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Are English SMEs disadvantaged in accessing Green Finance?

A STUDY OF UK (BANK AND NON-BANK) DEBT FINANCE PROVISION

Are English SMEs disadvantaged in accessing Green Finance? A study of UK (bank and non-bank) debt finance provision.

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Executive Summary

Building a low carbon, 'green growth' economy is a major part of the UK Government's policy agenda to address net zero and biodiversity commitments, 'level up' the economy and create a global leading UK green sector.

This report focuses on how to finance the green transition of established SMEs in England. Prior demand-side research demonstrated that surveyed SME access to debt finance for this transition is uneven across the UK and that smaller, less resourced SMEs in more remote locations from banking centres may be most disadvantaged.

This report draws on 21 in-depth qualitative interviews with the supply-side stakeholders and providers of bank and alternative non-bank debt finance across the English regions, with a focus on the urban London and more rural South-West regions. Our interviews covered the English debt financing ecosystem, including financial trade associations, high street and specialist green/sustainable banks and non-bank alternative debt finance providers, finance brokers and business support providers such as local authorities.

Our main findings are that a two-tier SME financing approach has evolved in England, whereby larger, better resourced SMEs are more able to access traditional high street bank debt finance and supporting government green grants and subsidies. **This results in a lower tier, vast majority of SMEs, that are smaller and less well-resourced that lack sufficient internal investment funds, information, support and access to the external finance (debt or grant) required to assist their green transition.** We find that more green transition active lower tier SMEs seek alternative non-bank debt finance, either directly or through brokers. Brokers offer an important relationship manager role but are uneven in their performance and unregulated. Furthermore, the combination of limited and poorly targeted grant funding and landlord-tenant property restrictions hold back green transition.

Key recommendations

1. First and foremost, establish a national, or sub-regional (Combined Authority) scale overarching authority, such as an expanded London Energy Efficiency Fund to act as a one-stop-shop agency to manage the scale-up of grant and subsidies for SME commercial energy and environmental work.
2. Provide national and local subregional SME **green finance roadmaps** which can be accessed online. These could link to accredited Financial Conduct Authority (FCA) regulated finance brokers for independent guidance, facilitating improved SME access to non-bank finance opportunities.
3. Provide a well-publicised national or local subregional targeted grant funding programme – drawing on key local trusted SME support agencies to deliver 'just transition' outreach to SME communities and 'levelling up'. This should be large enough to offer administrative economies of scale and sufficient grant funding (up to at least £10k) to make a difference to eligible SMEs. We find that grants of sufficient size and status can leverage additional private debt finance. Grants should perhaps be prioritised for building fabric (insulation), whilst loan products (which are better suited to capital equipment assets) become better developed in this area.
4. Encourage Local Authorities to explore the benefits of making wider use of '**Green' Business Rate incentives (under Section 69 of the Localism Act 2011)**, such as piloted by Sutton Council, to fund local SMEs in their green transition.
5. Public policy should **regulate Landlord requirements for tenanted commercial properties and make the uplift of** commercial property Environmental Performance Certificates (EPCs) a priority. A more transparent ratings approach and reduction in commercial property exemptions is required. Furthermore, there is a need to develop innovative aggregating schemes like Norwich Solar System for SMEs in order to bring together groups of businesses – large and small – to benefit from purchasing power agreements for commercial property energy and insulation retrofit. Although beyond the scope of this study, this might also include a combination of local authority and developer agreements with private business to improve the greening of commercial property, including the development of green property bond financing schemes.
6. Given that SME commercial property retrofit is such a crucial part of addressing climate change and appears to be unaffordable to so many SMEs in England, there is a strong argument in favour of a **Universal Payment System for retrofit** to small employer SMEs (e.g. micro enterprise of 1-9 employees) of up to £10k. This would offer more efficient blanket financial coverage of smaller businesses and avoid the inefficiencies of the current drip-feed, bureaucratic grant schemes. This would require local trusted support services to operate, and payment would only be available upon receipt of Energy Technology List approved works.

Introduction

Building a low carbon, 'green growth' economy is part of the UK Government's policy agenda to 'level up' the economy (HM Government Levelling Up the United Kingdom, 2022, UK Government; Net Zero Strategy: Build Back Greener 2021). The Net Zero Emissions Law, June 2019, aimed to kick-start a new green industrial revolution which could have profound and pervasive beneficial impacts on the UK economy. In particular, the Net Zero (NZ) transition creates huge opportunities for many of the UK's peripheral regions that lie outside the South-East or England, and where the largest emitting industrial sectors are often based. UK SMEs are crucial to delivering Net-Zero (NZ) and a Just Transition that addresses place-based socio-economic inequalities, given that they contribute 99% of private business, 60% of jobs, 50% of GVA and also 50% of greenhouse gas emissions (LSE, 2021).

This project is part of ongoing research into the factors influencing both the supply and demand for external finance by environmentally-oriented Small and Medium-sized Enterprises (SMEs) in the UK, in the context of the increased digitalisation of financial services and the accelerated pace of bank branch closures. Our previous work found that – amongst other factors – geographical proximity to financial services centres is a positive incentive for green oriented SMEs[1] to apply for bank debt instead of government grants to finance green projects (Gottschalk and Owen, 2023). In addition, we found evidence that peer-to-peer (P2P) lending does not replace bank credit for green SMEs.

This project thus aims to complement our recent quantitative secondary data analysis (Gottschalk and Owen, 2023) which is based on the Department of Business and Trade's annual UK Longitudinal Small Business Survey (LSBS), and to address research data gaps with enriching qualitative insights, by undertaking qualitative online interviews with 21 SME green finance providers and stakeholders in England. The LSBS presents two different groups of environmentally-oriented SMEs applying for funding, those prioritising green aims, and those that have green aims but prioritise financial objectives. Both groups may be start-ups or established SMEs that are seeking finance to transition to NZ business processes or assets (e.g. EV chargers, renewables on the UK government's Energy Technology List (ETL)).

The focus of this study was specifically on how English finance providers are funding the green transition of established SMEs, rather than start-ups. Therefore, we examined access to debt finance (rather than the high-risk equity finance associated with innovative startups). Traditional SME finance pecking order theory (Myers and Majluf, 1984) proposes that established SMEs with viable trading track records will first self-fund through trading surpluses. Where self-funding is not possible, SMEs will then seek the cheapest alternative external financing available, which is typically repayable debt finance in the form of bank overdrafts, term loans and equipment leasing arrangements. Debt finance is non-dilutive of ownership, when compared to equity finance, but often carries the burden of collateral and personal guarantees to secure. Alternatively, where government grants are available, which effectively offer free money, this will be preferable to debt finance and particularly where the decision to invest is unclear, such as the estimation of payback on renewable energy solutions.

The study also focused on why UK SME green finance quantitative findings, drawn from recent LSBS survey waves (2019-2021), indicated that finance for NZ transition might be harder to access (than

1—Green oriented SMEs were those seeking financing for environmental improvements (e.g. renewable energy, EV and retrofit), as opposed to SMEs seeking external financing for other purposes.

other types of finance) and particularly for SMEs that are more remote from banking centres – notably in rural areas. This called into question whether recent trends towards digital banking and alternative online financing (e.g. peer to peer ('P2P') and other non-bank sources) do not prevent this phenomenon. This also poses questions relating to the value of relationship banking and personal contacts in enabling SMEs' access to green finance. We further note that prevailing economic conditions and green regulatory drawback by the UK government may mean that other factors are preventing SME green investment decision making – at least in the short-term.

Methodology

The methodology adopted in this research follows a sequential exploratory mixed-methods design, where a quantitative part precedes a qualitative part (Creswell and Plano Clark, 2017). The quantitative investigation undertaken in 2023 informed the topic guide semi-structured qualitative interview study undertaken during the first half of 2024. Interviews were designed to capture the characteristics of lenders, namely, high-street commercial banks, government funders, peer-to-peer (P2P) lenders; the characteristics of the lending portfolio (e.g. green SMEs); characteristics of the interviewee (mostly professional experience); and characteristics of the debt products, e.g., pricing, regulation. Our interview sample included high street banks and alternative online SME finance providers, including brokers and local CDFIs. Financial services were contacted across England such as Cornwall, London, Midlands and North of England and covered urban and rural locations, as well as different types of online and in-person funding channels.

Institutions	Locations	Institutions	Locations	Institutions	Locations
Banks		Non-banks		Finance brokers	
Barclays	on-line	Ultimate Finance	in-person	White Rose	in-person
NatWest	in-person	Atom Bank	in-person	Finance for Enterprise	online
Triodos	in-person	Funding Circle	in-person	Ignition	online
Cambridge & Counties	in-person	Fleximize	in-person	Choice Finance	online
Co-operative	in-person	Iwoca	in-person	Swig Finance	online
Oxbury	online	LBL (Little Business Loans)	in-person	Government/trade associations	
		Bibby Financial Services	in-person	Cornwall City Council	online
		Cubefunder	in-person	UK Finance	online

Table 1: List of interviewees and locations (by type of financial institution)

Key findings

Locating and successfully accessing green finance can be complex and difficult for small, less well-resourced SMEs. The English SME green finance markets are complex and diverse. As such they vary across regions and localities according to the specific local support networks. For example, local authority European Regional Development Fund (ERDF)/Structural Fund Partnerships, such as operational through the UK Shared Prosperity Fund ('SPF') which replaced EU funding from 2023, which have funded local finance agencies like Oxford Innovation's SME Access to Finance (A2F) programme in Cornwall, or London's Better Futures programme.

Up to date regional/local green finance roadmaps are required, alongside support, because the green finance investment case needs to be set-out to persuade the often resource constrained SMEs to proceed.

Bank finance

We interviewed the main high-street banks and more specialist banks such as Triodos (ethical, sustainable lenders), Oxbury (Agricultural bank), and Cambridge and Counties bank, a B Corp certified business, i.e., one that is certified to meet high standards of social and environmental performance, transparency, and accountability. In addition, we interviewed UK Finance, a trade association of more than 300 financial institutions. The average profile of the interviewee is of an experienced financial services professional, more often than not a bank manager (or former high street SME banker) in charge of a large portfolio of loans. All interviewees had managed SMEs' loan portfolios at some stage of their career and could provide information about these specific clients.

One of the most surprising pieces of information that transpired from these interviews was that credit suppliers were adamant that there was no SME credit rationing, and no shortage of funds for Net-Zero transitions, low-carbon asset acquisition, or "*green*" finance in general. The discrepancy between reports from borrowers (demand-side) in surveys such FSB (2016) conducted for the Federation of Small Businesses, and from the bank managers interviewed (supply-side) was recurrent and puzzling. When inquired about it, most interviewees were at a loss to explain:

> "*[..] Typically – or not typically – businesses will say they didn't get the finance they wanted but it seems that very often the issues are the terms and the price of the debt, which is a separate issue from access. It is a more nuanced picture*."

It appears that the crux of the issue is the perception of what constitutes "access", which – for SMEs – centres on the obtention of credit, rather than on its availability as high-street banks report. With respect to green finance, commercial banks were also very clear that there was ample supply of funds and financial products geared towards Net-Zero (NZ) transition, in particular in the form of low-carbon asset acquisition (electric vehicles ('EV'), heat pumps, building retro-fitting).[2] Most interviewees explicitly mentioned the regulatory requirements to reduce Scope 3 emissions, i.e., emissions resulting from activities not controlled by banks, but which indirectly affect their value chain. Consequently, high street banks pointed out that it is in their interest to green their SME

2—This is nuanced and contentious, since e.g. the asset value of retrofit such as improved insulation, particularly in a tenanted commercial property is unlikely to be considered by lenders, or viable for borrowers (London Green Economy SME Finance, forthcoming).

portfolios to adhere to their NZ goals and reporting obligations to shareholders and government (Corporate Sustainable Reporting Directive 'CSRD'[3]). They also understand that a high proportion (90% plus) of their CO2e emissions come from 'Scope 3' portfolio client companies and that SMEs represent half of all UK private business emissions (BBB/IPSOS, 2021).

Most commercial banks offer advice on reducing carbon emissions, and special terms for loans for low-carbon production or business processes. Banks have set up SME support hubs and services (e.g. NatWest's regional accelerators programme to support early trading sustainable SMEs), including providing free carbon calculators, to stimulate interest and to provide guidance to 'persuade' SMEs to go green and invest in equipment to enable more efficient and green practices. They argue that with carbon checkers and e.g. Lloyds property EPC checker, they can present the efficiency and cost cases for investing in solar panels and other government Energy Technology List (ETL) items.

All high street banks offer lower cost green finance options, such as free loans (no set up fees) and green mortgage and term loans with lower interest rates and lower cost asset finance (e.g. through Lombard as part of NatWest). These come with ties, such as proof of purchase of ETL equipment and side-letters committing to green loan purpose. The banks admit that asset lending where proof of purchase of ETL products is clearest and are working towards improved checks to ensure avoiding greenwashing. The banks do want to demonstrate carbon reductions in their reporting – both Lloyds and NatWest are seeking a 50% reduction in client carbon emissions by 2050.

There appears to be a preference for asset finance, which concurs with recurrent reporting from interviewees that property ownership – provided as a collateral – was an essential requirement for a successful loan application of any type (green or not green). The "*green*" asset becomes an added collateral in the loan application. In fact, property ownership – either of business premises or of SME owners' residence – seems to be an essential factor in the approval decision. One participant stated that; "…*property ownership mattered more than the actual amount applied for*."

Smaller SMEs are disadvantaged by current banking services. Banks segment their markets, with specialist lending across sectors, rather than locations. Whilst they do not believe that rural businesses are in any way disadvantaged, they admit that the vast majority of banking and loan decisions are online and this is definitely the case for smaller loans (e.g. under £50k). They admit that this can create problems for smaller SMEs and that relational lending practices are typically for SMEs with £1M plus annual turnover. Banks and bank trade association representatives that we interviewed insisted that relationship managers continued to have an important role for lending to specific sectors such as agriculture, health and real estate, where specialist knowledge and follow-ups are required. Specialist bank managers may also be required to assist with asset finance. For small amounts, or SMEs with less than 250 employees/less than £1M turnover, loan applications and post-concession support are exclusively digital.

Farming is a particularly complex sector which the banks are increasingly concerned with. This is raised by a combination of high carbon emissions, nature positive rural land management and high proportions of SME portfolios that are farmers. Barclays – a bank established in rural East Anglia – has a high proportion of small farmers and has a farm sector lead/department which works closely with farmers to help finance their green transition. The banks are keen to get improved

3—What does the CSRD mean for the UK? | Grant Thornton

understanding of the farming sector and the value of natural land assets and are working with DEFRA and international calculations frameworks (e.g. Global Farm Metric[4]).

The **specialist banks** interviewed include Oxbury, which lends exclusively to farmers, and Triodos, which support all green initiatives (development of new products, NZ transition) and has a strong environmental focus itself. However, in common with commercial banks, relationship management based on customer needs is only available for loans above £1M. A characteristic of Triodos, which is often labelled an ethical lender, is the screening criteria for loans based on the UN's sustainable development goals (SDG). Notably, Triodos only lends between £100K and £20M[5].

Oxbury Bank, established in 2020, is a new specialist farm bank. Unlike most commercial banks, Oxbury has a significantly longer lending horizon than most financial institutions (excluding mortgage lending). Their loans are often very large and long term (average £1m over 21 years at fixed interest rates, usually circa 3%), given the need to provide farmers with long term banking solutions. They note that farm banking requires careful due diligence – requiring at some stage in-person communications – and understanding that the farm is working on green environmental stewardship. As such they are working with a pilot group of farmers to improve understanding of the value of soil carbon and the financial value of regenerative farming options.

Oxbury bank aims for responsible impact lending and the purpose of the loan – and how investment influences natural capital – are important decision criteria. The bank has a strong "*green*" ethos and some loans are initially loss-making, particularly those supporting regenerative farming, which are usually not profitable before 3 plus years. Clearly, Oxbury's borrowers do not approach typical commercial banks, which do not consider a loan with 3 plus years before profit a palatable proposition. However, these considerations are embedded in Oxbury's risk model. **Overall, it appears that their profitability and business model rely on the monopolistic position they have as suppliers of credit to the agri-food sector:**

> "*There is a market segmentation: larger farms and access to credit is not a problem it's the price. Smaller farmers are concerned with access to credit as it may be less attractive to the average high street bank.*"

Relationship lending is essential in agricultural lending and all banks specialising in this form of credit employ managers who constantly travel to visit local businesses, thereby mitigating the downsides of remote geographical locations.

Alternative non-bank debt finance

New financial intermediaries are playing an increasingly important role in the provision of SME green finance. Alternative financiers are typically not offering green funding or improved lending terms for green activities. However, alternative financiers note that they are very useful sources of matched funding for green grants and the combination for example of local Community Development Finance Institution (CDFI) loans alongside local SPF green grant programmes for SMEs can be very effective. This is particularly important because many grants require matching

4—NatWest Group and SFT to collaborate on The Global Farm Metric | NatWest Group
5—Small loans | Triodos Bank

funding because they pay-out retrospectively after the purchase, so bridging lending to 100% can be required to facilitate the grant. CDFI's working locally (to the applicant SMEs) are able to offer small-scale loans with a degree of due diligence that is not offered by traditional banks.

We interviewed Cornwall Isles of Silly Local Enterprise Partnership (LEP), Cornwall City Council (CC), and several digital/P2P funders (Ultimate Finance, Atom bank, Funding Circle, Fleximize, Iwoca, LBL, Bibby Financial Services, and Cube funder). We were interested in the emerging role of English local government in delivering SME green finance. LEPs were formally launched in 2010 to replace regional development agencies (RDAs). They were private sector-led, but most importantly, the funds available to LEPs were provided by central government. In turn, from April 2024 LEPs were abolished in favour of Combined Authorities (a legal working agreement of two or more local authorities[6]), single local authorities and the Greater London Authority (covering 32 London Borough authorities and the City of London).

Cornwall and Isles of Scilly LEP was one of 38 LEPs across England. Our interviewee was responsible for LEP deployment of local investment funds for more than a decade. Cornwall and Isles of Scilly LEP had £140m of European (ERDF/ESF) rural funding money prior to Brexit, but also managed equity and debt finance under the EU 2014-20 programme. Cornwall City Council has a long standing green revolving debt fund for assisting community businesses of about £2M, and a medium-term (7-8 years) Growth Fund which has supported some green projects. For example, in the early 2010s there was a big push on geothermal energy in Cornwall, which could not be funded by bank finance because it was perceived as too risky. Cornwall CC provided a local SME with a substantial specialist loan with a below market cost covering payback. Overall, Cornwall CC is a major provider of government grants to SMEs and these are typically small. Since Brexit, Cornwall CC has received a £20M UK Shared Prosperity Fund (SPF) allocation to support SMEs, where half is in grants and half is for support programmes such as Access to Finance (A2F), Net Zero and manufacturing.

However, all grants require 50% private spend and 100% up front private payment with grants applied retrospectively. As a result, start-ups (whether green or not), and small SMEs with limited working capital or turnover are likely to be excluded from Cornwall CC's funding. In addition, SME property ownership is a decisive factor in providing security for loans and especially in SME green energy procurement. Nothing has been done to counteract the private landlord problem for SME tenants who cannot control their property retrofit and use of renewables.

Regarding relationship lending and the importance of geographical location, Cornwall CC and Cornwall Isles of Silly LEP have only supported businesses in their officially defined area of activity, but low cost/high volume activities tend to be dealt with online, whereas higher value grants and loans require more scrutiny and personal contact. The Pandemic period led to a necessary escalation in online lending activities by all providers, and this has continued since. This has had unexpected outcomes, including wider regional and national coverage by non-bank providers like Community Development Finance Institutions (CDFIs), who are increasingly working with brokers who have wider regional and national coverage and office networks.

An analogous lending process operates at Swig, a (CDFI) supporting SMEs in the Southwest region of the UK, which also partners with the UK government's Start-Up Loan scheme. Swig generally

6—Combined authorities | Local Government Association

lends amounts from £25,000 up to £250,000. The process is mostly conducted online using the Atlas CRM system, with customers being interviewed remotely via telephone, video calls, and email. However, for larger loans over £100k, they typically visit the customer in person due to resource constraints. Our interviewee mentioned that customer preference for in-person meetings varies, but that the most important factor for SMEs is that the lender understands the customer's business, irrespective of how the knowledge is acquired (in-person or online meetings). The main selling point of alternative funders is that they are sources of matched funding for green grants, e.g., combination of local CDFI loans alongside local SPF green grant programmes for SMEs. CDFIs working locally are able to offer small-scale loans with a degree of due diligence that is not offered by traditional banks. Peer-to-peer/online funders' main selling point is their very fast – sometimes immediate – response and provision of funding. Online funders provide loans for almost any purpose, including green assets, but do not specifically offer green funding or improved lending terms for green activities.

Finance brokers

Specialist asset brokers are helping SMEs who lack awareness of financing options to find green finance solutions for sustainable projects like renewable energy solar, wind and heat pump installations. This service is personalised, so whilst they run online credit checks (using Delphi scoring), they also like to hold in-person meetings. The brokers are able to help the clients assess the cost and return options for green installations and then proceed to find the best funding solutions, which will depend on client asset and balance sheet status. Where there are balance sheet weaknesses they will seek more asset security.

Finance brokers have access to a wide range of credit products and providers and can assist customers in selecting loans that align with their financial needs and circumstances. Additionally, brokers help prepare and submit loan applications and monitor the process through to completion. They act as independent intermediaries between customers and financial institutions, CDFIs and even peer-to-peer funders.

Many SMEs are located in rental properties which reduce incentives and assets to support renewable energy and premises retrofit solutions. Whilst banks made the argument that landlords can benefit from green premises investment through the uplift of premises value and attractiveness to tenants by improving EPC ratings, the market appears slow in making these adjustments. Brokers certainly see lack of premises ownership and assets as holding back SME green investment.

Finance brokers are increasingly active to fill an established SME financing gap which banks are not providing. They are meeting clients online, or locally in person, where possible to undertake briefings and initial due diligence to establish the clients' requirements and the most suitable financing options for them. Often, they are able to offer faster channels to funding, because high street banks take weeks to assess and agree applications, whilst some online lenders will give an immediate response. They also note that whilst online lenders are typically more expensive than banks, the broker can find the cheapest alternative options and that some online options like IWOCA, or even from Nationwide, are actually very expensive (and can be avoided). During COVID finance brokers (e.g. Choice) became more reliant on internet-based services and networks and

were able to service customers from more locations and introduce wider financing network opportunities, including specialist local providers like CDFIs.

The increasingly impersonal operation of online transactional banking is discouraging SMEs. It creates communications barriers, initially through digital interface and then via call centres where no single person takes charge of an account. Brokers stress that SME clients like the one-to-one relationship management service offered and the majority of their business is through repeat custom, as the service saves customers search time and offers a degree of impartial advice and steer to the most appropriate and cost-effective borrowing options. They are also able to advise when debt funding is not possible, or not the best option.

The specialist banks we interviewed – except Oxbury – reported a 50% referral rate from finance brokers. Two digital lenders we interviewed at the National Association of Commercial Finance Brokers (NACFB[7]) reported that 50% and 80% of their loans, respectively, came from finance brokers, while the remaining came from direct online application. In fact, a membership survey conducted by the NACFB showed that 70% of the new business of commercial lenders that operate both direct and broker-led business models came via the broker channel in 2022 (NACFB 2023). The survey also reveals that lenders most commonly declined loan applications because they viewed a sector as 'too risky'. The industries generating the largest proportion of loan enquiries in 2022 were property at 44%, followed by construction at 13%, and manufacturing at 9%[8]. The finance suppliers that we found more reluctant to admit their engagement with finance brokers were high street banks (who maintain a strict policy of referral neutrality – referring to e.g. the British Business Bank Finance Finder[9]). However, most banks use finance brokers to promote their suitable "green" finance products.

It transpired quite clearly from our interviews that finance brokers were filling the relationship lending gap left by commercial banks in the wake of bank branch closures and their replacement with digital/mobile banking and call centres. They also provide the added benefit of offering a wider array of funding solutions to their clients, which commercial banks obviously never did.

However, despite the positive aspect of loan brokers' services, **we note two concerning features.** Firstly, finance brokers represent an additional layer of financial intermediation – and consequent extra financial hurdle – that small businesses and those transitioning to Net Zero have to navigate. Furthermore, interviewees reported that loan brokers' fees varied widely, were unregulated, and were added to the actual cost of the loans applied for. As an academic reviewer of this paper concurred:

> "*This is very concerning, with the current higher interest rates in the UK following the international energy crisis and higher inflation rates experienced, both reducing SME trading surpluses and their abilities to invest in lower cost energy efficiencies*."

The increasingly pivotal role of finance brokers in SMEs' access to external finance, led us to investigate whether secondary data from official sources supported the insights provided by our interviews. We collected data on non-bank intermediation published by the Office for National Statistics (ONS), which gathers data on UK Business Counts compiled from the Inter Departmental

7—https://nacfb.org/

8 —https://issuu.com/nacfb/docs/janfeb2023?e=0

9—3-Step Finance Finder | British Business Bank (british-business-bank.co.uk)

Business Register (IDBR) for all years between 2010 and 2023. This dataset records the number of local units that were live at a reference date annually in March, where a local unit is defined as an individual site (for example a factory or shop) associated with an enterprise (in this case a financial service/intermediary). Statistics are broken down by employment size band, detailed industry (5-digit SIC2007) and legal status. All data are available from country down to mid layer super output areas (MLSOA) and Scottish intermediate zones[10].

Figures 1 to 3 present the number of bank branches and the number of finance brokers ("*credit auxiliaries*") by UK regions in 2010 and 2023. The colours indicate the density of business units by geographical locations. Figure 1 shows that in 2010 the highest number of bank branches could be found in London (2,770 branches) and South East England (1,865 branches), followed by North West England (1,550 branches), South West England (1,515) and Scotland (1,505). The remaining regions had all less than 1,000 bank branches in 2010, with the lowest density in Northern Ireland (360 branches).

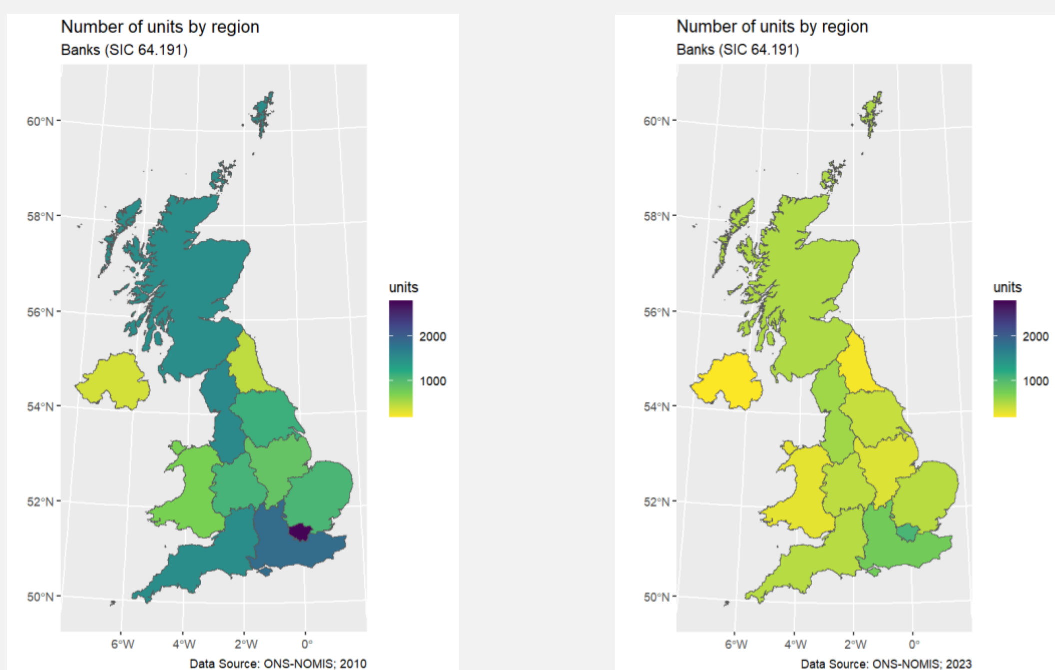

Figure 1 Number of bank branches by region (2010 and 2023)

The unequal regional distribution of bank branches remained to a large extent in 2023, viz., London and the South-East England were the two regions with the largest number of branches (1,055 and 770, resp.) in 2023. North-West England and Scotland had 570 and 505 branches, respectively, but all remaining regions had less than 500 bank branches. The two choropleth maps in Figure 1 share the same colour-coded legend for the number of units, which brings into evidence the striking reduction of the number of bank branches between 2010 and 2023. The darker shades indicate that densities above 1,500 branches that could be found in 2010 have completely vanished in 2023.

10—The dataset can be freely downloaded from https://www.nomisweb.co.uk/sources/ukbc

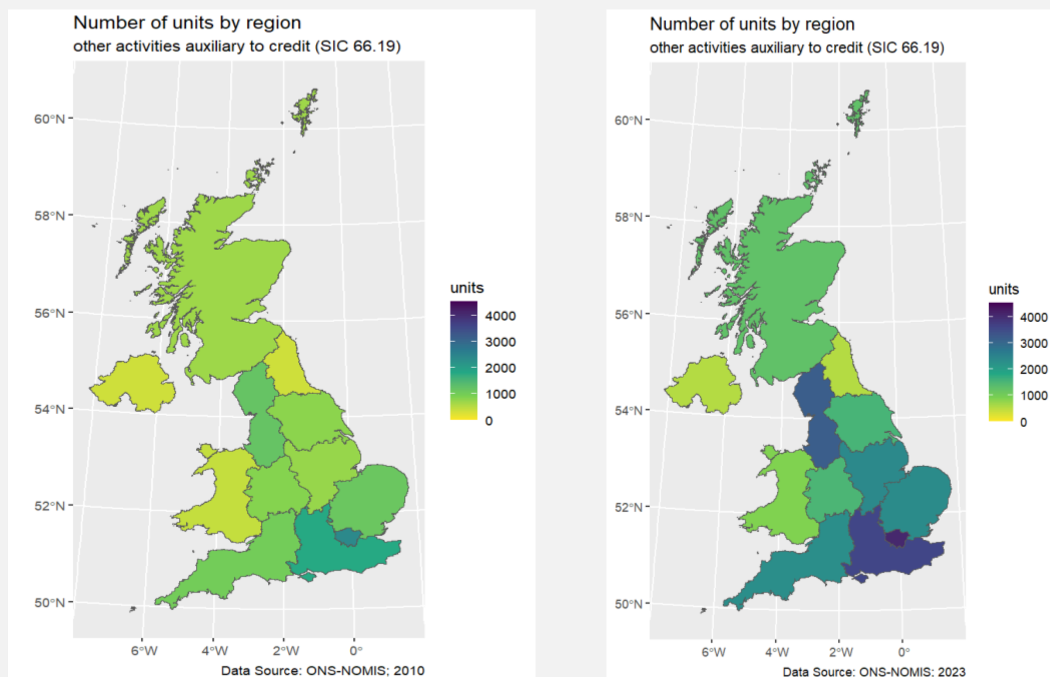

Figure 2 Number of credit auxiliaries by region (2010 and 2023)

Figure 2 shows analogous maps for the number of business units of the industrial sector SIC66.19 (Other activities auxiliary to financial services, except insurance and pension funding) for 2010 and 2023. The definition of SIC66.19 clarifies that it consists of firms that provide "*services involved in or closely related to the provision of financial service, but not providing themselves financial services*." Although the ONS does not explicitly label these firms as finance brokers, the definition of their activities indicate that they can be characterised as such. The left-hand map of Figure 2 shows that in 2010 the number of finance brokers was less than 2,000 in all regions, except in London (2,385 units). The second highest density can be found in South-East England (1,780 units). These two regions remain those with the first and second largest number of finance brokers in 2023 (4,045 and 3,565 units, respectively). However, it is clear that there has been a very significant increase in the numbers in other regions of the UK as well, namely, North-West and South-West England (3,150 and 2,285 units, respectively), followed by East Midlands and the East of England (2,370 and 2,335 units, respectively).

The four choropleth maps in Figures 1 and 2 share the same colour-coded legend, and very clearly show that the darker shades (higher densities) can be found in 2010 in Figure 1 (banks) and in 2023 in Figure 2 (finance brokers). The lighter shades (lower densities) can be found in the 2023 map of the bank branches and the 2010 map of the finance brokers. This mirror image suggests an inverse dynamic between the number of bank branches and that of finance brokers, which is confirmed in Figure 3, a choropleth map of the correlations between both over the period 2010-2023. All correlations in Figure 3 are negative, indicating that between 2010 and 2023 the number of bank branches decreases while the number of credit auxiliaries increases. The highest correlations in absolute values are 95% in the East of England, and 90% Yorkshire and the Humber, whilst the lowest – in absolute value – is 80% both in London and in the North-East of England. These values

for the correlation between the number of bank branches and finance brokers strongly suggest that between 2010 and 2023 the latter are replacing the former at a rate of almost 1 to 1.

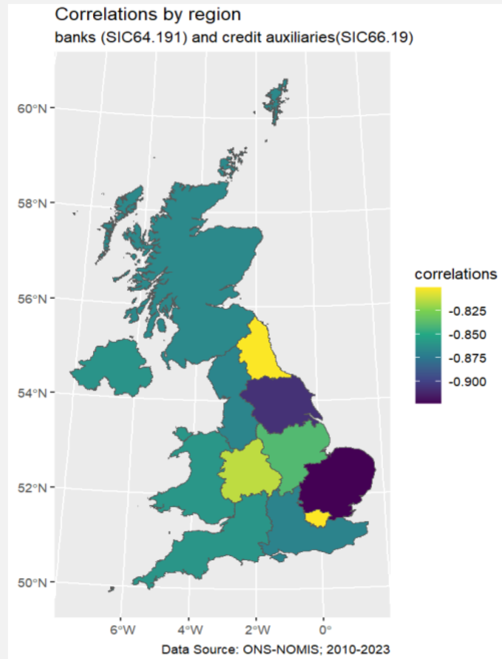

Figure 3: Correlation of number of bank branches and credit auxiliaries 2010-2023

The interviews and the ONS data strongly point to the essential role that finance brokers have been playing in financial intermediation between banks and SMEs since the early 2010s. The statistics on the number of bank branches are congruent with those presented in three studies published by the UK Parliament (Edmonds, 2018; Booth, 2022; and Browning, 2022), which showed that the trend in bank branch closures started in the mid-1980s, but intensified after the 2008 financial crisis.

Conclusion

The findings of interviews of bank managers, finance brokers, alternative funders, community development funders, and local government officials highlighted a discrepancy between the perception of funding shortage expressed by SMEs in surveys, and the claims by credit providers about the ample availability of funds, even for "green" loans, i.e., those used for Net-Zero transition, environmentally-friendly asset acquisition or building retrofitting. A recurrent theme in the interviews was the importance of property ownership – of premises and even personal housing – in securing a loan. This also explains to a certain extent why a significant proportion of commercial banks' green products focuses on asset finance, rather than unsecured "*green*" loans. In addition, most traditional funders tend to favour larger loans above £250,000, whilst peer-to-peer and other digital providers may lend from £5,000 up to £500,000 – establishing clear SME market differentiation.

High street banks only maintain relational lending for large SMEs (e.g. with a turnover above £1M) and when the amount applied for is large (e.g. above £50K). For smaller SMEs and/or smaller amounts, digital lending is preferred, i.e., applications have to be made online and the approval process – and subsequent customer service – is entirely digitalised. As a result, many smaller SMEs, SMEs that rent their premises, and SMEs requiring funds to transition to Net Zero often rely on credit brokers to navigate the complexities of credit applications, and to expand the range of lenders they can access. Loan broker businesses tend to be led by former high-street bank managers who can draw on a wide network of contacts in the banking industry to facilitate the approval of loans to the SMEs who use their services. Interviewees reported that loan brokers' fees vary widely, are unregulated, and are added to the actual cost of the loans applied for.

The picture emerging from our interviews is one of unequal access to advice and funding. Large SMEs banking with high-street providers appear to benefit from preferential access to relationship managers, whilst smaller SMEs are only provided with call centre or mobile app advice. The relationship gap has been filled, with some success, by loans brokers since at least 2008. Despite the positive aspect of loan brokers' services, they represent an extra financial hurdle that the vast majority of SMEs, including smaller SMEs, start-ups, tenant SMEs and businesses transitioning to Net Zero have to overcome. These findings shed some light on a recurrent theme in the literature, which our previous research has evidenced, viz, that government and local authorities' grants remain a significant source of funds for all SMEs, and for green SMEs, irrespective of their age and their financial performance. These grants are more easily available and may be matched by debt finance, if SMEs can signal to banks sufficient reduction in lending security risk.

Challenges and Recommendations for Policy

Fundamentally, our findings demonstrate a two-tier SME green financing structure across England where upper tier established larger SMEs are able to access bank finance and grants to assist their green transition. However, for the vast majority of established SMEs in the lower tier with a trading track record, but with lower turnover and margins – whose situation has been exacerbated during the recent energy price crisis – bank finance is likely to be less helpful and may not be an option without commercial or domestic property collateral. We also evidence that this private financing gap, which is holding back SME green transition, has been further aggravated by lack of knowledge to locate and successfully access alternative non-bank debt financing. The growth of

SME finance brokers demonstrates the ongoing importance of relationship banking to SMEs and financiers, but these emerging broker services are neither regulated by the FCA, nor consistently applied across England. Furthermore, the vast majority of SMEs are tenants and are not decision makers on land and premises issues, instead being subject to landlord decisions. The landlord and tenant relationship issue, alongside constraints applying to listed buildings, require urgent attention in order to facilitate more rapid deployment of commercial property retrofit and associated SME financing.

Finally, grant funds offer SMEs free money and can tip the balance in favour of capital equipment and premises investment (Cowling and Liu, 2023). However, currently they are often too small-scale and limited in availability and use across England. This means that they are more likely to be adopted by the more aware, better resourced upper tier SME owner-managers (Cowling and Liu, 2023). We suggest that grants and subsidies should be targeted at the lower tier smaller, less well-resourced SMEs where they could make most difference and leverage more private finance if operated on sufficient scale. Furthermore, it would make sense for one overarching agency – nationally, or sub-regionally to have oversight of commercial retrofit and environmental grant delivery, such as an expanded version of London's Energy Efficiency Fund[11].

In order for a more efficient and speedy SME green transition we suggest the following finance support policies:

1. First and foremost, establish a **national, or sub-regional** (Combined Authority) **scale overarching authority**, such as an expanded role for the Mayor of London's Energy Efficiency Fund to act as a **one-stop-shop agency to manage the scale-up of grant and subsidies for SME commercial energy and environmental work** to meet net zero, circular economy and biodiversity requirements.
2. Provide national and local subregional (Combined Authority) SME **green finance roadmaps** which can be accessed online. These could link to accredited FCA regulated finance brokers for independent guidance, facilitating improved SME access to non-bank finance opportunities.
3. Provide a well-publicised national or local subregional (Combined Authority) **targeted grant funding programme** – drawing on **key local trusted SME support agencies to deliver 'just transition' outreach to SME communities and 'levelling up'**. This should offer light touch targeted funding at lower tier SMEs. The essential points here are that the scheme is large enough to offer administrative economies of scale and sufficient grant funding (up to at least £10k) to make a difference to eligible SMEs. There is evidence that bridging and matching private debt finance can be leveraged through grants, if they are of sufficient size and status, with receipt of ETL equipment activating the retrospective grant payment.
4. Consider allowing Local Authorities to utilise **'Green' Business Rate exemption**, such as piloted by Sutton Council[12], to fund local SMEs in their green transition. This could work if such schemes were perceived as a quasi-grant which debt funders could bridge fund until receipted ETL work was paid for.
5. **Public policy should regulate Landlord requirements for tenanted commercial properties** and make the uplift of commercial property Environmental Performance Certificates (EPCs) a priority[13]. A more transparent ratings approach and reduction in commercial property

11—Mayor of London's Energy Efficiency Fund | London City Hall

12—Join the Green Enterprise Partnership – Sutton Council

13—https://www.gov.uk/energy-performance-certificate-commercial-property/exemptions; https://www.london.gov.uk/sites/default/files/mol_response_commercial_mees_final.pdf

exemptions is required. Furthermore, there is a need to develop innovative aggregating schemes like Norwich Solar System for SMEs in order to bring together groups of businesses – large and small – to benefit from purchasing power agreements for commercial property energy and insulation retrofit. Although beyond the scope of this study, this might also include a combination of local authority and developer agreements with private business to improve the greening of commercial property, including the development of green property bond financing schemes[14].

6. Given that SME commercial property retrofit is such a crucial part of addressing climate change, and appears to be unaffordable to so many SMEs in England, there is a strong argument in favour of a **Universal Payment System for retrofit to small employer SMEs** (e.g. micro enterprise of 1-9 employees) of up to £10k. This would offer more efficient blanket financial coverage of smaller businesses and avoid the inefficiencies of the current drip-feed, bureaucratic grant schemes. This would require local trusted support services to operate and payment would only be available upon receipt of Energy Technology List approved works.

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