Banks are failing to lend to firms which will drive the recovery, new report shows

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A new report published this week (7 June) by Lancaster's Big Innovation Centre warns that innovative small firms – those most crucial to jobs and growth – are finding it significantly more difficult than their peers to secure the funding they need to grow.

Over one in three innovative small firms that sought finance between 2010/12 did not obtain any of the funding they needed – nearly triple the rate of 2007/8 (see table). With innovative SMEs playing a crucial role in creating jobs and raising productivity, this highlights a systemic failure in the financial system that is holding back the UK economy.

Drawing on responses from nearly 11,000 Small and Medium Sized Enterprises (SMEs), "Credit and the crisis: Access to finance for innovative small firms since the recession" also shows how access to finance for all SMEs has worsened considerably since the start of the recession, with failure rates now double those of 2007/8.

The report shows that out of all SMEs seeking finance in 2010/12, over half had difficulties finding it, while one in four did not receive any funding at all (both roughly double the rates of 2007/8). However, innovative SMEs remain significantly more likely to encounter problems than non-innovative small firms.

Author Dr Neil Lee said: "The future growth of the UK economy depends on investment in new products and services. Yet it is harder for innovative small firms to obtain finance than their peers. A lack of finance for the firms which need it most will be a long-term drag on the UK economy. Without action from policymakers, banks are unlikely to change their lending behaviour."

Setting the context for these findings, a separate report published tomorrow in collaboration with Nesta raises major concerns over the long-term disconnect between capital raised by banks and investment in

innovative activities – those most likely to create jobs and growth.

"Two Spheres That Don't Touch: The relationship between British finance and British innovation" also finds that in the run up to the financial crisis, investment in innovation was falling as a proportion of total capital. Between 2001 and 2007, total capital raised by banks increased by £1340bn, while investment in innovation rose by just £26bn. This suggests a structural problem in the financial system that may have contributed to the depth of the crisis. Subsequent years' findings suggest that this disconnect has persisted beyond the recession.

These two reports point to a clear lack of investment in those companies and activities with the greatest potential to boost growth and create jobs.

Author, Hiba Sameen, said: "We would like to see government redoubling their efforts around finance for SMEs, particular those most likely to boost jobs and growth. The British Business Bank is taking steps in the right direction by promoting alternative sources of finance for SMEs, but its current scope and scale are too small to make a big difference in the finance gap for SMEs. The government needs to increase its scale by dedicating more capital to the bank, and also increase its scope by facilitating access to public corporate bond markets for SMEs."

The authors argue that policymakers must also prioritise access to finance through alternative lending technologies more suited to financing innovation, such as that suggested by the Breedon report published last year. The Big Innovation Centre also recently published its own proposal for a new, effective form of debt finance for SMEs.

Provided by Lancaster University

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