FINANCING SMALL AND MEDIUM BUSINESSES: THE BRITISH EXPERIMENT

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Abstract

Financing any business project anywhere in the world is the biggest hurdle that faces its owner. Most businesses whether small or large require finance at some point, whether at the outset or at a later stage and whether in the form of a bank loan, an overdraft, a grant, an equity funding or a combination of these. Finance is the blood that flows in the veins of economic institutions and helps them face the challenges they encounter, However, if the sources of finance are limited or difficult to secure or if there are other hurdles such as the lack of security and stability, this will definitely have adverse effects on all aspects of life, not only the economic but the social, the political and even the cultural.

The aim of this paper is to shed some light on financing small and medium businesses in the UK, the different sources of finance available them, and how easy or difficult to secure this finance. But before this, a brief overview will be given on the importance of the small and medium business sector in the United Kingdom, the role that this sector plays in the British economy, the problems it faces and the facilities put at its disposal. This is done through an expose of some data and other information on this important sector and a discussion about its impact on the national economy especially in creating new additional jobs, creating new investment opportunities, creating new and varied products, increasing competition, and contributing to the wellbeing of the British society.

The paper concludes by stating that small and medium-sized enterprises (SMEs)

ملخص:

إن تمويل أي مشروع تجاري كان وفي أي بلد كان هو العقبة الكؤود أمام بدئه ونجاحه. فالتمويل هو الدم الذي يسري في شرايين المؤسسات الاقتصادية ويعينها على تحدي الصعوبات، وتشجيع الإبداع، وزيادة النمو، ودفع عجلة التنمية بكل ما ينتج عنها، ولكن إذا كانت مصادر التمويل محدودة، وصعبة المنال، أو هناك عوائق أخرى كنقص الأمن والاستقرار، فإن هذا يؤثر سلبا على جميع مرافق الحياة ليس فقط الاقتصادية منها وإنما الاجتماعية والسياسية وحتى الثقافية.

تهدف هذه المقالة إلى إلقاء بعض الضوء على تمويل المنشآت الصناعية والتجارية الصغيرة والمتوسطة في المملكة المتحدة وعلى مختلف مصادر التمويل المتوفرة، ومدى سهولة أو صعوبة الحصول عليها. وقبل هذا وذاك، تعطي المقالة فكرة واضحة ومختصرة عن أهمية هذه المنشآت الاقتصادية والدور الذي تقوم به، وعن المشاكل التي تتعرض لها أو التسهيلات الموفرة لها، حتى يستفاد من هذه التجربة في الجزائر أو في غيرها من البلدان النامية. وسنقوم بذلك من خلال عرض بعض المعطيات والمعلومات المهمة عن هذا القطاع، ومناقشة أثره على الاقتصاد الوطني في توفير مناصب عمل إضافية، وتوفير فرص استثمارية، وزيادة المنتجات الوطنية وتنويعها، وزيادة المنافسة، ونشر العلم والمعرفة، واستثمار الأموال المدخرة، وزيادة الدخل القومي، الخ.،

ويخلص البحث إلى القول بأن المنشآت الصناعية والتجارية الصغيرة والمتوسطة في بريطانيا تساهم مساهمة كبيرة في الاقتصاد الوطني، وأنه وبالرغم من أن هناك مصادر كثيرة للتمويل في بريطانيا وقدر كبير من الأمن والشفافية، إلا أن بعض المشاريع الاقتصادية والتي قد تعود بالفائدة الكبيرة على الاقتصاد الوطني تفشل في الحصول على التمويل اللازم في بداية مشوارها أو في الحصول على الدعم اللازم عندما

in the United Kingdom contribute significantly to the wider economy. However, despite the fact that there are many sources of finance available to them in the country as well as a large number of support facilities and a great extent of security and transparency, some business projects, which might be very useful for the national economy, still fail to secure the necessary start-up or working capital when faced by some financial difficulties or crises.	تواجه مشاكل أو أزمات مالية أثناء عملها. ومن هنا نستطيع أن نقول أن التجربة البريطانية مثلها مثل بعض التجارب الأخرى، جديرة بالدراسة والتفحص للاستفادة منها بما يتلاءم وظروف الجزائر أو أي دولة أخرى تسعى للاستفادة من هذه التجربة الرائدة.

1. Introduction

The economic importance of small and medium businesses has grown dramatically in developed countries since 1980s (Wetzel *et al.* 1994). After that, much attention has been paid to small firms worldwide due to their potential for generating jobs and economic growth, for example the UK now has more than one million small businesses than it had in 1979. As a result, it is now accepted government policy that the small firm sector is the main vehicle for recovery from recession and the main provider of jobs. Similarly in the US, the economy passed a milestone of great importance in 1979 by the shift from industrial manufacturing economy composed of large firms to an entrepreneurial economy driven by information and innovative technology (Wetzel, 1996). In fact, whilst the Fortune 500 companies lost over 4 million jobs between 1979 and 1995, over 24 million jobs were created by the entrepreneurial economy as the number of new small businesses skyrocketed almost 200% (Conlin, 1989).

Since the 1960s many of the International Development Organisations, such as the International Labour Organisation, have given the unemployment problems great attention. The World Employment Programme has called for more support to small businesses due to their effects on job creation. China is an outstanding example in using small firms for developing regional areas. Recently the development plans of many developing countries have given an important emphasis to the creation and support of small businesses, with the aim to decrease unemployment, achieve a better income distribution, and increase the growth rate for these economies (Sekaran, 1992).

The emphasis on the economic contribution of small businesses is now a familiar characteristic of both developing and developed economies. Research has shown five main types of economic benefits, among others, achieved by small businesses. These are innovation, employment, the 'shock absorber' role in declining sectors, increased competition, and flexible specialisation. Thus, the economic benefit of small businesses is well documented, especially when compared to large firms. In the US, Wetzel (1982) even stated that "Relative to their larger, established counterparts, small technology based firms are more effective contributors to the generation of new jobs, innovative technology, productivity, price stability and a favourable international trade balance".

To finance small entrepreneurial firms, most entrepreneurs initially utilise personal savings and bootstrapping (i.e., the use of credit cards, second mortgagees, etc) to fund growth, relying also on internally generated retained earnings when produced (Wetzel *et al.*, 1994). But for many of these fast growth firms, personal funds and internally generated funds are just not enough to finance growth, and so they may seek external financing. Unfortunately, many of those entrepreneurial firms which seek external funding have difficulty locating it (Harrison *et al.*, 1996); particularly from more mainstream sources like banks. In particular, this is because these firms usually have short performance history, small scale operations, weak access to supply and distribution markets, illiquidity, long gestation periods, uncertain growth rates, no collateral, relatively high transition costs for the size of the investment, potentially high information asymmetries between entrepreneurs and potential investors, low survival rates, and some times involve an innovation which increases its already high risks (Tyebjee *et al*; 1981, Landstrom,1993, Bank of England, 1996). Not surprisingly, Jankowics (1995) found that in a survey of the 100 fastest growing firms in the UK, financing was the most frequently self-reported obstacle to growth.

2. The Importance of the Small and Medium Size Business Sector in UK

Small and medium-sized businesses (SMBs) or small and medium sized enterprises (SMEs) as they are also called, contribute significantly to the British economy. Their contribution may be gauged by the vital role they play in boosting research and development, creating new jobs, increasing competition, creating new products, raising productivity, etc..

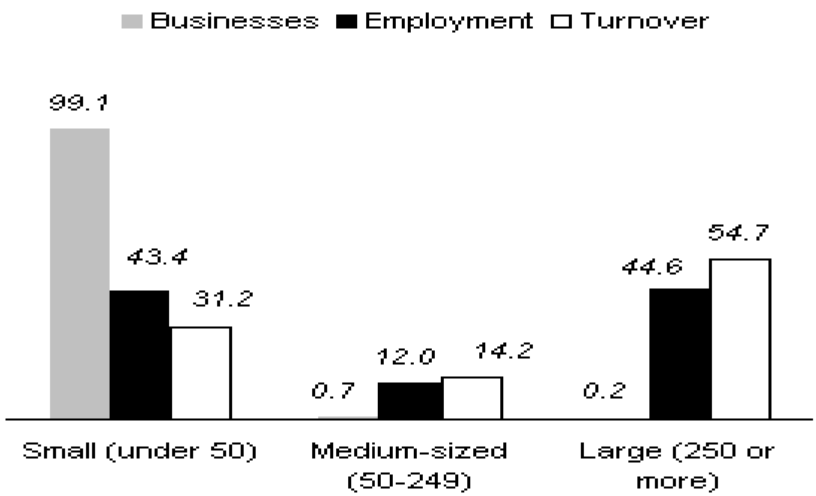
There is no single definition of a small or a medium business. Small business is variously defined for regulatory or other purposes by either the number of employees or turnover, or a combination of both. Different agencies apply different criteria, often arbitrarily. However, the widely used definition is the one that uses the size of the workforce as a criterion. On this basis, SMEs are defined as any business with fewer than 250 employees and categorised as follows:

- micro, 0-9 employees
- small, 10-49 employees
- medium, 50-249 employees

2.1. The Number of Small and Medium Business Enterprises in the UK

Taking the number of employees as a criterion, there are 3.7 million active small and medium businesses in the UK. They account for over 99% of UK businesses and 45% of UK's total business turnover compared with 55% from the 7000 largest businesses (see figure 1). The majority of SMEs have a turnover of between £10,000 and £50,000 per annum.

Figure 1. Share of private sector businesses, in terms of number, employment and turnover by size of business, UK



Source: Small Business Service Website

The number of business enterprises has remained almost constant over the last few years. However, the business stock is more than 1.3 million above the level in 1980, the first year for which comparable figures are available. Most of the growth in the business population has been in the number of 'micro' businesses employing fewer than ten people and in the number of one-person companies. Table 1 shows the number of business enterprises in different sectors of the economy and according to size.

Table 1. The Number and Size of British Businesses

No. of Enterprises		Size (number of employees)			
	=100%	**None**	**1-49**	**50-249**	**250+**
All industries	3,746,340	69.3	29.8	0.7	0.2
Agriculture, forestry and fishing	181,140	68.8	31.1	0.1	0.0
Mining, quarrying, energy, water	5,800	69.7	26.2	2.5	1.6
Manufacturing	292,750	57.2	39.1	3.0	0.8
Construction	691,800	82.6	17.1	0.3	0.0
Wholesale, retail and repairs	541,655	51.8	47.1	0.8	0.2
Hotels and restaurants	123,425	13.7	84.6	1.4	0.2
Transport, storage, communication	235,565	80.7	18.5	0.6	0.2
Financial intermediation	64,300	71.9	26.5	1.0	0.5
Real estate, business activities	867,485	69.3	30.0	0.5	0.1
Education	117,430	89.3	10.2	0.4	0.1
Health and social work	233,035	77.6	21.2	1.0	0.2
Other social/personal services	391,955	78.5	21.1	0.3	0.1

Source: Small Business Service Website

2.2. Job Creation by Small and Medium Businesses in the UK

The establishment of new businesses provides a significant source of job creation. New companies in the UK, especially smaller new ones, are the greatest single source of new jobs. Of the 3.7 million businesses trading in the UK, nearly 2.6 million are sole proprietorship and partnerships and 1.1 million enterprises are considered to be employers. They employ around 12 million people. SMEs jobs are of course less secure than jobs in larger companies.

According to a report by the Federation of Small Businesses, more than 1.5 million jobs were lost in established firms in the 5 years to 2000, but new firms created 2.3 million jobs. Of these 1,972,000 were in new small and medium sized businesses proving that most new jobs are in firms that start small.

The share of employment provided by small and medium businesses (1-250 employees) varies greatly between industries. In finance for instance it is about 15 percent compared to 85 percent in construction (see Table 2).

Table 2. The number of employees per economic sector and the share of employment of different size enterprises in the UK

	Employment Size (number of employees)				
Enterprises	**=100%**	**None**	**1-49**	**50-249**	**250+**
All industries	22,622,000	12.8	30.6	12.0	44.6
Agriculture, forestry and fishing	452,000	40.3	53.8	-	-
Mining, quarrying, energy, water	221,000	2.2	5.1	-	-
Manufacturing	4,103,000	4.7	24.3	21.8	49.2
Construction	1,666,000	36.1	38.7	9.7	15.5
Wholesale, retail and repairs	4,652,000	7.0	33.6	9.5	49.9
Hotels and restaurants	1,560,000	1.6	41.8	10.4	46.2
Transport, storage, communication	1,657,000	12.6	17.9	8.6	60.9
Financial intermediation	1,076,000	4.7	10.3	-	78.5
Real estate, business activities	3,491,000	18.5	38.4	13.4	29.8
Education	289,000	38.2	30.2	16.0	15.6
Health and social work	2,253,000	9.4	24.1	8.5	58.0
Other social/personal services	1,200,000	27.3	35.9	9.9	26.9

Source: Small Business Service Website

2.3. The Share of Small and Medium Businesses in the turnover of all business enterprises in the UK

The share of small and medium sized businesses in the turnover of all business enterprises in the UK amount to about 45% and is also variable between industries. For instance, small and medium businesses account for 100% of the turnover in agriculture, forestry, fishing, mining, quarrying, energy and water, while they account for only 37% of the turnover of manufacturing, health and social work. As for education and construction they account for 85% of the total turnover. (see table 3 for more details).

Table 3. The Share of Small and Medium Enterprises in the turnover of all industries

Turnover (£million)	**Size (number of employees)**				
Enterprises	**=100%**	**None**	**1-49**	**50-249**	**250+**
All industries	2,112,013	7.2	29.0	15.1	48.6
Agriculture, forestry and fishing	26,250	24.6	67.4	-	-
Mining, quarrying, energy, water	95,418	6.6	3.4	-	-
Manufacturing	457,239	1.7	16.4	18.3	63.6
Construction	136,927	18.7	40.0	16.0	25.3
Wholesale, retail and repairs	725,436	4.9	32.9	15.0	47.2
Hotels and restaurants	49,359	3.1	43.9	11.4	41.5
Transport, storage, communication	168,449	5.3	20.2	12.6	61.9
Financial intermediation**					
Real estate, business activities	292,203	13.9	41.0	17.1	28.1
Education	9,912	26.1	42.5	17.5	14.0
Health and social work	74,911	5.5	23.9	7.4	63.2
Other social/personal services	75,909	17.2	34.2	12.0	36.5

Source: Small Business Service Website.

** turnover for the finance industry is not available on a comparable basis.

2.4. Contribution of UK's SMEs to Research and Development

It is estimated that 33% of SMEs in the UK are actively engaged in research and development. The Dynamic innovative nature of SMEs benefits industrial productivity by offering the market new products and processes. The presence of innovative firms in the economy enhances its efficiency. Firms that are unsuccessful at acquiring innovation or do not have the necessary firm specific attributes to produce services profitably will eventually exit the market.

2.5. Contribution of UK's SMEs to Competition

It is generally agreed that strong competition between businesses leads to increased innovation and greater efficiency which in turn leads to increased growth and productivity. If the old enterprises are unable to match the productivity of the new or fast growing SMEs, then they are either forced to exit the market or their market share is reduced, thus increasing the productivity of the market as a whole. Furthermore, any efficiency gains can be passed on to consumers through lower prices and greater choice. However, although on one hand, more competition may push firms into making maximum use of their assets, more competition, on the other hand, may increase uncertainty, shorten time horizons and hinder some people from entering the business market.

The churning of those entering the market and those exiting it and the subsequent shifts in resources from the least to the most efficient improves the market and increases the productivity.

2.6. Contribution of UK's SMEs to Social Inclusion

Small new businesses also have an important role to play as potential contributors to the welfare of the poorest and most marginalised communities and localities in the UK. Business start-ups can increase income for business owners (if they are currently unemployed or in low income jobs) as well as for any employees for whom they may create jobs. The result is an increased spending power which can generate extra demand for local services, and providing new opportunities for businesses.

Entrepreneurship can also increase opportunities for groups that are otherwise disadvantaged or excluded. For example, discrimination in the labour market is one of the factors influencing some members of ethnic or religious minorities to set up businesses and thus creating a "virtuous circle" effect.

Although businesses are privately established for economic and not social reasons, entrepreneurship in the form of new SMEs is one of the ways the poorest and most marginalised communities and localities in the UK contribute to the economy and get involved in their social inclusion.

Starting a business can also benefits women who want work and serve as the starting point for career path of many young fresh graduates to realise their vision and aspirations.

Recent government initiative such as the launch of the Phoenix Fund, support for community Development Finance Institution, Community Development Ventures Fund, and City Growth Strategies all aim at promoting the importance of enterprises in addressing the problems facing disadvantaged areas or communities.

3. Sources of finance for small and Medium businesses in the UK

Every business, whether new or old and/or big or small, needs finance for start-up and for working capital. Some business people have enough money to invest everything themselves that their business requires; others have nothing and expect to borrow everything they need and some others need to raise equity from third parties. Banks are usually very cautious in lending to new and less experienced businessmen and want to lend as little as possible.

Funding from different sources has different costs reflecting the different risks. A key consideration in choosing the sources of finance for a new business is to strike a balance between equity and debt in order to ensure the funding structure that suits the business. The main differences between borrowed money (debt) and equity are that bankers request interest payments over capital repayments, and the borrowed money is usually secured on business assets or the personal assets of the owner. A bank also has the power to place a business into administration or bankruptcy if it defaults on debt interest or repayments. In contrast, equity investors take the risk of failure like other shareholders, whilst they will benefit through participation in increasing levels of profits and on the eventual sale of their stake. However, in most circumstances some venture capitalists also require more complex investments (such as preference shares or loan stock) in addition to their equity stake. The overall objective in raising finance for a company is to avoid exposing the business to excessive high borrowings, but without unnecessarily diluting the share capital. This will ensure that the financial risk of the company is kept at an optimal level.

Equity can be profits that are retained in the business or new investments from partnership with family members or friends. In can also be investment from external sources such as venture capital provided by professional investors or by individuals investing as ‘Business Angels’.

Debt can be bank lending or overdrafts or it can be based on the assets of the firm, such as factoring and invoice discounting, or hire purchase and leasing. The debt is usually secured against the assets of the business or else is guaranteed by others.

There are a number of potential sources of finance to meet the needs of small and medium businesses in the United Kingdom. However, despite the many attempts to encourage alternative methods of finance such as venture capital, small businesses are still mainly relying upon bank funding. In a survey carried out for the Federation of Small Businesses, (Small Businesses' Finance and the Economy, Electoral Reform Ballot Services, December 1998) 66 per cent of respondents used a bank to finance their business, 65 per cent used their own resources, while only 1 per cent used venture capital, only 4 per cent used other private individuals and just 3 per cent used factoring.

3.1 Own Finance

This is one of the most common ways of funding a small business. There is no waiting around and virtually no red tape involved. However, if something goes wrong and there is nothing to fall back on, one could face a big loss or bankruptcy. If one's own money is not quite enough, he/she may choose to seek help funding from friends and family. This of course could be in exchange of a stake in the business. Written guarantees and/or legal documentation may also have to be drawn up.

3.2. Bank loans and Overdraft financing

3.2.1 Bank Loans

Bank lending is the most common form of financing available to businesses. In fact, approximately between 60% and 70% of small businesses request their local banks to lend them some money to help them reach the next stage of growth or to get the company functioning well. However, it is nor easy to convince a bank to give loans. Banks usually require that the business should demonstrate not only the viability of the project but also enough security against the loans they offer. Thus, many useful businesses may be turned away.

As commercial lenders, banks are more concerned with getting a good return on their investments and they do not want to lose their money on businesses that are likely to go bankrupt. This is usually because the business is being started by someone with little or no previous experience, little or no own capital and the security is perhaps not sufficient. Acceptance will almost always depend on the type of business and the amount of security the bank can receive in return for funding.

Examples of the security required by banks include:

Life Insurance Policy: The businessman would sign over to the bank a policy with a surrender value of more than the value of the loan, for the duration of that loan. If the borrower dies the bank will automatically be repaid and any balance handed over to the family. If the loan is defaulted, the bank will surrender the policy and reclaim its money.

Mortgage on one's home: In the event of default the bank has a right to sell the home to reclaim its money. This usually only applies for very large loans.

Stocks and shares: Shares worth more than the value of the loan can be signed over to the bank for the duration of the loan. If there is a default on the loan the bank will sell the stocks and shares. If payment of the loan is made, the businessman gets back his shares.

It's worth stressing that much small business is run through personal accounts and loans, not necessarily SME accounts - in 1999 24% of SME's used credit cards as a source of finance. Lending to SME's via overdrafts fell through much of the 1990's and is currently running around £12 bn, whereas term lending, a far more efficient form of medium term lending, has risen to £3Obn (Mullen, 2001).

There are different types of bank loans. These are:

Short-term loans: These are normally for a period of up to 2 years. Interest rates are different for each bank, and can be either fixed or can vary with the base rate. Short-term loans are often useful for purchasing equipment as this is often cheaper than hire-purchasing or leasing equipment.

Medium-term loans: These are usually up to 10 years in duration, and repayment schedules are usually flexible. For example, one can just make repayments at any time of the year, or if he is a start-up company he may not have to make any repayments for the first few years.

Long-term loans: These are normally over 10 years in duration, as they are normally used to buy assets with a long life span such as buildings or large machinery.

Commercial mortgages: These are useful for buying property. They are normally of shorter duration than domestic mortgages - perhaps 15, rather than 20 to 25 years. This form of mortgage has tax relief and there is no upper limit on the size of the loan. Signing over the deeds of the property to the lender is usually the form of security required.

3.2.2. Overdrafts

This is a useful way of borrowing smaller amounts of money in the short term. There are several bank charges involved with an overdraft including a set-up charge, a monthly administrative fee, and high penalties if one withdraws more than the overdraft limit.

3.3. Grants

This is one of the cheapest forms of finance but sometimes non-financial conditions are attached to the grant. These could include the number and type of people employed and occasional restrictions on items on which the money can be spent. However, small firms find the grants system too complicated and time consuming. Applying for grants tends to be a long-winded process but small firms need quick replies as to whether they will be successful or not.

Grants range from local initiatives run by local development agencies to Business Link funding as well as private funds across the country. Grants may also be available in certain parts of the country or for certain types of business projects. For example the discretionary Regional Selective Assistance (RSA) grants are available to help projects that either create new jobs or protect existing jobs in those parts of the UK designated as Assisted Areas, such as former coal mining towns. This scheme provides fixed grants to smaller companies proposing new capital investment. One may apply for a grant covering 15% of the cost of fixed assets of his project, up to a maximum of £15,000.

3.4. Venture Capital

Venture capital is a means of equity financing a growing business where a portion of the share capital is sold to the financier in return for a major share in the business. Whilst some measure of personal control over the business is lost to the new shareholder, the amount of finance gained can be very large indeed.

Prior to 1980 there was very limited academic interest and research on venture capital. However, the success of venture capital backed companies in the 1980s and 1990s has increased the significance of venture capital as an area of academic interest and research.

Venture Capital contract has some similarity with Islamic financial contracts such as *Musharakah* and *Mudarabah*. This makes it acceptable to the large British Muslim community in the UK which does not want to be involved in interest based transactions. However, not all British Muslims are aware of this.

Furthermore, the managerial and technical benefits of venture capital can be provided for small firms in UK which is not available directly through government or bank financing.

UK's venture capital industry is the largest and most developed in Europe, accounting for about half of the total annual European venture capital investment. The British Venture Capital Association was founded in 1983, and in 1984 members reported investing £190 million in 479 businesses. By 1995 investment had risen by thirteen times to a record £2.5 billion in over 1,100 companies (Joy, 1996:35). Since then the UK venture capital industry has invested almost £50bn in about 23,000 companies and it is still growing, with the total funds invested by UK venture capitalists in 2001 rising to £12 billion, up 36% from the previous year.

There are three different types of potential venture capital investors one could approach for funding:

- Venture Capitalists
- Business Angels
- Business Incubators

3.4.1. Venture Capitalists

These are investment companies that provide long-term, risk sharing equity capital to help unquoted companies grow. There is a large element of risk for them to do this, but this is compensated for, by them having a share in the equity of the business they finance. The amount of equity taken varies between different Venture Capital companies. A definite advantage of using a Venture Capital is that they have the experience and contacts to be able to advise the business and help it develop. Venture capitalists only provide funding of about £2 million and upwards, so this will probably exclude most, but not all, potential small businesses.

3.4.2. Business angels

These are informal investors (wealthy senior executives/businessmen) searching for profitable investment opportunities. They are willing and able to make small scale equity investments in SMEs and operate in the same way as Venture Capital companies in that they invest in small businesses in return for an equity share of the company. Many are also able to provide hands-on management and other expertise which can be of benefit to a small business. The main differences are that most business angels invest less than £100,000 and they tend to invest in start-up unquoted companies only.

Most regions of the UK now have 'business angel' matching services, which encourage local investment and mentoring on a smaller scale. The National Business Angels Network matches investors with small businesses requiring £10,000 to £250,000 on a national scale and is sponsored by several banks.

3.4.3. Business incubators

Business incubators are financiers who provide a nurturing, instructive, and supportive environment for entrepreneurs during the critical stages of starting up a new business. The goal of incubators is to decrease the chance that a start-up business will fail. They serve as a launching pad for young and small businesses at their start-up, improving their chances of survival and help young companies overcome the problems that often lead to their early downfall, in particular a lack of business skills and inadequate financing. During a start-up's early development, an incubator will also provide access to a range of business skills and training to help the business grow and enable new enterprises to stand on their own feet more quickly than if they were to go it alone.

Companies housed within UK incubators had an average success rate of more than 80% compared with the national average of less than 50% of all small- and medium-sized companies registered and trading in that year.

Business incubators do vary a lot but they all provide aid to start-up companies. They may provide office equipment at discount rates, temporary support staff such as administrators, or perhaps assistance with getting financial backing. As with Venture Capitalists, incubators expect an equity share of the business in return. Incubators are there more to help building up the infrastructure of the company and point in the direction of where to get funding, rather than provide huge amounts of capital themselves.

3.5. Factoring and Invoice discounting

3.5.1. Factoring

Factoring is one way of freeing up to 90% of invoice value upfront and the invoice finance provider is responsible for collecting payment of invoices and associated administration. For example, if a manufacturer has an invoice for £10,000 against goods that he has supplied to one of his customers on credit terms, he can convert this invoice into £9,000 cash within 24 Hours.

3.5.2. Invoice discounting

Invoice discounting is a similar service to factoring. However, it is for medium businesses whose turnover is more than £250,000. It is a way of ensuring strong cash flow while allowing the client to maintain total control over invoicing and credit control, therefore retaining customer contact. It is the process of turning newly raised invoices into cash.

3.6. Asset Finance: Leasing and Hire Purchase

Acquiring assets such as capital equipment or machinery is a major commitment for many businesses. It requires careful planning as it can often make sense for a business to look for ways of spreading the cost of acquiring an asset to coincide with the timing of the revenue generated by the business.

Two potential sources of medium term finance for small and medium sized businesses are leasing and hire purchase. These are financial facilities which allow a business to use an asset over a fixed period, in return for regular payments instead of paying for it fully on one go. The difference between the two is that in the hire-purchase contract, after all payments have been made, the business customer becomes the owner of the equipment, either automatically or on payment of an optional purchase amount. As for leasing the ownership of the equipment does not pass to the business customer.

Leasing and hire purchase are perhaps the best ways of ensuring a business to always have the most up to date equipment. They enable a user of equipment or machinery to benefit from its use whilst paying for it in small instalments. A wide range of equipment can be financed, from computers and software, through shop fittings, to plant and machinery.

Leasing and hire purchase contracts are also very similar to the Islamic financial contracts of *Ijarah* and *Ijarah Wa Iqtina'*. However, again the majority of the Muslim community in Britain does not know that.

Between 1990 and 1997 leasing and hire purchase rose from 16% to 27% of small business lending.

Finance and Leasing Association (FLA) is the leading UK representative body for the consumer credit, motor finance and asset finance industry. Members of the FLA achieved £73.5 billion of new business in 2001. Of this, £23.3 billion was provided to the business sector, representing 25.4% of all fixed capital investment in the UK in 2001.

4. Other sources of funds

There are many other ways and means for small and medium businesses to get finance which can help them not only to establish themselves but also avoid the crippling effects of bad debt brought about by current economic conditions. Funds are available from the Department of Trade and Industry, the European Union and various other organisations. However, small businesses have yet to take full advantage of these different facilities.

4.1. Small Business Support Networks

Financial assistance and advice to small businesses is available all over the country, especially in areas of high unemployment and economic deprivation. The networks of organisations that make financial support and advice available to small firms seem to be constantly changing. Identifying the right package of support can be complicated.

Several regional networks - Business Links (England), Small Business Gateways (Scotland), Business Connects (Wales) and the Local Enterprise Development Unit (LEDU) Regional Offices in Northern Ireland - can help. All of these networks provide 'one-stop shops', bringing together information on all of the most important local and national business support services for small and medium sized businesses.

Funding for small businesses is frequently raised most effectively as a package of support from several sources. Backing from one source can inspire the confidence of another. The best way to assemble a suitable package of support is through an experienced business adviser acting as an intermediary.

Financial assistance, especially for business start-ups, is often associated with business skills courses. Undertaking business training not only improves personal skills, but will increase the confidence of potential investors in the business.

Financial assistance is often provided for specific purposes, e.g. marketing, rent relief; for specific types of business, e.g. manufacturing, technology; for particular types of people, e.g. unemployed or young people; or for specific areas, e.g. rural areas or areas of industrial decline.

Anyone starting or developing a business and looking for financial assistance must produce a comprehensive business plan, clearly setting out the financial case. Business advisers can assist with this and can also refer clients to other agencies for more in-depth advice and training.

4.1.1.The Government's Small Firms Loan Guarantee Scheme

The Small Firms Loan Guarantee Scheme is a joint venture between the Department of Trade and Industry and the currently participating 23 lenders including the main banks and a number of other financial institutions. It is administered by the Small Business Service (SBS) and was introduced in 1981 to fill a recognised gap in the market for small businesses access to finance. It assists viable small firms that are unable to raise conventional finance because of lack of security. The Scheme provides a guarantee, which encourages banks and other financial institutions to lend where they would normally be unable to do so.

To date it has guaranteed over 82,000 loans valued at more than £3 billion. Loans are for fixed terms, with a minimum of 2 years and a maximum of 10 years. The guarantee generally covers 70% of the outstanding loan. This rises to 85% for established businesses who have been trading for two years or more. Loans are generally for amounts between £5,000 and £100,000. The maximum loan size is £250,000 for established businesses that have been trading for two years or more.

4.1.2. Scottish Equity Partners (SEP)

This is an independent venture capital company which specialises in investment for emerging growth technology companies throughout the UK and Ireland. They are currently investing from a £110 million venture capital fund, backed by leading UK and European institutions. In particular, the fund targets investments in software, communications, microelectronics, healthcare and energy. SEP can invest in start-up, early stage and expanding technology companies. Most investments are in the £250,000 to £5 million range.

SEP looks to invest in companies with strong growth prospects and the potential to achieve significant increase in value. Emphasis is placed on companies with high calibre, entrepreneurial and forward-looking management teams, with the potential to secure a leading position in their market.

4.1.3. The European Investment Bank (EIB)

The European Investment Bank provides medium and long term loans to cover up to 50% of the fixed capital costs. The minimum size of an EIB loan negotiated directly in the UK is usually about £10m (minimum project size about £20m). Normally the guarantee of a bank or well diversified parent company is required. An EIB loan may be additional to Regional Selective Assistance. Most UK banks and finance houses have EIB financing facilities to help support their lending to customers with capital investment projects of up to about £20m.

4.1.4.The Enterprise Investment Scheme

This is designed to provide targeted incentive for new equity investments in qualifying unquoted trading companies and to encourage "business angels" (outside investors who introduce finance and expertise to a company). It offers income tax relief on qualifying investments up to £100,000 in any tax year.

The Enterprise Investment Scheme allows businesses to raise up to £1 million per tax year. Individuals are encouraged to invest up to £100,000 per tax year in a company by receiving tax relief on that sum. Investors previously unconnected to the company can become paid directors. The aim is to encourage 'business angels' - wealthy people with extensive business experience - to provide finance and expertise.

4.1.5. Loan Funds from Development Agencies

Loan funds are often managed by enterprise or development agencies. Terms and conditions often depend on the region or area of the applicant. Interest is often fixed for the period of the loan or charged below bank rates. Less security is usually required compared with banks. Repayment periods can be flexible, with repayment 'holidays' usually available. Loans are often only available to businesses that are viable, but cannot raise all the finance required from banks. Most funds require borrowers to be monitored for the period of the loan and some integrate loan finance with advisory schemes.

4.1.6. Small Firms Training Loans

These loans are available through the Department for Education and Employment (DfEE), and several major banks to help small firms who employ between 1 and 50 people to pay for vocational education or training. Businesses can borrow between £500 and £125,000 to cover training costs and, subject to a maximum loan of £5,000, consultancy advice on training matters. Any type of training course is eligible (either full or part-time, and on-site or distance learning), as long as companies can show that it will help them achieve their business objectives. Businesses that can apply are those already trading or about to trade, with 1 to 50 permanent employees or any sole traders, business partnerships, co-operatives, franchises and limited companies. There is nothing to pay for up to 12 months of training - the DfEE pays the interest for this period. The loan is repaid over a minimum of period of one year up to a maximum of seven years.

4.1.7. Career Development Loans

These deferred repayment loans help individuals including self-employed people, pay for vocational training courses lasting no longer than two years plus a maximum of one year practical experience where it is part of the course. They can be obtained from four of the major UK banks, and the government pays the interest on the loan during the course and for up to 1 month afterwards. The borrower can then repay the loan and any further interest over a period agreed by the bank.

5.1.8. Training for Work Scheme

The Training for Work Scheme is available for people who have been unemployed for more than 12 months. Such individuals can receive training and financial support to assist their move into self-employment.

4.1.9. SMART (Small firms Merit Award for Research and Technology)

SMART is an annual competition for individuals and businesses with less than 50 employees, who are involved in research and development. It provides grants of up to £45,000 to help with the costs of technical feasibility studies into innovative technology. Winners may also receive further assistance under the SPUR scheme to develop a prototype.

4.1.10. SPUR (Support for Products Under Research)

SPUR provides grants of up to £162,000 for the development of new products and processes which involve a significant technological advance. SPUR favours small businesses in particular.

4.1.11. The Teaching Company Scheme

Run by the Teaching Company Directorate, the TCS helps any business (but favouring small firms with growth potential), to access knowledge, technology and resources at UK universities. A TCS programme involves 1 or more graduates each working for two years on key technology transfer projects identified by the company. For small firms 70% of the cost of using a graduate's skills can be awarded in grant form, and the remaining 30% has to be found by the firm itself.

41.12. Export assistance

Advice on exporting is available to any individual or small firm wishing to export products, from Business Link in England, Scottish Enterprise in Scotland, or Business Connect in Wales. Special funding is available for companies who want to operate in Central and Eastern Europe. The European Investment Bank also finances loans to small and medium enterprises. The European Investment Fund underwrites loans to small firms. The Export Award for Smaller Businesses is also available. Any small firm that exports goods or services can apply, each successful candidate gets £5,000 and advice.

4.1.13. Highlands and Islands Enterprise (HIE)

HIE is concerned with assisting the social and economic development of the Highlands and Islands - roughly half of Scotland. Potential candidates are variable, but currently HIE is interested in new businesses in the IT, tourism, food and drink and manufacturing and production sectors.

4.1.14. The Prince's Youth Business Trust and the Prince's Scottish Youth Business Trust:

Both organisations help unemployed young people aged between 18 and 30 to start their own businesses by providing financial help, business monitoring and marketing opportunities. Applicants must have a viable business idea with the necessary commitment to make it succeed, and they must have been unable to obtain funding from other sources. Loans are available up to a maximum of £5,000 to people starting a business. Repayment terms of 3% per £1,000 per annum over a 1 to 3 year period are available, and there are no repayments for the first six months. Business expansion loans are also available for people under the age of 30 who have already received a loan or bursary. The total of all loans for one individual or small business may not exceed £5,000.The Trust also offers bursaries of up to £1,500 to individuals or £3,000 to groups in exceptional circumstances. Test Marketing Grants (up to £250) are available to help applicants assess if there is a market for their product or service.

5. Why do SME's find financing a problem?

The main problem, that faces small and medium enterprises (SMEs) when trying to obtain funding, is that of uncertainty because:

• SME’s rarely have a long history or a successful track record that potential investors can rely on in making an investment with them;

• Larger companies (particularly those quoted on a stock exchange) are required to prepare and publish much more detailed financial information – which can actually assist the finance-raising process;

• Banks are particularly nervous of smaller businesses due to a perception that they represent a greater credit risk.

Because the information is not available in other ways, SME’s will have to provide it when they seek finance. They will need to give a business plan, a list of the company assets, details of the experience of directors and managers and demonstrate how they can give providers of finance some security for the amounts provided. Prospective lenders – usually banks – will then make a decision based on the information provided. The terms of the loan (interest rate, term, security, and repayment details) will depend on the risk involved and the lender will also want to monitor their investment.

A common problem is often that the banks will be unwilling to increase loan funding without an increase in the security given (which the SME owners may be unable or unwilling to provide). A particular problem of uncertainty relates to businesses with a low asset base. These are companies without substantial tangible assets which can be used to provide security for lenders.

When an SME is not growing significantly, financing may not be a major problem. However, the financing problem becomes very important when a company is growing rapidly, for example when contemplating investment in capital equipment or an acquisition. Few growing companies are able to finance their expansion plans from cash flow alone. They will therefore need to consider raising finance from other external sources.

6. Conclusion

Governments all over the world, whether developed or developing are giving top priority to developing small and medium businesses because they are the real engine of growth. They contribute significantly in promoting the growth of the economy by providing job opportunities, enhancing the quality of human resources, nurturing a culture of entrepreneurship, fostering creativity, and opening up new business opportunities. Many, however, as a result of their scale of operation have limited financial and managerial resources. The quality of service they receive from their banks and other financiers and the terms on which it is provided are key factors in the success of this sector.

Contrary to large businesses, the flexibility and the lower start-up and operating costs enable SMEs to spring up, reposition and adjust themselves quickly in response to market and economic changes. Moreover, they can easily expand or contract within a short period of time, to clinch new business opportunities or pull out where there is an over-supply.

SMEs in the UK as in other countries have not only survived the impact of big enterprises and the law of economies of scale, but have carved out niches for themselves which enable them to co-exist with big enterprises. In fact many SMEs are strategic partners of big enterprises.

Despite the fact that there are many sources of finance available to SMEs in the UK as well as a large number of support facilities and a great extent of security and transparency, some small business projects, which might be very useful for the national economy, still find it difficult and sometimes impossible to secure the necessary start-up or working capital when faced by some financial difficulties or crises. Besides, there is some degree of unawareness amongst many minority communities in the UK of the facilities available to them. Many are those who do not know what are the modes of finance that are available to them if they so wish to use them and how compatible are they with their beliefs.

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