b>	<b>49</b>

**Table 4.2: SME respondent size measured by employee numbers**

<b>Employees</b>	<b>Total sample</b>	<b>UK</b>	<b>Germany</b>	<b>Spain</b>	<b>Hong Kong</b>	<b>US</b>
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
Owner only	4	5	3	2	0	10
1–4	23	31	31	20	12	21
5–9	17	17	19	20	17	13
10–19	16	15	17	13	21	12
20–49	19	14	13	22	25	23
50–99	10	7	9	11	12	11
100–249	8	7	7	8	10	7
250–499	3	4	1	4	3	3
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
<b>N=</b>	<b>1004</b>	<b>203</b>	<b>200</b>	<b>201</b>	<b>200</b>	<b>200</b>

## 4.2 MARKETS

Table 4.3 summarises the various markets in which the SMEs operate. It is worth noting that many of the companies surveyed operate in more than one of these markets. Looking at the results in Table 4.3, although one might expect the UK and Hong Kong to be similar in relation to internationalisation, as both are island nations operating in small currency markets, the internationalisation of Hong Kong company markets is much higher than that in the UK. Interestingly, the percentage of UK SMEs operating in the national market is higher than that indicated by the equivalent responses from other countries. It is perhaps worth noting that there is some correlation between the markets in which SMEs operate and their responses to some of the questions posed, especially in relation to the use of banking services relating to foreign currency and international trade.

**Table 4.3: Markets in which SMEs operate by country**

<b>Market</b>	<b>Total sample</b>	<b>UK</b>	<b>Germany</b>	<b>Spain</b>	<b>Hong Kong</b>	<b>US</b>
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
Local	49	46	48	50	47	57
Regional	36	32	40	41	31	37
National	36	49	25	43	26	33
International	34	37	24	29	51	28

### 4.3 SECTORS REPRESENTED

Table 4.4 sets out the sectors represented in the sample. Points worthy of note are the relatively low percentage of manufacturing in the UK and German samples, the high percentage of wholesaling and retailing in the UK sample and the relatively high involvement in construction and public-service-related industries in the German sample.

An analysis of the sector-related data by size, Table 4.5, shows that there is a wide spread across sectors in all size ranges. Nonetheless, some patterns are apparent, with the personal and leisure services, as well as business services, being more prevalent at the smaller end of the SMEs included in the sample.

**Table 4.4: Sector analysis by country**

	<b>Total sample</b>	<b>UK</b>	<b>Germany</b>	<b>Spain</b>	<b>Hong Kong</b>	<b>US</b>
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
Agriculture	2	2	3	3	1	3
Production or manufacturing	33	25	24	39	39	34
Construction	9	9	12	8	6	7
Wholesale or retail	27	34	24	24	28	22
Catering	2	2	4	4	0	0
Transport or communications	4	4	4	4	4	4
Property or finance	4	6	4	1	6	5
Business services	14	14	17	14	13	15
Public admin, health and education	2	1	4	1	2	3
Personal or leisure services	3	3	4	2	1	7
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>



**Table 4.5: Sector analysis by SME size**

	All	< 50K	50K	250K	500K	1m	5m	10m
	%	%	–250K	–500K	–1m	–5m	–10m	–25m
			%	%	%	%	%	%
Agriculture	2	1	5	0	2	3	0	4
Production or manufacturing	33	31	24	25	31	40	43	30
Construction	9	10	5	15	9	7	8	9
Wholesale or retail	27	20	23	30	24	26	32	36
Catering	2	5	3	1	5	1	1	1
Transport or communications	4	7	4	5	4	5	2	2
Property or finance	4	2	7	5	18	4	3	5
Business services	14	18	19	14	0	10	9	10
Public admin, health and education	2	1	5	1	3	2	0	1
Personal or leisure services	3	5	5	4	4	2	2	2
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

**Notes**

For turnover all amounts were converted to their equivalent to the categories above in local currencies. For the tables, turnover is expressed in sterling with categories relating to thousands – £K, and millions – £m.

#### 4.4 THE ACCOUNTANTS' SAMPLE – UK AND HONG KONG

Because of issues around access to accountants dealing with SMEs in each country, different approaches were taken to the collection of data from accountants, depending upon the country concerned. In the UK and Hong Kong an online survey was carried out with practising members of the Association of Chartered Certified Accountants. In the UK there were 377 responses, and in Hong Kong there were 127 responses. The online survey mirrored the SME survey in a number of respects, albeit that the questions were being answered from a differing perspective. In both cases some questions were not fully answered but, looking across the whole research instrument, around 80% of respondents in both countries completed all or nearly all the questions.

The profile of the accountants' businesses and their clients' businesses are provided in Tables 4.6 and 4.7.

As can be seen from Table 4.6, where employee numbers are used as the proxy size measure, the majority of the clients that these accountants deal with fall firmly within the UK definition of SMEs. A similar result can be found in Table 4.7 which uses turnover as the proxy for business size.

The client groups in both countries were, as would be expected, biased towards the service rather than manufacturing sector and the majority of clients were set up as limited liability companies with the relevant percentages being 67% in the UK and 94% in Hong Kong, with the remainder being made up of sole proprietors and partnerships.

**Table 4.6: Client base by number of employees**

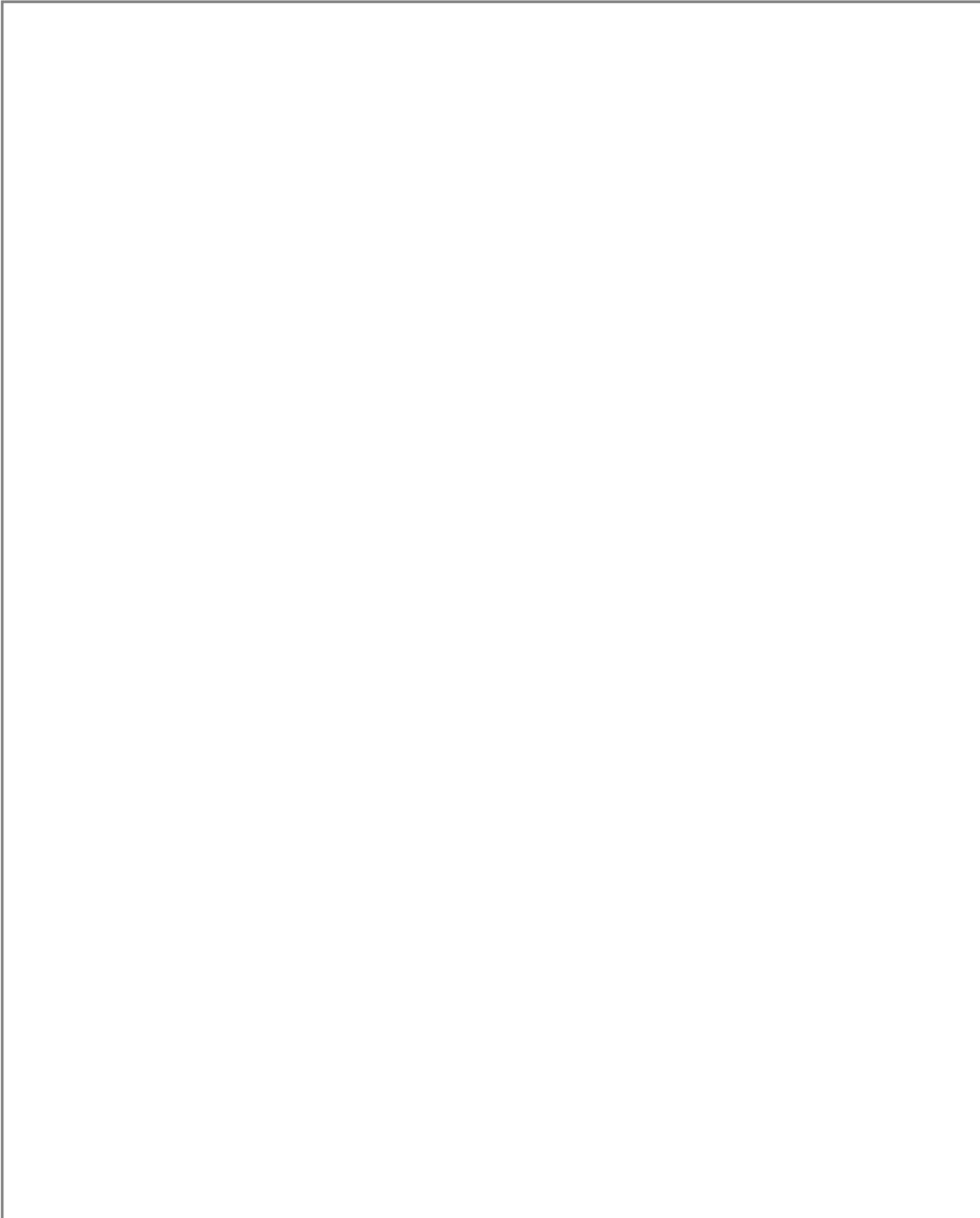
	UK		Hong Kong	
	Number	%	Number	%
Micro businesses (0–9 employees)	102	33	17	16
Small businesses (10–49 employees)	140	45	41	39
Medium-sized businesses (50–249 employees)	47	15	27	26
Large businesses (over 250 employees)	10	3	8	8
Mixed sized businesses	14	4	11	11
<b>Total respondents</b>	<b>313</b>		<b>104</b>	
skipped this question	64		24	

**Table 4.7: Client base by turnover**

	UK		Hong Kong	
	Number	%	Number	%
Less than £50,000	37	12	20	20
£50,000–£100,000	44	15	13	13
£100,000–£500,000	76	25	28	27
£500,000–£1 million	46	15	8	8
£1 million–£3 million	46	15	10	10
£3 million–£5 million	10	3	6	6
More than £5 million	44	15	17	17
<b>Total respondents</b>	<b>303</b>		<b>102</b>	
skipped this question	74		26	

#### **4.5 THE ACCOUNTANTS' SAMPLE – GERMANY, SPAIN AND THE US**

As has been explained, owing to difficulties in carrying out extensive survey work in Germany, Spain and the US, different approaches were adopted. The aims of the research were slightly altered so that, instead of obtaining independent evidence for comparison, confirmatory and explanatory evidence was gathered to support that already collected from SME respondents in each of these countries. This allowed the researchers to get more in-depth knowledge of country-based differences. In Germany and Spain, the actual data were collected from a focus group consisting of accountants whose main business clients were SMEs. As it was not possible to find a mutually convenient time to run a focus group in the US, the data were collected through a series of face-to-face interviews over a two-day period. In all three countries a common approach was adopted in terms of the questions asked and the issues explored.



## 5. Banking relationships

This chapter looks at the relationships between SMEs and their banks, how that relationship is maintained and the SMEs' levels of satisfaction with their banks.

### 5.1 SINGLE OR MULTIPLE BANKING RELATIONSHIPS

It is clear from Table 5.1 that one factor that is influential in whether an SME has a single banking relationship or multiple banking relationships is the size of the SME. Smaller SMEs are more likely to have a single relationship than larger ones, with the changeover point being turnover in the range of £500,000 to £1 million.

Nonetheless, although the size of the SME is clearly a factor in the number of banking relationships, a country-by-country analysis of the firms in the sample reveals that the 'norms' of the country appear to be more influential. Single banking relationships are the norm in the UK, as reported by Fraser (2004), while multiple relationships are the norm in Spain. This latter finding concurs with the point made in the Observatory of European SMEs' report (2004) which states 'several southern European countries' SMEs tend to have credit lines with more than one bank' (p. 19). It also corresponds with the findings of Cardone et al (2005) reported in the overview of the banking structure in that country (section 2.3, page 14). This would seem

**Table 5.1: Number of banking relationships**

Number of banking relationships	All	<50K	50K	250K	500K	1m	5m	10m
	%	%	–250K %	–500K %	–1m %	–5m %	–10m %	–25m %
1	44	58	60	54	36	40	30	33
2	19	16	22	22	17	20	19	15
3	18	16	13	14	24	20	18	21
4	8	6	3	7	12	7	15	9
5	4	2	1	2	6	6	6	8
6–7	3	1	1	1	2	5	5	7
8+	3	1	0	0	1	2	7	7
n=	1001	147	210	140	106	167	129	102
<b>Average</b>	<b>1.9</b>	<b>1.7</b>	<b>1.6</b>	<b>1.8</b>	<b>2.2</b>	<b>2.0</b>	<b>2.1</b>	<b>2.0</b>

to lend weight to the idea that these differences are country specific rather than size related.<sup>5</sup> Fig. 5.1 provides a diagrammatic representation of the relationship patterns reported by the respondents.

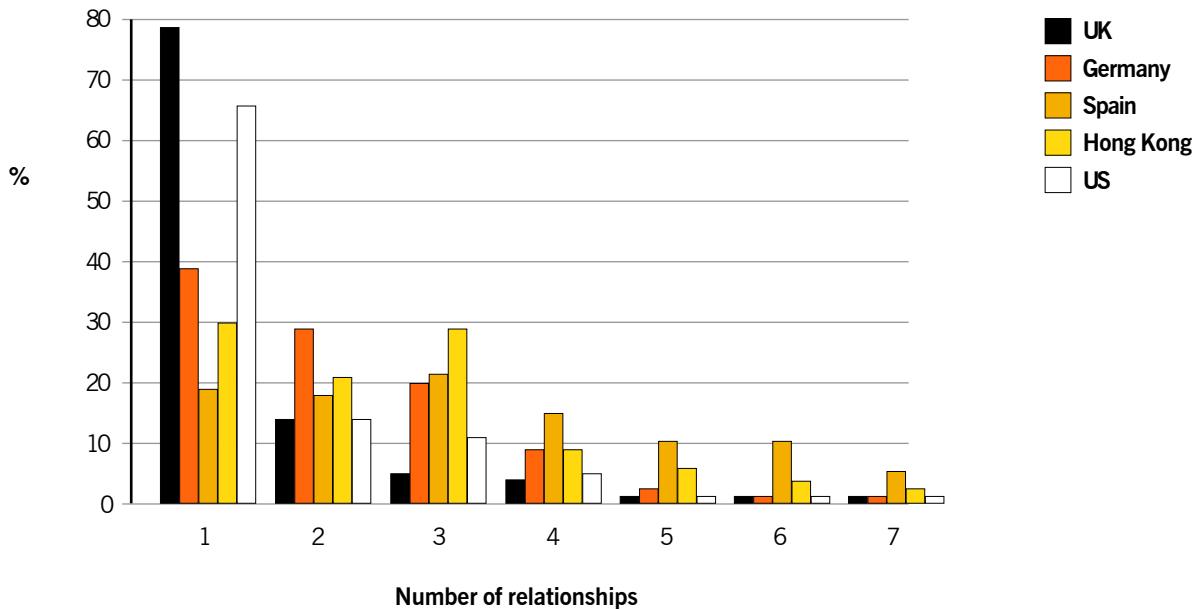
Looking at the graph in Fig. 5.1, Spain stands out as being the most likely to have multiple banking relationships followed by Germany. Table 5.2 below provides details of the average number of relationships of the various countries and shows Spain with an average number of relationships of 2.97 compared with 1.37 in the UK.

The figures for the UK, and to an even lesser extent those for Hong Kong, do not fully mirror the view of the accountants. In the UK, for example, accountants in

our sample claimed that approximately 40% of their clients used more than one bank. In Hong Kong the accountants claimed that 76% of their clients had more than one banking relationship. This use of multiple relationships may, in part, result from advice offered by the accountants, encouraging SMEs to have more than one banking relationship. As we shall see below, this was a common factor in both Germany and the US, where multiple banking relationships were encouraged to reduce the risk of exposure of the SME to changes in bank policies.

The German focus group discussions identified the reasons for multiple banking relationships as threefold. The first of these is the banking system itself (see Chapter 2, section 2.1 for details) with regional state

**Figure 5.1: Number of banking relationships – country analysis**



<sup>5</sup> As was noted in Chapter 4, section 4.1, the business size profiles of all countries are broadly the same with 50% being below £500,000 turnover and 50% above.

**Table 5.2: Average number of relationships by country**

Country	Percentage single relationship	Mean number of relationships
Spain	18	2.97
Hong Kong	30	1.85
Germany	39	2.15
USA	66	1.67
UK	78	1.37

banks (Landesbanken), savings banks (Sparkassen), as well as commercial banks, all operating. The second was that in the mid 1990s many of the bigger banks moved out of the SME lending market and SMEs often had to increase the number of banks they dealt with in order to get a full range of services. The third reason identified was that accountants are advising their clients to have more than one bank so that they are not overly reliant on a single bank in times when banks are changing strategies.

*'We now advise [clients] to have more than one bank... they [the banks] are changing their strategies more often in the last five years compared to the previous 30 years... so they try to get rid of SMEs, private customers...'*

Similarly in Spain, the focus group identified a number of factors that interacted together to encourage multiple banking relationships. The first of these was the competitiveness of the banks that are approaching the companies for business; the second was that the SMEs themselves shop around for the best deal for each of their component needs so they may place money with one bank as it pays higher interest, while using other services from other banks. Structurally, in Spain the banks that deal with the small business sector tend to be small themselves. As a result they 'tend not to offer a full range of services' thus necessitating multiple

banking relationships. An interesting insight was that, because some banks in Spain require fees to close accounts, many SMEs, rather than incur those costs, simply leave the account open while in practice moving the business account to a new bank.

The picture in the US was slightly more complex as the industry is still changing by continuing consolidation in the banking sector and some limited entry of new local banks. This consolidation has a number of effects, the first being that the newly consolidated bank may not wish to deal with a particular market segment, so creating pressure for an SME to move. The second is that often the consolidation leads to a less personal and often remote service in relation to decision making, and to prolonging the decision-making process, thus causing SMEs to look for alternatives and back-up banking facilities. As is the case in Germany, the accountants themselves are advising clients to think about multiple banking relationships in an effort to avoid being 'left stranded' by a policy shift at their bank.

*'They [the banks] are not a partner – they are not an advocate for the business so they are better off having multiple relationships – they just want deposits, credit card fees etc. ...you need a back-up bank so that if the bank decided to get out of the industry sector you had a back up.'*

Another factor leading to multiple relationships was the competitive nature of the banking market within the US, with banks offering variable interest rates, free loan set up, interest on current accounts and a 'free toaster or television'! Despite these influencing factors, however, the majority of SMEs in the US, 60% in this survey, still have a single bank, which accords with the findings of Strahan and Weston (1998).

## 5.2 BANKING RELATIONSHIPS – SERVICES USED

With the exception of current accounts, the services that are used by SMEs in the sample tend to be a function of a number of factors: the size of the SME, the country in which it is based, and the market in which it operates. As might be expected, the bigger the organisation the greater the range of financial services used by that business. In a UK context the low number of relationships combined with the greater spread of services used by larger businesses would suggest the presence of suppliers with multiple products or services. This accords with the description of the UK banking structure provided in Chapter 2, section 2.4.

A fuller analysis of the various types of banking service and their use can be obtained by comparing the results in Table 5.3 with those in Table 5.4 on page 37. This shows that the use of deposit accounts and overdrafts among the sample respondents is influenced more by country than size. There is relatively low use of deposit accounts by respondents from continental Europe and low use of overdrafts in Spain and the US. On the other hand, it would seem that in Spain there is greater use of leasing and factoring by the SMEs that responded to the survey than is the case in other countries. Some of the other services have multiple factors affecting their usage. For example, the use of international services, eg foreign currency, and international trade is a function of the turnover, trading region (see Table 4.3) and the country of domicile, with the samples of Hong Kong and UK SMEs showing the greatest use of these services. Other differences may be a result of

substitution effects, for example factoring as a method of financing working capital as a substitute for overdrafts.

The results for the UK broadly accord with what might be expected from the survey of accountants, with areas of difference in both loans and leasing. Here, the accountants' responses would lead one to expect a higher percentage use, as in each of these cases they answered that more than 60% of their clients used this type of service. In the case of Hong Kong, the results from the accountants' survey would suggest more use of foreign currency accounts and international trade services and of leasing.

In Spain, the focus group suggested that the high use of factoring is due to a combination of factors. The first is that historically there have been, and still are, tax advantages in using this form of finance. From the SMEs' perspective it also provides the advantage of getting paid sooner than the norm in a country where waiting 'up to four months for payment' is not abnormal. From a supply-side perspective, the focus group commented that banks want to sell high commission services and factoring provides higher returns than overdrafts, etc: 'the banks look at what gives them the highest commission... so overdraft is sold less as they make less money on that form of finance'.

German SMEs have the highest use of overdrafts and loans, which the focus group suggested was historic and dated back to the rebuilding of German industry.

*In old Germany, it was a public effort to provide overdrafts for the Mittelstand, the big ones and the small ones... it was seen as the public duty of the banks to have this 'public conscience.'*

This use of overdrafts and loans was a substitute for equity and has been encouraged by the tax regime and the government, and it worked well while there was



Table 5.3: Banking services used, analysed by turnover

Turnover	Current %	Deposit %	Loan %	Mortgage %	Overdraft %	Foreign currency %	International trade services %	Treasury services %	Lease %	Factoring %
Less than £50,000	97	43	37	18	23	14	9	6	21	14
£50,000–£250,000	97	51	41	12	34	18	10	5	23	14
£250,000–£500,000	99	63	49	18	45	26	16	15	25	16
£500,000–£1 million	97	61	47	14	44	39	20	18	34	25
£1 million–£5 million	99	61	47	22	46	27	26	20	36	24
£5 million–£10 million	100	58	64	24	47	32	30	21	48	28
£10 million–£25 million	98	73	52	27	47	53	38	38	37	25
<b>Average</b>	<b>98</b>	<b>59</b>	<b>48</b>	<b>19</b>	<b>41</b>	<b>30</b>	<b>21</b>	<b>18</b>	<b>32</b>	<b>21</b>

Table 5.4: Banking services used – country analysis

Country	Current %	Deposit %	Loan %	Mortgage %	Overdraft %	Foreign currency %	International trade services %	Treasury services %	Lease %	Factoring %
UK	98	68	31	11	48	34	19	20	29	11
Germany	97	35	56	15	58	9	3	0	32	5
Spain	98	37	33	20	18	11	27	27	50	38
Hong Kong	98	84	49	27	52	74	39	25	27	29
US	97	61	47	20	25	7	10	8	16	16

expansion but started to fail when expansion stopped and the effects of providing 'risk capital' started to be felt. The financing and tax regimes essentially encourage the use of debt finance and low levels of equity. This, therefore, also provides the explanation for the relatively low levels of deposit accounts: 35% compared with an aggregate of around 63% in the other four countries, as it would encourage the withdrawal of surplus cash in order to keep the equity base low.

On the low take up of factoring, the group suggested that this is likely to be caused by a combination of factors. First, there is a perception that it signals that the business is in trouble and secondly, as the German SME owners are mainly engineers and technologists, they lack financial understanding and sophistication and would not see trade receivables as a source of finance. Interestingly, the dominance of engineers and technologists, and their lack of commercial, financial and management awareness was a theme running through the focus group's discussion.

Looking finally at the US, we see here a relatively low use of overdrafts, which interviewees indicated are 'frowned upon' and usually have 'huge fees'. The low take up of factoring was explained by its not being well understood and being a comparatively cumbersome alternative to a 'line of credit'. The low usage of leasing was interesting as this is 'very easy to come by', because the leasing companies aggressively market their product, and those leasing equipment are very successful. The accountants stated that this has to be balanced against the prevailing culture, in which it is thought that one is better off buying than leasing as one will get a better deal. Thus the advice they would provide to clients in most cases would be to look at buying outright and financing the purchase another way, rather than leasing.

### 5.3 BANKS AS A SOURCE OF FINANCE

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Respondents were asked if they had sought to raise external finance in the last three years. As can be seen from the first line of Table 5.5, only 22% of all respondents had done so. For these, their bank was either the main source in 53% of the cases, and one of the sources used in 18% of cases, so overall banks were actively involved in 71% of cases. Although there are differences between the responses from the different sizes of SME in the sample, these are not statistically significant. It is, however, apparent from Table 5.5 that SMEs with turnover in excess of £1 million are more likely to be successful in their applications for finance. Table 5.5 also shows that in the vast majority of cases (84%) the SME was wholly successful, or partially successful (6%) in its attempts to raise finance and that only in a small minority of cases, 3% overall, was the failure to raise finance a result of a refusal by the financier. In another 1% of cases the SME decided not to accept the finance offered. This may well have been on the basis that the terms on which the finance was being offered were not considered acceptable to the SME. These results in terms of the relative success rates are mirrored by the surveys of accountants in the UK and Hong Kong.

A country-based analysis of the sample, see Table 5.6, shows that banks were most likely to be used as a source of finance in Spain and least likely to be used in the UK. The figures for the UK show a decline in the use of bank finance from that reported by Lund and Wright (1999). The corollary of the lower use of bank finance is that the use of 'other sources' is much more prevalent in the UK than elsewhere. The use of banks as the main source of finance in Spain was attributed by the accountants' focus group to a lack of sophistication and knowledge of alternative forms of finance among SME owners and the high levels of competition among banks. In Germany, the focus group made a number of allusions to the predominance of

**Table 5.5: Banks as a source of finance – size analysis**

	All %	<50K %	50K –250K %	250K –500K %	500K –1m %	1m –5m %	5m –10m %	10m –25m %
External finance sought in last three years	22	16	13	19	15	23	39	35
From: Main bank	53	50	39	58	63	62	56	42
Other source	29	33	43	35	25	31	18	28
Both	18	17	18	8	13	8	26	31
Successful in full	84	79	79	81	81	87	96	86
Successful in part	6	4	4	15	6	5	2	6
Refused by financier(s)	3	4	7	0	6	3	2	6
Refused by the SME	1	4	4	0	0	0	0	0
Did not know	5	8	7	4	6	5	0	3

**Table 5.6: Banks as a source of finance – country analysis**

	All %	UK %	Germany %	Spain %	Hong Kong %	US %
External finance sought in last three years	22	17	19	28	22	24
From: Main bank	53	37	57	66	54	43
Other source	29	54	27	14	23	36
Both	18	9	16	20	23	21
Successful in full	84	89	81	87	80	92
Successful in part	6	9	3	9	5	2
Refused by financier(s)	3	0	5	4	7	0
Refused by SME	1	0	3	0	2	2
Did not know	5	2	8	0	6	4

engineers and technologists running SMEs and their lack of financial understanding and sophistication.

It is worth noting that in the UK only 17% of SME respondents to this survey indicated that they had tried to raise finance in the last three years and there were no cases reported where the finance was refused. This 17% compares with 44% in the Warwick survey (Fraser 2004), which asked about a similar period of time, and 18% in the Small Business Service (2006) survey of 2004/5, which related to only a 12-month period. The reasons for this may be explained by the inclusion of start-ups in the SBS sample and the relative bias of the sample data on which this report is based towards small and medium-sized businesses rather than micro businesses.<sup>6</sup> These businesses are likely to have been around longer and would therefore be expected to have a more stable financial base than start ups, which are more likely to be included, at least initially, in the micro business category.

As was the case with the Warwick survey (Fraser 2004), the responses indicate that contrary to expectations about finance gaps, in the vast majority of cases in all countries the SMEs were successful in raising the finance they wanted. Actual refusals related to between 4% and 7% of cases in each country and in only 2% of cases did this cause the SME significant financial difficulties. In the other cases the SME either raised the finance from another source or changed its plans.

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<sup>6</sup> In line with the classification used by the Observatory of SMEs' report (2004), micro businesses are defined as those having fewer than 10 employees, small businesses are those with 10 to 49 employees and those with 50 to 249 employees are defined as medium sized.

#### 5.4 REASONS FOR REFUSAL OF FINANCE

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The reasons why finance was refused were explored by providing accountants in each of the countries with a list of reasons for refusal:

- not enough equity in the business
- poorly presented business plan
- poor quality of management
- lack of security/collateral
- poor market feasibility
- other.

The main reason for refusal of finance, from the accountants' perspective in all countries except Germany, was 'a lack of collateral/security' and this was followed in most cases by a lack of equity. In some countries, eg the US, the lack of security was offset, to some extent, by real-estate booms. In Germany, although lack of collateral was seen as an issue, the primary issue was not enough equity in the business. This is explained by the tax and regulatory regime, which has encouraged the use of debt finance and discouraged keeping equity in the business. This has inevitably led to problems since the start of the present century, when the period of expansion was over, as there were also changes in what was seen by banks as an 'acceptable financing structure'. It is noticeable that in all countries the more 'business related' reasons do not cause many problems; the decision is financially based and dominated by the collateral/security issue. In Spain the focus group saw changes in policies and provided interesting comments on the way in which the system has operated and is changing.

*Banks are not used to management information; they look at buildings, warranty and then the financials ... not the business plans. But this is changing ... for young people they might use a business plan for a start up ... but the banks are not lending their money ... it is a public institution behind the bank that is providing the money.*

The first part of this comment is perhaps not surprising when one considers the prevalence of multiple banking relationships. In these cases, in contrast to a single banking relationship where the bank can track the business's cash performance through the bank accounts it holds, any individual bank will see only part of the picture and as such management information cannot be easily validated from their own records. Interestingly, in all three countries where more in-depth data collection was undertaken another theme that emerged was refusals due to changes in banks' strategies and policies. In the case of Germany, this manifested itself in new policies regarding equity in the business, while in Spain and the US it was related to banks' decisions to get out of an industry sector or size-related sector of the business market.

The sectors that seemed to be experiencing difficulties in raising finance varied from country to country. In the UK, accountants' responses indicated no general pattern; instead there were mentions of a wide variety of sectors, including manufacturing, construction, technology-based, retailing, hospitality and catering-related industries. In Spain, Germany and the US, construction is a difficult area to finance and respondents in the US also mentioned restaurants as an area of business that is problematic, although it was accepted that this is a sector with a high failure rate.

At a more general level, in every country the accountants identified start-ups as a significant problem area for raising finance. The reasons for this were lack of track record, together with an over reliance by banks on collateral and security as a prerequisite for

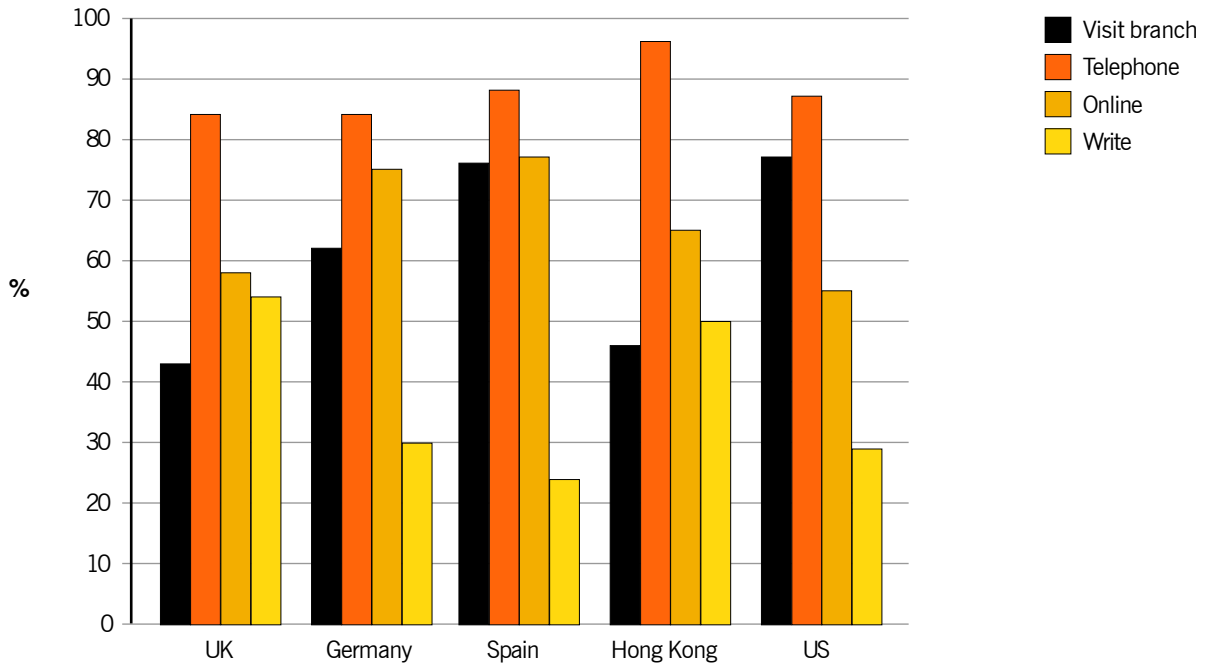
granting credit. In the US there are particular schemes to help ethnic minority and female owners to start businesses, while in Germany the main ethnic minority community, ie Turkish, have their own banks. In Spain, as can be seen from the quote above, the banks are used as agents in providing public money for start ups.

## **5.5 BANKING RELATIONSHIPS – COMMUNICATION**

Communication was looked at from the point of view of whether the SME has a dedicated official or not and how the SME communicates with its bank. Broadly, the results show that the vast majority of SMEs have a dedicated manager or official of their bank allocated to them (over 90% in all countries except the US, which has 70%). It is also clear that the larger the SME the more likely it is that it will have a dedicated official dealing with it.

Similarly, as one might expect, the ways in which SMEs deal with their banks is affected by size, with 74% of the smallest SMEs visiting their banks while only 34% of the largest businesses use this method of communication. On the other measures, ie telephone, writing and electronic communication, essentially the larger the business the more likely it is to use these forms of communication. In the case of writing, 20% of micro businesses use this form of communication compared with 54% of the largest SMEs. For electronic communication the percentages are 48% and 86% respectively. Although differences did arise by country, see Fig. 5.2 on page 42, it would appear at first sight that size is the dominant factor affecting how SMEs communicate with their banks. It is worth noting, however, that in those countries with a tradition of local or regional banks, ie the US, Germany and Spain, visiting the banks is noticeably higher rated. This would accord, in the US, with the results of the NFIB Small Business Poll (2005), which shows that convenient location and knowledge of the local and regional market are among the top characteristics small business owners look for in their banks.

Figure 5.2: SMEs communications with banks



**5.6 BANKING RELATIONSHIPS – SATISFACTION WITH BANKS AND PROPENSITY TO CHANGE**

Table 5.7 provides the results on eight measures of satisfaction with the service provided by the SME’s main bank. The respondents were asked to score their bank on a 1 to 5 Likert scale from very dissatisfied (1) to very satisfied (5). The overall satisfaction score has been computed by a simple aggregation of all the other scores. The data have been ordered in descending order of satisfaction based on the results of the sample as a whole. The first point to note is that the overall

level of satisfaction is 3.8 on a 5-point scale, indicating a reasonably high level of satisfaction. As can be seen in Table 5.7, these overall levels of satisfaction vary slightly with size, with the very small, less than £50,000 turnover, and the larger businesses, more than £1,000,000 turnover, generally being more satisfied. In the case of satisfaction with their main contact and the competence of staff, the high scores from the larger SMEs would accord with the results referred to in section 5.5 above, which show that these businesses are most likely to have a named or dedicated official dealing with them.

Table 5.7: Satisfaction with bank measured by SME turnover

	All	<50K	50K –250K	250K –500K	500K –1m	1m –5m	5m –10m	10m –25m
	%	%	%	%	%	%	%	%
<b>Mean score on a 1 to 5 satisfaction scale</b>								
Main contact	4.0	4.2	4.1	3.9	3.9	4.2	4.1	4.1
Availability of finance	3.9	3.9	3.7	3.7	3.7	4.0	4.1	4.0
The range of services offered	3.9	4.1	3.9	3.7	3.8	4.0	4.1	3.9
The competence of staff	3.9	4.1	4.0	3.7	3.8	4.0	4.0	4.1
The speed and efficiency of service	3.9	3.9	3.9	3.7	3.8	3.9	4.0	4.0
The overall quality of service	3.9	4.1	3.9	3.7	3.8	4.0	3.9	4.0
How well they understand your business	3.7	3.7	3.6	3.6	3.7	3.8	3.9	3.9
Charges or tariffs	3.2	3.3	3.1	3.0	2.9	3.4	3.2	3.4
<b>Aggregated satisfaction score</b>	<b>3.8</b>	<b>3.9</b>	<b>3.8</b>	<b>3.6</b>	<b>3.7</b>	<b>3.9</b>	<b>3.9</b>	<b>3.9</b>

Interestingly, respondent SMEs in the £50,000 to £1,000,000 and, in particular, in the £250,000 to £1,000,000 ranges are less satisfied than the others on virtually every measure, although why this should be the case is not immediately apparent.

The interviewees in the US suggested that this was because the banks are more interested in the larger businesses and that this ‘middle’ group suffers from having an increasingly sophisticated banking service requirement which it is not profitable for banks to provide. This has led to a situation in which some banks openly discourage this size of business customer because of the difficulty of making a reasonable return.

It is worth noting the specific areas where SMEs are less satisfied. The first of these is concerned with the perception of the banks’ understanding of the business. On this measure, the banks’ perceived performance seems to be better the larger the business. The second area of relatively low scoring is that concerned with charges and tariffs, where the mean scores are considerably lower than on all the other measures. It should be borne in mind, however, that the score is above the median score of 2.5, which indicates that the SMEs are generally satisfied rather than dissatisfied with this aspect of their banks’ service. Each of these areas is discussed in more detail in the country-based analysis below.

**Table 5.8: Satisfaction with bank measured against country of SME**

	All	UK	Germany	Spain	Hong Kong	US
<b>Mean score on a 1 to 5 satisfaction scale</b>						
Overall quality of service	4.0	4.0	4.0	4.3	3.7	4.4
Availability of finance	3.9	3.9	3.7	3.9	3.6	4.2
Range of services offered	3.9	3.9	3.7	4.0	3.7	4.3
Competence of staff	3.9	3.9	3.8	4.0	3.7	4.3
Speed and efficiency of service	3.9	3.9	3.8	3.9	3.7	4.3
Main contact	3.9	3.9	3.8	4.0	3.8	4.3
Level of understanding of your business	3.7	3.6	3.7	4.0	3.5	3.9
Charges or tariffs	3.2	3.0	2.9	3.2	3.1	3.8
<b>Overall</b>	<b>3.8</b>	<b>3.8</b>	<b>3.7</b>	<b>3.9</b>	<b>3.6</b>	<b>4.2</b>

An analysis by country, see Table 5.8, shows that UK banks are comparable to their counterparts in the other countries on the aggregate measure and also on six of the eight measures of satisfaction, where the UK mean score is the same as the overall mean for the total population.<sup>7</sup> Despite the finding reported in section 5.3 above, that UK SMEs are less likely to have used their bank as a source of finance, the level of satisfaction with the availability of finance is equal to that in Spain, where banks are most likely to be used as a source of finance.

<sup>7</sup> On questions where respondents were asked to rank satisfaction on a 1 to 5 scale, respondents from Hong Kong scored satisfaction consistently below the average while those from the US scored consistently higher than the average. Whether this reflects the SMEs' experience with their banks and accountants or is a national trait in satisfaction rating is unclear.

The two measures on which the UK banks are rated below the average are the level of understanding of the SME's business, and satisfaction with charges and tariffs. The lack of understanding is a classic example of information asymmetry, where the SME and the SME's accountant know more about the business than the bank and believe that the bank would be able to make more informed and better decisions if it really understood the business. On this item, for the UK banks the rating is slightly above that of Hong Kong although, as noted in footnote 7, Hong Kong consistently has lower scores than the other countries. For satisfaction with charges and tariffs, the UK SMEs score their banks higher than their counterparts in Germany but lower than SMEs in any of the other countries.



In general, the accountants were more critical of banks than the SMEs. From the perspective of accountants in the UK and Hong Kong, by far the lowest scores are for satisfaction with banks' tariffs and charges.

Accountants were also more critical about the level of understanding of their clients' businesses, the speed and efficiency of service and the competence of staff. In the US, the accountants interviewed were generally satisfied with the charges and tariffs but were very critical of the bank staffs' level of understanding of the business and their competence. The reasons for this were varied but some were common across the two countries; on education and understanding, the comments from accountants in both countries reveal a picture of competent managers supported by poorly trained staff, with SMEs experiencing difficulties getting to the manager. Other common issues related to the organisational structure of banks where those making the credit decision are separated from the relationship manager, causing mixed messages and delaying decisions. There were comments about the base level of understanding of what a business does and about the increased sales culture within banks, causing bankers to become sales oriented. In the UK, another issue raised, especially for the smaller SMEs, was the difficulty in communications caused by inability to get beyond the call centre to talk to someone who could deal with the business sensibly.

As we have already mentioned, in Germany the changing structures and policies of banks are causing a level of dissatisfaction. In Spain, however, although the accountants were satisfied with the availability of finance and the charges and tariffs, questions were raised about the competence of staff and their general business-related expertise, and about the speed of service, with more loan requests being pushed to a centralised office that might take 'up to a month to make a decision on a large loan'.

## 5.7 PROPENSITY TO CHANGE BANKER

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The analysis shows that the customer's propensity to change banks is not a function of the size of the business, but it is affected by the country in which the SME is based. The respondents here split between continental Europe, ie Spain and Germany, where 40% and 34% respectively said they would consider changing if approached by another bank, and the UK, US and Hong Kong, where approximately 20% would consider changing. The reasons for these differences may relate to the number of banking relationships the SMEs have in Spain and Germany, see Table 5.2 on page 35, as well as their levels of satisfaction with their banks as shown in Table 5.8. A further factor identified by the German focus group is the changes in banks' policy following reunification, which have caused SMEs to have to change banks. In the case of Spain, the focus group suggested that the high level of competition is a significant issue in causing SMEs to work with multiple banks and this could also be an explanatory factor for the high propensity to change. The results for Spain accord with Cardone et al. (2005) who point to relatively short banking relationships.<sup>8</sup>

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<sup>8</sup> See Chapter 2, section 2.3, subsection on 'Banking and SMEs – other factors', page 14 for details.

Figure 5.3: Current account benefits – analysis by size

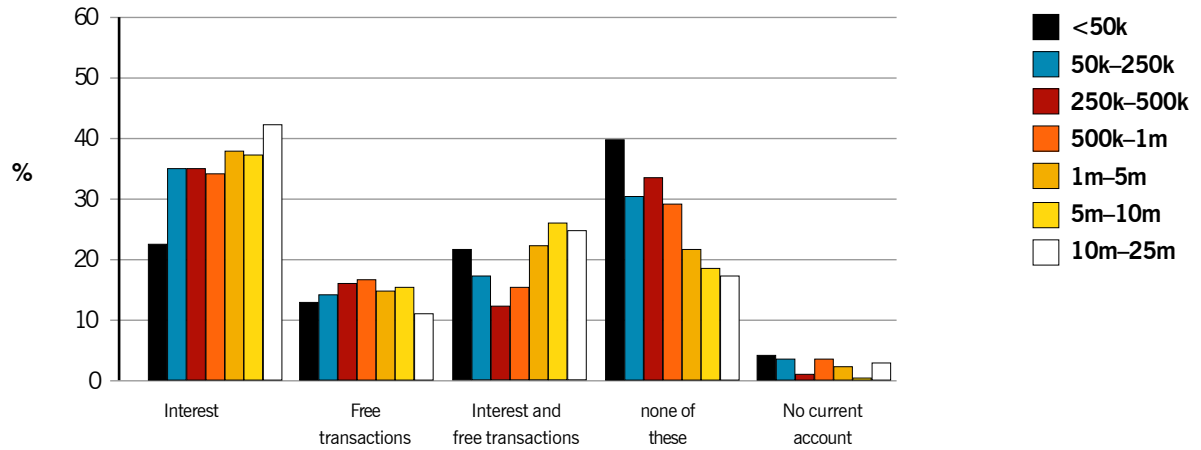
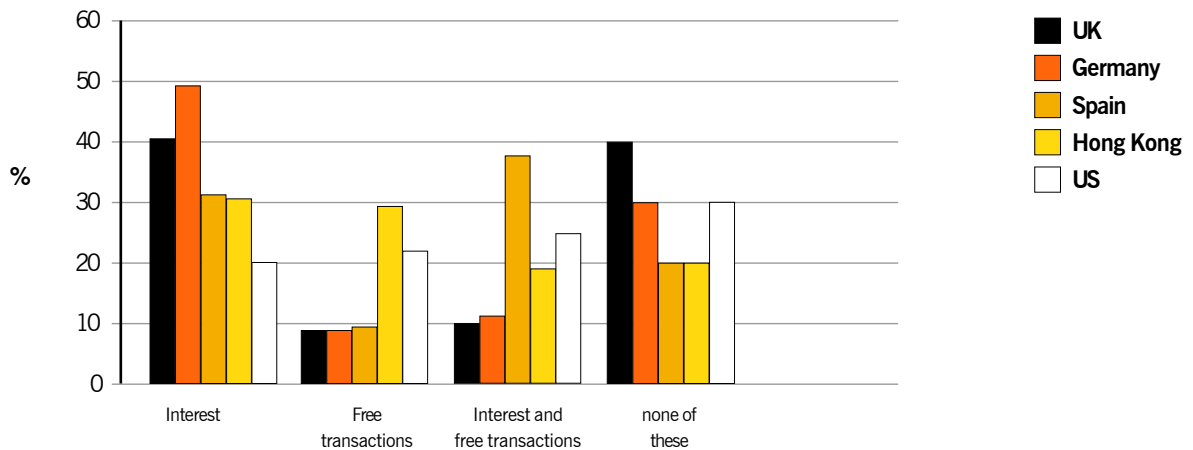


Figure 5.4: Current account benefits – analysis by country



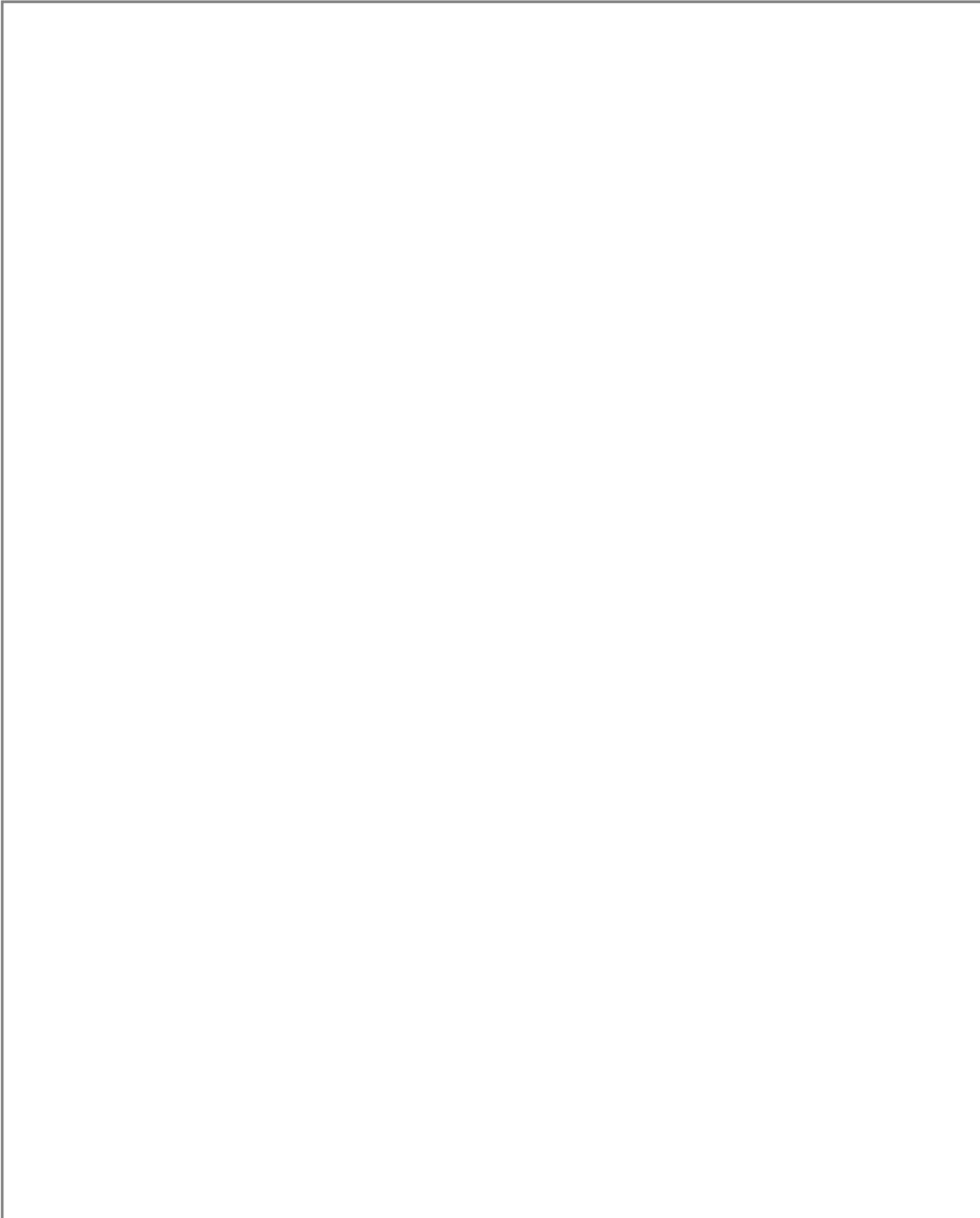
## **5.8 BANKING RELATIONSHIPS – CURRENT ACCOUNT BENEFITS**

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An analysis of the benefits that the SMEs in the sample received from their current accounts, based upon size (see Fig. 5.3) shows an uneven pattern of benefits, with the very small businesses generally being the group most likely to have no benefits; 39% receiving no benefits compared with 19% for the larger SMEs, and an overall average of 28%.

A country-based analysis, Fig. 5.4, shows that the pattern of benefits is more likely to be affected by the particular norms within the country concerned. Fig. 5.4 shows that for current accounts, SMEs in Spain and Hong Kong are least likely to receive no benefits while SMEs in the UK are most likely to receive no benefits.

Looking at the types of benefit offered, more SMEs in the UK and Germany receive interest while free transactions are more prevalent in the samples from Hong Kong and the US. It is worth noting that Fraser (2004) shows that 34% of SMEs in the UK receive free banking and 56% receive interest. SMEs in Spain receive the greatest benefits on their current accounts, with only 20% getting no benefits and a greater proportion getting both interest and free transactions than was the case in any other country. It should be borne in mind, however, that although the data show that these SMEs receive some interest and some free transactions, they do not show the rate of interest or the number of free transactions or the conditions attached to those free transactions. As such, the comparisons may provide only a partial picture.



## 6. Challenges faced by SMEs

Two questions were asked relating to this topic. The first was an open-ended question: 'What would you consider to be the biggest challenges facing your business?' The second question required respondents to score a predetermined randomised set of business issues on a 1 to 10 Likert scale, with 10 indicating the issue had the highest importance and 1 the lowest importance.

### 6.1 RESPONSES TO THE OPEN-ENDED QUESTION

On the open-ended question the responses were wide ranging. Table 6.1 provides an overview and an analysis by size, of all issues raised by 4% or more of the total respondents. Starting with the overall analysis we can see that increased competition is the most cited

issue, being cited by 20% of the sample. The next most frequently cited area is getting new business. As might be expected, given the responses in the previous chapter showing that only 22% of the sample had tried to raise finance in the last three years and that 90% of those were successful, issues relating to finance are not as frequently cited as competition and increasing sales. Nonetheless, the fact that it is the third most frequently cited issue may reflect the fact that this category brings together matters relating to finance, working capital management, cash flows, etc, rather than just access to finance.

Looking at the effects of size, competition was a more important issue for the larger SMEs, although it is also worth noting that a country-based analysis, see Table 6.2,

**Table 6.1: Biggest challenge faced by businesses – size analysis**

Issue	All	<50K	50K	250K	500K	1m	5m	10m
	%	%	–250K	–500K	–1m	–5m	–10m	–25m
Increased competition especially foreign	20	18	11	15	20	19	20	26
Getting new business	16	14	20	14	19	14	17	9
Finances and cash flow	10	10	10	9	8	10	11	8
Getting work/ staying in business/ surviving	9	6	12	11	6	9	6	9
Pricing and price competition	7	2	7	7	5	5	10	15
Costs	6	3	7	4	5	8	8	9
Economic conditions	6	8	7	8	4	4	4	4
Declining sales/demand	5	3	6	6	5	4	7	5
Changing markets	5	5	7	3	1	4	12	5
Slow paying customers	5	8	6	5	7	5	3	2
Finding qualified staff	5	4	5	1	7	7	4	3
Regulation/ red tape	4	1	3	5	3	4	6	3

shows that this is more of an issue for SMEs based in Spain and Hong Kong. Pricing and price competition together with cost-related issues are also more often seen as an issue for larger SMEs, ie those with turnover in excess of £1 million. Similarly, 6% of the largest businesses identified exchange rates as an issue although this was cited by only 2% of all the SMEs surveyed and is therefore excluded from the tables. Virtually all those raising this as an issue came from the UK and Hong Kong. This is hardly surprising given the size of the Eurozone and Dollar markets. At the other end of the size spectrum, slow-paying customers are more of an issue for smaller businesses, being cited by 8% of the smallest class of SMEs compared with only 2% of the largest. The country-based analysis indicates that this is, however, a particular issue for

German SMEs. Economic conditions seemed to be of more concern to smaller SMEs and to those from countries other than the UK and Spain.

Looking at the country-based analysis in Hong Kong, in both the accountants' survey and the SME survey, the highest scoring issue is competition. This may be related to the fact that over 50% of the sample is involved in international markets as well as to the impact of competition from China. The reasons for the high scoring by SMEs in Spain is not so clear from the data, as there was less involvement in international markets at only 29% (see Table 4.3 on page 27 for details of markets). As the first and second issues, ie competition and getting new business, are related, it is likely that there is some substitution effect between

**Table 6.2: Biggest challenge faced by businesses – country analysis**

	All %	UK %	Germany %	Spain %	Hong Kong %	US %
Increased competition especially foreign	20	15	9	32	31	14
Getting new business	16	14	21	22	5	17
Finances and cash flow	10	9	11	6	9	14
Getting work/ staying in business/ surviving	9	11	14	10	0	9
Pricing and price competition	7	7	11	6	7	6
Costs	6	5	6	4	6	9
Economic conditions	6	3	9	2	8	8
Declining sales/demand	5	10	6	2	2	6
Changing markets	5	5	4	5	5	7
Slow paying customers	5	5	10	3	4	4
Finding qualified staff	5	2	2	8	2	10
Regulation/ red tape	4	8	5	2	1	1

these categories. If the citation scores are combined we see that these appear to be more of an issue in Spain than other countries. The accountants' focus group suggested that Spain is no longer a low-wage economy but also '[does] not add a lot of value' during the production process and as such it is facing increased competition from low-wage economies such as China and the accession states, Poland in particular, as a result of the EU enlargement. UK SMEs are more concerned with declining sales/demand than others. Once again there may be an element of substitution here, with increased competition causing the decline in sales rather than a declining market demand as a whole.

On the more general finance-related issues it is worth noting that 14% of the respondents from the US cited this as an issue compared with only 6% from Spain. The interviews with accountants in the US suggest that this is more likely to relate to cash flows as there are problems in raising working capital finance for inventory, and cash flow problems are exacerbated by very slow payment from state and government. The issue of slow payment is a particular issue for German SMEs. The German focus group put this down to the dominance of engineers and technologists at the head of small businesses and their lack of understanding of the need to collect cash and manage the financial side of the business. The other reason they put forward was that it may well reflect a preponderance of public sector customers, as the public sector was a very slow payer.

Further analysis of the total data set shows that 6% of German SMEs and 5% of Hong Kong SMEs cite poor support from their banks as the biggest issue facing their business, compared with about 2.5% in the UK and the US and 1% of the sample from Spain. The problem of finding qualified staff seems to affect SMEs in the US more than elsewhere. This was explored in depth during the interviews with accountants in the US. They were quite clear that this is in fact the case for their clients, as one interviewee remarked: 'Staffing

is the nightmare of all nightmares in 95% of SMEs; it is especially bad in construction industries where you cannot get supervisors or foremen'.

He went on to argue that in some cases this was putting a brake on expansion. The reasons put forward for this related to the relative riskiness of jobs in small versus large businesses, the lower level of benefits, flexibility and the unrealistically high expectations of graduates and others entering industry.

Finally, it is worth noting that a substantially larger percentage of the sample of UK and German-based SMEs raised the issue of regulation compared with respondents from the other countries. This was borne out by the accountants' survey, where this was cited as an issue by 42% of UK accountants compared with only 19% of the Hong Kong respondents. The focus group from Germany confirmed that Germany is 'very regulated', resulting in a greater than average use of lawyers for advice. This is an area that will be revisited in Chapter 7 of this report.

## 6.2 THE STRUCTURED QUESTION

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Turning now to the structured questions on business issues, where the respondents were asked to score each issue on a 1 to 10 score from least important to very important, Table 6.3 shows the results on this question, ranked and then analysed by size. Some points worthy of note are the high weighting of future planning and the low weighting of finance-related matters and access to business advice. The results on finance can be compared with those from the Observatory of European SMEs' report (2004), where around 30% of respondents raised 'lack of purchasing power of customers' as a constraint. This can be equated with the high ranking of achieving enough sales and access to new markets. Similarly the trend found in the Observatory report (2004), which showed that the larger the business the more important was the

issue of skilled labour, is broadly mirrored in the results from this survey, although as noted above in the US it is an issue for smaller SMEs. Finally, in relation to access to finance, the Observatory report (2004) identified this as more of an issue for the businesses in the middle of the size spectrum, and the results in Table 6.3, together with the discussions with accountants, support that finding.

For the country-based analysis, Table 6.4 provides both a ranking and score by country. This enables the reader to see the relative importance of the issues in each country and compare these without being affected by

the issues relating to high and low scoring in the US and Hong Kong referred to earlier (see footnote 7 on page 44). The country-based analysis of the responses shows some slight variations, with Germany and Spain ranking employee-related issues higher than the other countries. As might be expected from the responses to the open ended questions discussed above, issues relating to sales, markets and competition received a higher importance ranking from the respondents from Hong Kong. Of particular interest in terms of SME banking relationships are the rankings of the cost of finance. This was ranked lowest by SMEs from the UK. In terms of access to finance it is worth noting that of

**Table 6.3: Importance of business issues – analysed by size**

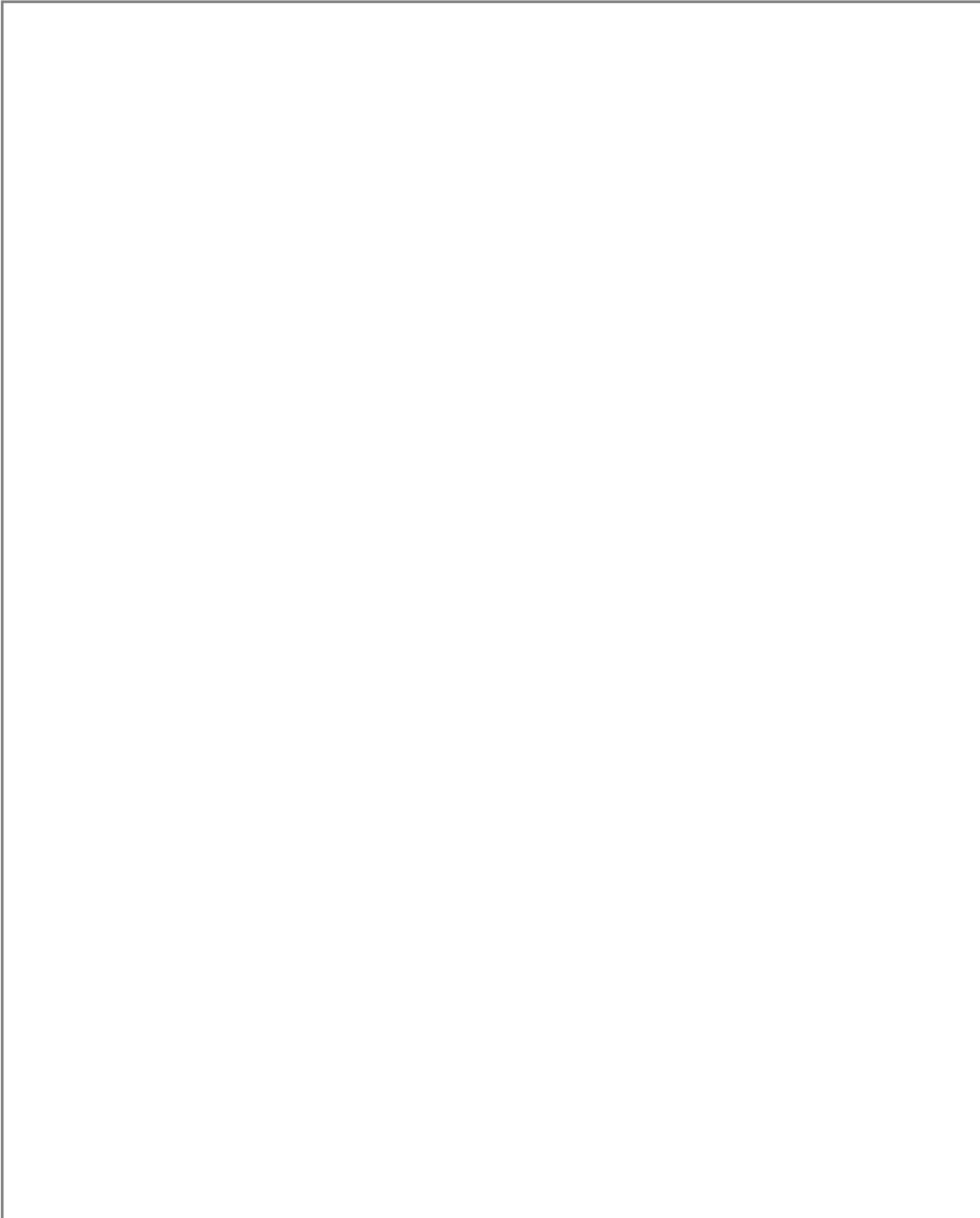
	All %	<50K %	50K –250K %	250K –500K %	500K –1m %	1m –5m %	5m –10m %	10m –25m %
Achieving enough sales	8.0	7.6	7.9	8.1	8.1	8.1	8.2	8.4
Planning for the future of the business	7.8	7.3	7.8	7.8	7.8	7.9	8.0	8.0
Finding and retaining skilled employees	7.3	6.4	6.7	7.6	7.5	7.7	7.9	7.6
Access to new markets	6.7	6.2	6.5	6.4	7.1	6.8	7.2	7.2
Competition from other firms	6.9	6.2	6.2	7.0	7.5	7.1	7.4	7.6
The cost of employees	6.9	6.1	6.5	6.9	7.4	7.4	7.2	7.2
Government or other regulation or red tape	6.2	5.9	6.4	6.2	6.3	6.1	6.0	6.5
The cost of finance	6.1	5.8	6.1	6.3	6.6	6.0	6.3	5.7
Access to finance	6.1	5.7	5.9	6.1	6.5	6.4	6.2	6.2
A lack of business support or advice	5.5	5.4	5.6	5.5	5.8	5.3	5.2	5.6
The cost of or finding suitable premises	4.8	4.6	4.6	4.7	5.1	4.9	4.9	4.8
<b>n=</b>	<b>1004</b>	<b>147</b>	<b>212</b>	<b>140</b>	<b>106</b>	<b>168</b>	<b>129</b>	<b>102</b>



those respondents in the UK who accessed finance, only a minority, 37%, obtained this from their bank (see Table 5.6 on page 39). Thus the relatively low ranking of cost and access may reflect cheaper finance from sources other than the respondents' banks. On the ever-topical issue of regulation and red tape, mean scores for the UK and Hong Kong gave this a ranking of sixth in importance. The US, Germany and Spain each ranked it lower, at seventh, eighth and ninth place respectively. This higher ranking from the UK respondents confirms the findings from the open-ended question discussed earlier and is confirmed by the accountants' survey.

**Table 6.4: Importance of business issues – analysed by country**

	All		UK		Germany		Spain		Hong Kong		USA	
	Rank	Mean	Rank	Mean	Rank	Mean	Rank	Mean	Rank	Mean	Rank	Mean
Achieving enough sales	1	8.0	1	8.2	2	7.8	1	8.6	1	7.4	1	8.2
Planning for the future of the business	2	7.8	2	7.5	1	8.0	3	8.1	3	7.3	2	8.1
Finding and retaining skilled employees	3	7.3	3	6.7	3	7.6	2	8.3	5	6.9	3	7.0
The cost of employees	4	6.9	4	6.5	4	7.4	5	7.3	6	6.7	6	6.6
Competition from other firms	5	6.9	5	6.4	6	6.6	4	7.4	1	7.4	5	6.8
Access to new markets	6	6.7	6	6.0	5	6.7	6	6.9	4	7.1	4	6.9
Government or other regulation or red tape	7	6.2	6	6.0	8	5.9	9	6.3	6	6.7	7	6.1
The cost of finance	8	6.1	9	5.6	7	6.1	7	6.8	8	6.3	9	5.7
Access to finance	9	6.1	8	5.7	8	5.9	8	6.7	8	6.3	8	6.0
A lack of business support or advice	10	5.5	10	5.0	10	5.0	9	6.3	10	6.1	10	5.1
The cost of or finding suitable premises	11	4.8	11	4.6	11	3.4	11	5.7	11	5.8	11	4.2



## 7. Advice and the role of external accountants

### 7.1 WHO ADVISES SMES?

The fact that a lack of business advice has a relatively low importance rating, tenth of the 11 issues on which respondents were asked a direct question, and the fact that there is no variation in ranking from country to country (see Tables 6.3 and 6.4) would suggest that either the SMEs do not think they need advice or they are satisfied with the level of advice to which they have access. The answer may in fact be a combination of these two factors, as the responses shown in the top line of Table 7.1 show that just over half the SMEs questioned sought external advice.

More interestingly, the data in the top line of Table 7.1 show that the propensity to seek external advice is affected by size, with 43% of the smallest firms seeking advice and the percentage steadily rising

through the size bands to reach a level of 75% of the largest firms.

Turning to the advisers used, some interesting facts emerge. The more obvious ones are the high ranking of accountants, solicitors and banks as sources of advice. The bigger the firm, the more likely it is to use these three sources of advice. Interestingly, but perhaps unsurprisingly, the ranking of family or friends shows exactly the opposite trend, ie they decrease in relative importance and use as the business gets bigger. As regards the government and public agencies, the pattern here is very mixed with only 25% of the smallest SMEs that ask for advice using this source. If one takes account of the fact that only 43% of these businesses seek advice at all this amounts to about 10% of the total sample of SMEs of this size.

**Table 7.1: Propensity to seek advice and advisers used – size analysis**

	Overall	£ < 50K	50K – 250K	250K – 500K	500K – 1m	1m – 5m	5m – 10m	10m – 25m
<b>Business seeks external advice</b>	53%	43%	47%	49%	49%	55%	65%	75%
<b>Source of advice</b>	% Rank	% Rank	% Rank	% Rank	% Rank	% Rank	% Rank	% Rank
Accountants	79 1	75 1	78 1	81 1	73 1	87 1	76 2	82 2
Solicitors	76 2	64 2	61 4	79 2	72 2	82 2	85 1	91 1
Banks or financial institutions	66 3	57 3	63 2	62 3	52 4	70 3	68 3	82 3
Business colleagues	60 4	46 5	62 3	53 4	65 3	62 4	66 4	62 4
General business advisers	42 5	41 6	44 7	34 7	44 5	43 6	43 5	45 5
Friends or family	42 6	48 4	50 5	44 5	44 5	46 5	36 7	24 7
Government or public agencies	38 7	25 7	46 6	42 6	27 7	40 7	39 6	40 6
<b>n=</b>	<b>535</b>	<b>63</b>	<b>99</b>	<b>68</b>	<b>52</b>	<b>93</b>	<b>84</b>	<b>76</b>

The other factor that affects the propensity to seek external advice is the country in which the SME is based. The first line of Table 7.2 shows that there are variations, from 37% of firms in the Hong Kong sample up to 66% in Spain, with the UK sitting close to the overall average of 53%.

The country analysis shows some changes in the ordering of accountants, solicitors and banks between countries. In the case of Germany and Spain, the different rankings of lawyers and accountants may result from the differing roles and structures of the professions in those countries. In Germany, the accounting profession is essentially divided into auditors and tax advisers/accountants. In addition, many lawyers also undertake the tax adviser role and

the focus group suggested that this may have caused some confusion among the SME respondents. This, when combined with the comments that Germany is a relatively regulated environment, would provide a clear explanation for the difference. In Spain, a similar picture emerges from the focus group; it was explained that the lawyers' function covers advice on tax, personnel-related matters and payroll-related issues. In the US, the low ranking of lawyers was explored further with interviewees and the responses indicate that it could be part of a general view prevalent in the US that lawyers are there to look after their own business, not their client's.

Perhaps the most interesting finding to emerge from a country-by-country analysis of the advisers is that,

**Table 7.2: Propensity to seek advice and advisors used – country analysis**

	UK		Germany		Spain		Hong Kong		US	
<b>Business seeks external advice</b>	54%		61%		66%		37%		49%	
<b>Source of advice</b>	%	Rank	%	Rank	%	Rank	%	Rank	%	Rank
Accountants	91.7	1	71.9	2	70.7	2	77.0	1	87.8	1
Solicitors	79.8	2	72.7	1	82.7	1	74.3	2	68.4	4
Banks or financial institutions	69.7	3	61.2	4	60.9	3	73.0	3	69.4	3
Business colleagues	68.8	4	70.2	3	29.3	6	51.4	4	84.7	2
General business advisers	40.4	6	33.1	7	53.4	4	40.5	5	41.8	6
Friends or family	38.5	7	56.2	5	24.1	7	36.5	6	55.1	5
Government or public agencies	51.4	5	39.7	6	34.6	5	31.1	7	30.6	7
<b>n=</b>	<b>109</b>		<b>121</b>		<b>133</b>		<b>74</b>		<b>98</b>	

based upon a ranking of the mean scores, SMEs in the US rank business colleagues as the second most frequently used source of advice whereas this is almost the lowest ranked source of advice in Spain. When these rankings were explored, the view from the Spanish focus group was that this was to do with competition while in the US the view was that taking advice from business colleagues who may have faced and solved the same or similar problems is so obviously sensible that it is done all the time. In Germany, where business colleagues and friends and family are also highly ranked, this was seen as entirely consistent with a long tradition of family-owned business, the Mittelstand.

The low ranking of government agencies in the US and Hong Kong is also of interest and raises questions about whether this reflects the impact of those agencies or the extent of activity in those countries. In the US, the general view from the interviewees was that the low take up was primarily an issue of trust but that there were other factors at play as illustrated by the following quote.

*People don't trust government – if you are in government you're not in business – they're not the crème de la crème and would not survive in business – they change the rules – ask for more and more information so people don't work with them – they follow rules not logic – they are not in a hurry – their money is not on the line.*

On the other hand, the high level of use of family and friends in Germany and the US was explained partially by the issue of trust but also, and more importantly, in both countries the respondents argued that there was a long tradition of family-owned businesses that enabled current entrepreneurs to draw upon a wealth of relevant experience in their own family circle.

## **7.2 THE EXTERNAL ACCOUNTANT AS AN ADVISER – SERVICES OFFERED**

It is worth noting that the majority of the SMEs surveyed (62%) had someone with a professional financial qualification in charge of running the financial side of their business. This percentage ranged from 43% in the smallest firms to 92% in the largest.

Table 7.3 on page 58 provides details of those accountants' services that respondents said they use. As might be expected, the smaller the firm the less likely it is to use all the services that accountants might offer. There are also some interesting patterns that might indicate that once firms reach a turnover of around £1 million they become less reliant on the external accountant. This may be because they have in-house financial expertise. As can be seen in Table 7.3, the role that accountants play is still the traditional one of accounts preparation, tax and audit, although with larger firms it is clear that there is also greater involvement in planning, advice and consultancy.

The results in relation to the involvement in preparation of accounts would appear, at first sight, to be at odds with the idea that larger firms have internal expertise. The increasing complexity of the regulations and the number of standards with which financial accounts have to comply may, however, provide an explanation for this. Given the easing of the audit requirement for SMEs in Europe, the percentage of firms that still have their accounts audited is higher than might be expected. This may partially reflect the structure of the respondent firms, which have a bias toward larger SMEs. It may also be connected with the need for firms to produce financial accounts to comply with standards and regulation. It is worth noting that the questionnaire contained a check question on this, which confirmed the responses in respect of whether firms have their accounts audited. This apparent anomaly is discussed in more detail below.

**Table 7.3: External accountants – analysis of services used, by size**

	Overall	£ < 50K	50K – 250K	250K – 500K	500K – 1m	1m – 5m	5m – 10m	10m – 25m
	%	%	%	%	%	%	%	%
Tax planning and advice	84	74	81	94	84	86	85	83
Audit	76	59	73	79	76	82	82	87
Preparing accounts	70	56	73	84	76	68	67	64
Business planning	38	32	34	44	34	34	39	53
Access to finance and investment advice	38	27	38	41	37	39	46	42
General business advice	37	27	34	44	39	37	33	52
Management consultancy	35	27	33	36	33	35	40	46
<b>Accounts audited</b>	<b>88</b>	<b>71</b>	<b>86</b>	<b>89</b>	<b>95</b>	<b>91</b>	<b>95</b>	<b>97</b>

One of the more interesting results in Table 7.3 is the relatively low use of external accountants for access to finance and investment advice. It has to be borne in mind, however, that only 22% of the sample said they had tried to raise finance in the last three years so it may be that the results here reflect that low demand for finance and a corresponding low requirement for advice on how to access finance.

A country-based analysis of the data is shown in Table 7.4. The data on audit, tax and preparation of accounts need to be treated with caution, however, and read in the light of the differences between the accounting professions and their roles highlighted in Chapter 3 of this report. It is worth reiterating some of the issues from that chapter, and from our discussions in the focus groups and interviews, to shed some light upon the figures.

In Germany, where small firms are exempt from audit, the focus group was clear that when firms grow the banks demand audited accounts. The group's members were equally clear that many bankers do not know the difference between 'an audited set of accounts and prepared accounts as both are signed'. Similarly, in Spain the group argued that banks are increasingly demanding audited accounts as they 'do not trust the financial accounts any more'. In the US, interviewees again claimed that banks are asking for audited accounts. Interestingly, the other big demand for audited information comes from public bodies, which will not appoint suppliers without prior provision of audited accounts. A common theme among the focus groups and interviewees was the relatively low level of financial sophistication among their SME clients and often also among their bankers. Add to this the various levels of reports in the US and Germany and it would

**Table 7.4: External accountants – analysis of services used, by country**

	<b>All %</b>	<b>UK %</b>	<b>Germany %</b>	<b>Spain %</b>	<b>Hong Kong %</b>	<b>US %</b>
Tax planning and advice	84	86	84	83	79	86
Audit	76	88	63	66	93	73
Preparing accounts	70	73	90	67	69	51
Business planning	38	34	32	41	41	41
Access to finance and investment advice	38	34	33	41	41	43
General business advice	37	42	33	38	30	42
Management consultancy	35	22	26	62	34	31
<b>n =</b>	<b>958</b>	<b>200</b>	<b>188</b>	<b>189</b>	<b>196</b>	<b>185</b>

not be unreasonable to suggest that perhaps the high response on audit masks a misunderstanding of the term rather than a reliable figure.

Moving away from the financially related services, an interesting finding here is the apparent use of accountants, by over 60% of Spanish SMEs, as a source of management consultancy, compared with the relatively low use of this service by UK SMEs. Members of the focus group in Spain were sceptical of this figure, however, suggesting it was probably due to a misunderstanding of the term by the participants in the SME survey.

It is also worth noting, given the high ranking of planning identified in Tables 6.3 and 6.4, that this is an activity where only a minority of SMEs involve their external accountants.

From a UK accountant's perspective, the results show that accountants are used less for non-traditional services by the SMEs in the sample than they are in other countries in the sample, apart from Germany. In Germany, the result showing relatively low use under this heading was confirmed by the focus group, which suggested that the current focus is on tax work only. Members also indicated that this work will be under threat in the future because of the increasing availability of tax-related software and that this would force accountants to provide a broader range of services although, given their other remarks about expertise and competence of the tax advisers on areas beyond tax advice, there would appear to be some doubt as to whether all sections of the profession are ready and adequately equipped to undertake a broader remit.

### 7.3 THE EXTERNAL ACCOUNTANT'S ROLE IN FINANCIAL DECISIONS AND NEGOTIATIONS

Although only 38% of respondents identified advice on finance and investment as one of the services for which they used their accountant (see Table 7.4), when asked the direct question 'Does your accountant advise you on the type of finance you should raise or that is best suited to your business?', 49% said that they did get this advice and 40% said they did not (see Table 7.5). Table 7.5 also shows that, of those accountants who did advise on finance, only 70% took an active role. This represents 34% of the total sample.

The inter-country analysis in Table 7.5 shows that, for SMEs, obtaining their external accountant's advice on finance is most prevalent in Spain, at 67%, and least prevalent in the UK at 36%. In the UK it is also

interesting to note that, even for those SMEs that do involve their accountants in advising on financing decisions, the accountant takes an active role in negotiating finance in fewer than half the cases.

Once again these results need to be put into the context of the various distinctions between the role of the auditor and that of the tax adviser or accountant compiling accounts for tax or statutory purposes. An accountant who acts as an auditor would, in most countries, be precluded from offering advice on finance or taking any part in the decision-making process. The interviewees in the US also offered an interesting insight into their role by saying that they are virtually always involved in raising finance in some way. This can be because the client comes to the accountant for advice first, or the client goes to the bank first and then comes to the accountant because the bank wants some

**Table 7.5: Accountant's advice on finance and involvement in negotiations – country-based analysis**

	All %	UK %	Germany %	Spain %	Hong Kong %	US %
<b>Advice on finance</b>						
Yes	49	36	52	67	47	43
No	40	49	38	28	40	44
Do not need	11	15	10	5	13	13
<b>n=</b>	<b>958</b>	<b>200</b>	<b>188</b>	<b>189</b>	<b>196</b>	<b>185</b>
<b>Active role</b>						
<b>n=</b>	<b>328</b>	<b>32</b>	<b>67</b>	<b>105</b>	<b>83</b>	<b>41</b>
<i>Percentage of those who advise</i>	<i>70%</i>	<i>44%</i>	<i>69%</i>	<i>83%</i>	<i>90%</i>	<i>52%</i>
<i>Percentage of total sample</i>	<i>34%</i>	<i>16%</i>	<i>36%</i>	<i>56%</i>	<i>42%</i>	<i>22%</i>



further information, or the bank comes to the accountant to obtain an interpretation of the information provided. So, at one level they are providing an interpretation service between the business owners and the financiers. In Germany, on the other hand, the focus group members were sceptical about the knowledge, abilities and competence of tax advisers in relation to business finances, even going so far as to say that they are implicated in the fact that German companies are dramatically under-capitalised in terms of equity. The implication is that the advice given is based upon maximising taxation benefit rather than on sound economic principles of business finance. They did, however, state that part of the current role of the tax adviser and accountant is to provide a communication and interpretation channel between the SME owner and the bank, and vice versa.

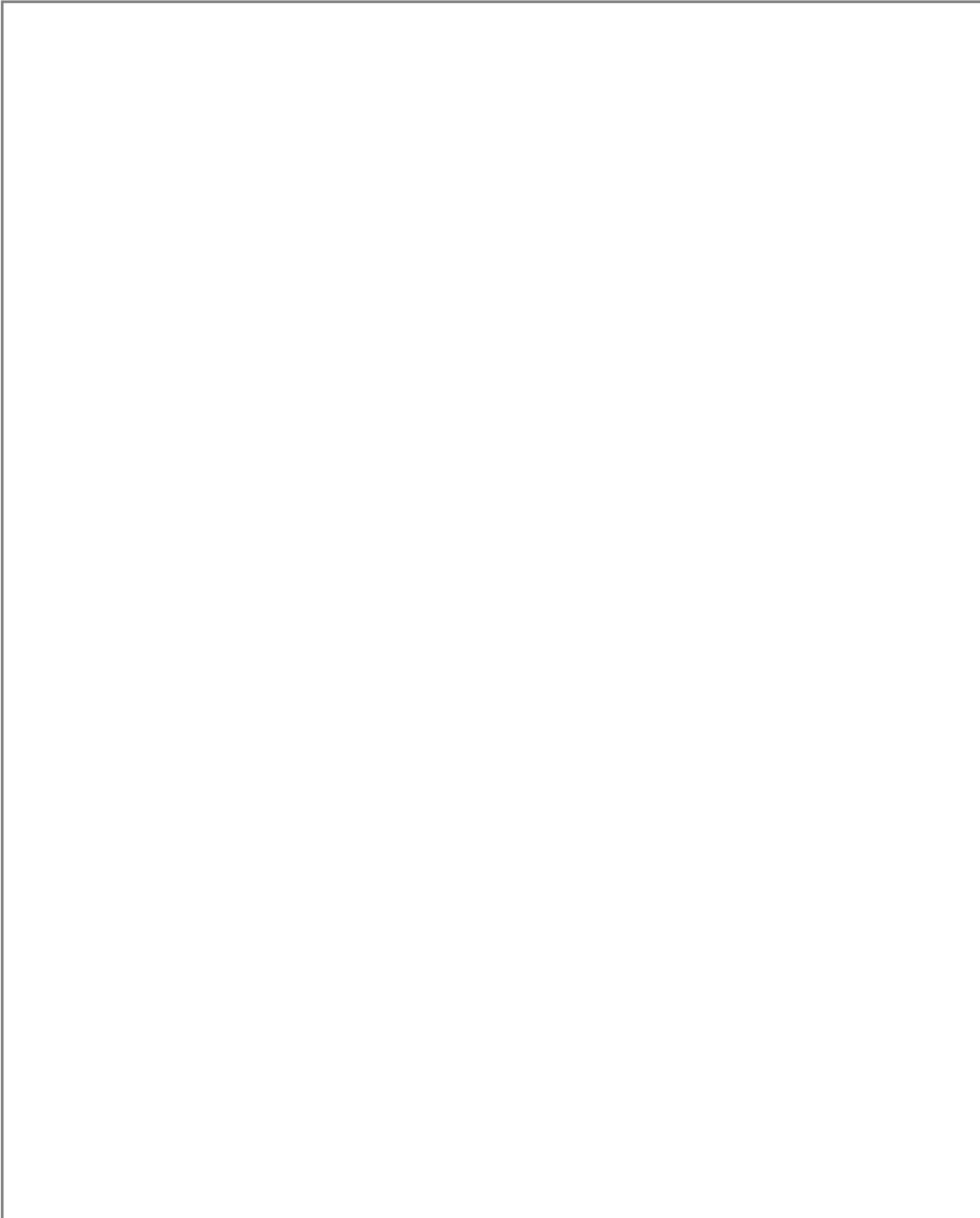
An analysis of the data by size of SME shows a general trend towards an increasing use of accountants in negotiating finance as the size of the SME increases.

A final question relating to the SMEs' satisfaction with their accountants, from not at all satisfied (1) to very satisfied (5) produced the responses shown in Table 7.6. Overall, SMEs are satisfied with the services and advice their accountants offer. A country-based analysis shows Hong Kong scoring lower on this and the US scoring higher. As mentioned in footnote 7 (see page 44), however, this type of result applied to all questions on which respondents were asked to rank their answers on satisfaction scales and may reflect cultural differences rather than real differences in satisfaction.

**Table 7.6: Satisfaction with accountants' services and advice**

	All Mean	UK Mean	Germany Mean	Spain Mean	Hong Kong Mean	US Mean
Satisfaction score	4.1	4.2	4.1	4.2	3.7	4.4

Scale: 1 = dissatisfied to 5 = very satisfied



## 8. Conclusions and areas for further research

### 8.1 BANKING RELATIONSHIPS

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The pattern of banking relationships and the range of services used, together with their frequency of use, shows marked differences between SMEs in different countries that are not explained by other factors, such as size. Multiple banking relationships are most prevalent in Spain and least prevalent in the UK. The reasons for this are partially related to the structure of the banking industry. The UK banking industry is dominated by four banks that provide, either directly or through their finance subsidiaries, a comprehensive range of services. They provide banking for approximately 80% of all UK-based SMEs. In Spain, Germany and the US the structure of the banking industry is more varied, with localised banks, specialist banks and finance providers as well as regional and national banks. Hence SMEs in these countries have to use more than one supplier to meet their needs and there is competition for business between the various banks. In both Germany and the US, changes since the mid 1990s in the structure and practices of banking have also led accountants to advise their SME clients to have multiple banking relationships as a hedge against changes in banking policy and practice.

The patterns of use of different banking services and forms of finance also vary from country to country. Some of these differences can be traced back to the tax regime, as is the case in Germany where it is not tax efficient to have surplus equity kept within the firm, thus affecting the use of deposit accounts. The tax regime also provides an explanation for the greater use of loans and overdrafts. In Spain, the high use of factoring is explained by the tax advantages and relatively higher margins to be earned from this form of finance than from overdrafts. On the other hand, the relatively low use of factoring in the US and Germany seem to be related to the cost of factoring and 'negative signals' that the use of factoring engenders in the US, and a lack of financial sophistication among SME owners/managers in Germany.

It may also be reasonable to assume that there is an element of substitution at work here. For example, one could conjecture that, while in Spain factoring is used extensively as a tool for working capital management, in the UK and Germany an overdraft is used for this purpose. Other factors that seem to be influential are country-based norms, eg overdrafts and factoring are 'frowned upon' in the US, and there is a culture biased towards owning rather than leasing, although this is to some extent offset by aggressive and successful marketing of their products by leasing companies.

It is also worth noting that the larger the SME, the greater the range of different financial services used. This is unsurprising and accords with previous research in the area of SME finance. If this finding is put alongside the finding in Chapter 7 that the smaller the SME the less likely it is to seek advice, it does raise questions relating to the financing of growth within SMEs. One might conjecture that a lack of financial sophistication may be a barrier to growth, especially when security/collateral is a driver in bank lending practices.

These results do not explain all the differences between countries or different sizes of SMEs. To understand these different patterns fully requires further research into the nature of the banking and financial industry in each country and the relative advantages perceived by different SMEs, because there is clearly a cultural dimension to what is acceptable and what is less acceptable, eg factoring is acceptable in Spain but frowned upon in US. It is also worth noting from the findings that countries operate on different 'norms' around debt equity ratios, different banking structures have applied and still apply, and changes in banking structures through merger and consolidation have led SMEs to change their banking practices. These findings help us to get a better picture of the complexity of the subject and also provide a clear indication that it is unlikely that there exists a universal 'right' solution or banking structure to meet SMEs' finance needs.

The findings show that although the banking structures and the number of banking relationships that SMEs have vary from country to country, there are few differences in their satisfaction ratings of their banking services. Once again the results suggest that despite the clear differences in the number of banking relationships, for example in the UK and Spain, there is no universally 'right' structure or 'optimal' number of banking relationships an SME should have. It would appear from this work and other emerging work in the area of small business finance that different banking and financial structures and practices have evolved in different countries, and these satisfy the needs of SMEs within the broader context of that country.

In general, the SMEs surveyed were satisfied with their banks, rating them at around 4 on a five-point satisfaction scale on all eight categories. The analysis of satisfaction by size, rather than by country, indicates that SMEs in the size range of £250,000 to £1,000,000 turnover are generally less satisfied than other SMEs. This could be caused by a combination of the increasing sophistication of their needs compared with those of the smallest SMEs and a failure of banks to recognise or to meet those needs. In the US the accountants interviewed suggested that the banks do in fact recognise the needs of this group but do not choose to meet them.

Overall, the responses show two areas where SMEs were less satisfied and this was the case irrespective of the country in which the SME was based. These were 'charges or tariffs' and the banks' 'level of understanding' of the business. Looking more specifically at the benefits provided on current accounts, some country-based differences are apparent. Spanish and Hong Kong SMEs are the most likely to receive some benefit and UK-based SMEs are the most likely to receive no benefits. The Spanish focus group suggested that this is because of the high levels of competition and SMEs having multiple banking relationships. In the US, where approximately

70% of SMEs have interest paid on their accounts or free transactions or both, the level of satisfaction is higher than in any other country. Here the accountants' responses indicated that they thought the banking industry was competitive and the charges were fair. By contrast, in the UK, only 60% have interest paid or free transactions, or both, and here the satisfaction rating is considerably lower on tariffs and charges, and the accountants were more critical of this aspect of banks' services. The whole question of what benefits are received and, perhaps as importantly, what they are worth is an area for further research.

The other category where SMEs' level of satisfaction with their banks is lower than on the other categories is on the banks' level of understanding of the business. This difference was not as great as was the case with charges and it seems to be a general issue that is neither size nor country related. The accountants in the US and the UK were more damning of the level of understanding the banks had of their small business clients. In the US this is exacerbated by the consolidation of the banking industry, which has led to a loss of the 'local knowledge'. In both the UK and the US the separation of the lending decision from the work of the 'relationship banker' and centralised or regionalised decision making were cited as causing a deterioration in the service provided.

The results show that, in general in all countries, SMEs that wish to raise finance can do this successfully, although the extent to which the bank is used varies dramatically from country to country, with the least use being found in the UK and the most use in Spain. Once again the reasons for these results are not clear, although one could conjecture that having multiple banking relationships could have an effect on the responses obtained.

Before leaving the subject of SMEs' relationships with their banks, it is worth noting that the pattern of communication with banks is size dependent, with

smaller businesses being more likely to visit their bank and larger SMEs more likely to use other forms of communication. Particularly striking is the fact that the number of the largest SMEs that use electronic communication is nearly twice as great as for the smallest companies.

Finally, in relation to SMEs' relationship with their banks, it is worth noting that other measures of satisfaction, such as the propensity to change banks, show that SMEs are generally unlikely to change their banks, especially where single banking relationships are more prevalent, ie in the UK, Hong Kong and the US. Similarly, the fact that banks are more often used than other advisers as a source of advice, with the exception of accountants and solicitors, would suggest that SMEs place a high reliance and/or value upon their relationship with their banks.

## **8.2 CHALLENGES FACED BY SMES**

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The clear message from the survey is that obtaining new business and general finance-related issues, eg keeping costs down, collecting debts, were the most important issues facing SMEs. There is more emphasis on future planning than might have been expected, since this is not mentioned in the Warwick survey (Fraser 2004). It is not clear where the advice and help with planning for the future comes from or if it is provided at all. It does not, however, appear to be coming from the firm's external accountant, especially in the UK. Once again this looks like an area that would warrant further research as it may have a dramatic effect on a range of SME-related issues such as managing growth and succession planning, as well as perhaps informing the direction of government support policies and practices to develop a healthy SME sector.

Some of the issues identified are country specific, for example Spain is experiencing the effects of competition from low-wage economies and German SMEs have a particular problem with slow payment,

which the accountants' focus group attributed mainly to poor working capital management by SME owners. Another interesting factor to emerge from the focus groups and interviews is a general view that public sector bodies, as a group, are slow to pay.

No report on the issues faced by UK-based SMEs would be complete without a mention of regulation and red tape, which was raised unprompted by a higher percentage of SMEs in the UK and Germany and ranks higher than in other countries as an important business issue, although in neither case is it the most important issue by a long way. The UK accountants' survey supports the SMEs' view that the amount of regulation is too high, and the focus group in Germany also confirmed that German SMEs, and indeed the country as a whole, is highly regulated but members were more neutral on the effects of this.

## **8.3 ADVICE AND THE ROLE OF EXTERNAL ACCOUNTANTS**

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Given the question raised above about who offers help and advice on planning for the future, it would be useful to find out whether, in the view of SME owners, there is enough advice and help available on this important topic. The responses to the question on issues facing SMEs, where lack of support or advice is ranked eleventh out of the 12 issues on which SME owners were questioned may indicate that they do not believe that they need help on business planning. If this is the case it would at least provide a partial explanation for the low take up of advice. Overall, only 53% claim to use advisers, although the pattern varies with size; 43% of the very smallest businesses use advisers compared with 75% at the larger end of the size range.

The results show that accountants are used by most business as a source of advice and they are followed closely by lawyers and banks. The results indicate that, for larger businesses, lawyers and banks become

relatively more important. This is not, in itself, surprising as one would expect that as a business becomes larger so its needs become more sophisticated. Nonetheless, it does point to a strength or weakness in the sources of financial advice as the results indicate that banks and financial institutions become more important as businesses grow while such a trend for accountants, who might be seen as independent financial advisers, is not obvious. This may be partly explained by the accounting profession's rules relating to the independence of the auditor. In Germany the use of tax advisers rather than accountants may also account for the lack of use for finance-related advice as the focus group indicated that there is some question about the wider knowledge of these specialist tax advisers.

It is also apparent that overall, as a potential source of advice, government and public agencies are the lowest-ranked entities that the SME respondents have used. In the US this was explained by a combination of lack of expertise and a lack of trust. In the UK this may not be the case as here they are ranked fifth out of seven. In the UK the pattern of take up of government advisers shows that there is less use by SMEs with less than £1,000,000 turnover.

Interestingly, in the US and Germany there was a much greater use of business colleagues, and the accountants saw it as merely common sense for businesses to use other businesses that may have had similar experiences or solved similar problems as one of the main sources of advice. They also cited the tradition of family-owned businesses as an explanation for this.

In general, accountants were used by a majority of respondents for tax, audit and accounts preparation work. It is possible that the figures for accounts preparation are understated in the US, in particular, as SMEs do not have to produce accounts except for tax purposes. Although these tax accounts, which are prepared by the external accountant, have a wide

acceptance and are frequently the accounts used when raising finance, their primary purpose is related to tax and as such it is possible that SME respondents may have viewed this as tax work.

The responses on audit are out of line with what might be expected in the US and the EU, given that there is no requirement for audit of SMEs in the US, and in the EU around 75% of the firms in the sample would be exempt from audit. The results for Hong Kong do, however, make sense as there is no audit exemption. The US and EU results are also out of line with the results of the accountants' survey and discussions. The reasons for this are not immediately apparent. Explanations such as the requirements of banks and public sector bodies for audited accounts may provide a partial explanation for some cases but they are unlikely to apply to more than a minority. Other factors suggested that may have had some impact are the relative lack of financial sophistication (Germany); the complexity of the different types of service; compilation; review; and audit (US). Nonetheless, overall this result remains something of an anomaly.

Only a minority of SMEs used their accountants for business planning, general advice, consultancy or advice on access to finance. As one might expect, the use of accountants varies with size and the legislative regime. In the UK, the smaller the business the more likely it is to use its accountants for accounts preparation and the less likely it is to use them for audit. The fact that fewer UK SMEs (36%) get financial advice from their accountants may affect the range of financial products they use as compared with SMEs in Spain, where 67% use their accountants for advice on finance.

In general, the accountants' responses indicated a greater involvement in advising on or involvement in raising finance than was indicated by the SMEs' responses. This difference may arise partly from the way in which the question is interpreted, as interviewees took a wider view of involvement to

include preparing financial data and interpreting them for the banker. Some of the interviewees saw this role as more of a communication and interpretation role acting as an intermediary between the SME and the banker. Once again it is suggested that this is an area where further research is warranted as it was also clear from the accountants' questionnaire responses, interviews and focus groups that a lack of collateral is the main reason for finance being refused and this may lead to a brake being put on growth. The use of alternative sources of finance may be the way around this for SMEs and the results on the use of different sources of finance show that the larger SMEs are more sophisticated in their use of finance. This group is also most likely to seek external advice whereas fewer than 50% of businesses with turnover under £1 million or its equivalent seek advice. The question that therefore arises is whether a lack of knowledge and financial sophistication together with a low propensity to seek and use advice is a contributory factor to a lack of growth for some SMEs.

Finally, in relation to SMEs and their advisers, the results show that SMEs are marginally more satisfied with the services offered by their accountants than with those offered by their banks, although in both cases the ratings are at the high end of the Likert scale.

#### **8.4 OVERVIEW**

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Overall, while acknowledging the limitations inherent in any research, this report provides a unique insight into banks' relationships with customers, as seen by SMEs and accountants from five countries. It highlights areas of difference in the nature of the relationships with banks that may or not be advantageous to SMEs. These may reflect greater choice of banking relationships in countries with less oligopolistic banking sectors than the UK, or it may reflect the diversity of services and degrees of specialisation of financial institutions in the countries surveyed. The research shows that, in general, SMEs are satisfied with their banks and the

areas of service where the satisfaction rating is slightly down are common across countries. Accountants were in general more critical of banks, especially in the areas of charges and knowledge of the clients' business. The results indicate that SMEs are generally satisfied with their accountants although here the services used differ between countries. The findings provide some questions for accountants, SMEs and policy makers in respect of the take up of their advice, particularly in respect of financing the business.

#### **8.5 AREAS FOR FUTURE RESEARCH**

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The areas identified for further research are issues around substitution of services, further investigation of why SMEs in the middle-size range are less satisfied with the services received, and whether financial institutions are offering an appropriate range of services for this group of SMEs. There are also questions related to the provision of advice for this group as well as questions around their comparatively low take up of advice.

Although the findings, when read in conjunction with the background to the different banking structures, provide some indication of the reasons why different benefits are offered in different countries, the work provides no information on the nature of actual benefits received.

The reasons behind the country-based differences in the use of banks' services and the extent of their use as a source of finance warrant further investigation.

The answers on business planning and its relative importance as a business issue raises further questions on how much this is used as a management tool by SMEs, and who provides them with advice on this area. The role of the accountant in the provision of advice and, in particular, financial advice emerges as worthy of further investigation as this may be a limiting factor on the potential growth of some smaller SMEs.

## 8.6 RECOMMENDATIONS

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The recommendations below are offered for consideration by the banking industry, the accounting profession and policy makers.

### The banking industry

Although in general the banking industry in each country is providing a service that satisfies its SME customers, there are areas that warrant further consideration and research. These are:

- the possible gap between the aspirations of SMEs with turnover up to £1 million and the services provided
- the level of satisfaction with charges, tariffs and benefits and the impact of this upon banking relationships
- the effects of moving from localised decision making to more centralised decision making in terms of understanding an SME's business and the business environment in which it operates
- the apparent remoteness of the decision makers from the SME and the education and training processes used to ensure staff are competent at what they are expected to do.

### The accounting profession

The survey results show very high levels of SME satisfaction with their accountants, but they also highlight some areas for concern. These are:

- the relatively low use of accountants for advice on matters relating to finances, which, as an ever-increasing range of financial products become available must raise the question of the sources of advice that SMEs are currently using and the adequacy and appropriateness of that advice

- the effects of regulatory and self-regulatory regimes relating to audit independence on access to accountants as a source of advice
- the question of whether they should be taking a proactive rather than reactive role in assisting their SME clients with finance-related advice
- the extent to which they can play a positive role in identifying simpler structures for accounting to meet the needs of the various users, eg to what extent the needs of the owner, the tax authorities and financiers can be met by one single form of reporting.

### Policy makers and government

The findings show that the effects of regulation and red tape are not universal problems and lessons can therefore be learned from other countries. Some other issues thrown up by this work that may be worthy of consideration include:

- whether there are lessons to be learned from the issues around the cost of employment and the difficulties in recruitment being faced by SMEs in Germany and the US
- whether to encourage more use of business colleagues as a source of advice, as is the case in Germany and the US, and how to achieve this change
- how to encourage smaller SMEs to access the advice that is clearly available to them and how to improve the take up of government sources of advice to SMEs.



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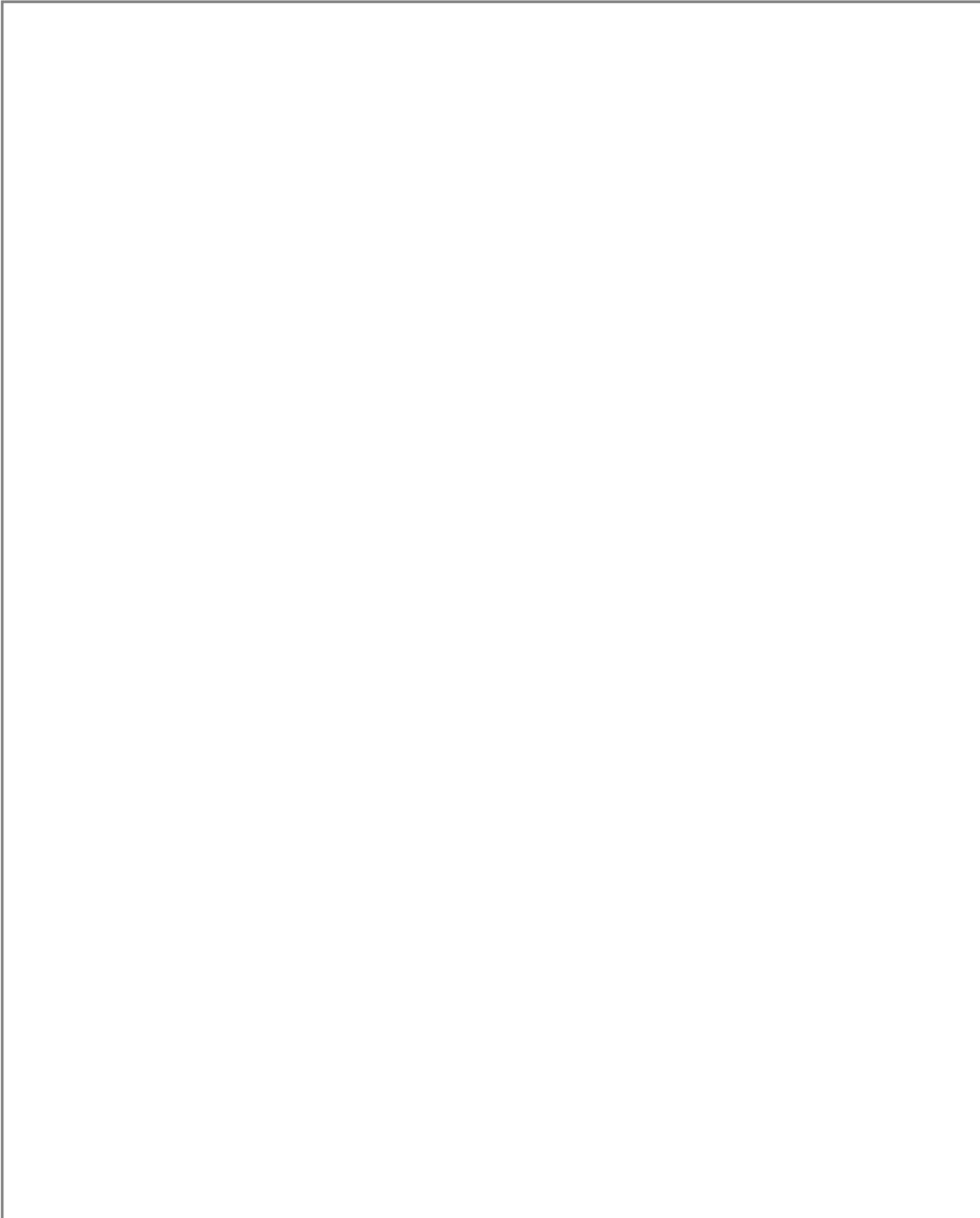
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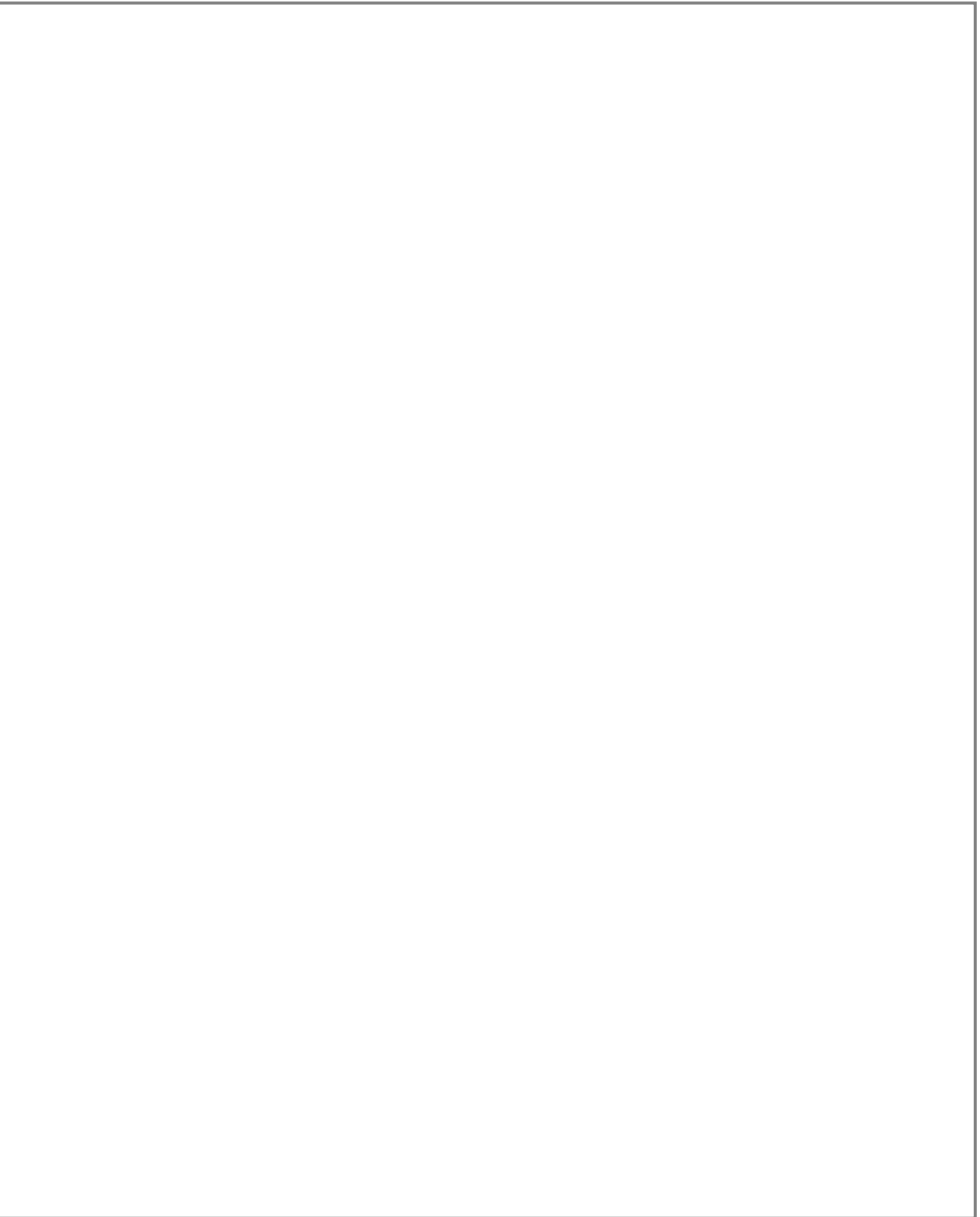
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