The financing of smaller quoted companies: a survey

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This article summarises the results of a survey on the financing of smaller quoted companies (SQCs) conducted in February and March 2004 and builds on earlier work by the Bank and other organisations. It explores SQCs' recent and possible future use of external finance, their views on the availability of debt and equity finance and their views on possible constraints on such finance that are thought to be particularly relevant to SQCs. The results suggest that most SQCs are not currently experiencing any major difficulties in accessing either debt or equity finance.

Introduction

This article summarises the results of a survey commissioned by the Bank, relating to the financing of UK smaller quoted companies (SQCs).(1) It updates and extends the findings reported in the *Quarterly Bulletin* of Spring 2002, which were based on a more limited survey of SQCs and a series of liaison meetings with selected companies.(2) It also throws further light on possible constraints on the provision of debt and equity finance to SQCs, an issue highlighted in the Bank's tenth annual report on finance for small firms as meriting further investigation.(3) In recent years, several official working groups have drawn attention to possible barriers to the financing of SQCs.(4) Their reports have highlighted in particular possible difficulties in raising equity finance, attributed to such factors as persistent secondary market illiquidity in SQC shares, consolidation in the fund management industry and an associated increased emphasis of market analysis, research and investment strategy on larger companies.

The Bank's previous work focused more on the debt side. It found that, by reason of their size, SQCs do not generally have access to bond markets and, partly in consequence, are more dependent than FTSE 350 companies on short-term finance. Their relative lack of usage of longer-term finance was partly attributed to supply constraints, with banks being less willing to extend them long-term than medium or short-term loans, and partly to demand factors, with longer-term commitments viewed by SQCs themselves as reducing flexibility. But the research did not find evidence of any general problem with access to debt finance. Most SQCs surveyed were able to achieve desired levels of gearing and used a wide variety of debt instruments. Gearing levels were generally lower than those of FTSE 350 companies, having remained fairly stable over recent years while gearing levels at large companies have risen substantially. At first sight, this difference appears surprising. If SQCs do face greater difficulties in raising equity finance, it might be expected, other things being equal, that they would be more geared than large companies. It may, however, reflect greater risk aversion on the part of SQCs, rather than any major problems with access to debt finance. On the equity side, the Bank's liaison meetings with SQCs have suggested that a significant number of companies are able to raise additional equity but choose not to do so in order to retain family control.

The new survey

As noted above, the Bank's earlier research was based on small surveys and a limited number of contacts in the SQC sector. And the work was carried out during a period of unusual weakness in equity markets, which was making it more difficult for all companies to raise additional equity. The new survey was designed to overcome these problems by covering a much larger

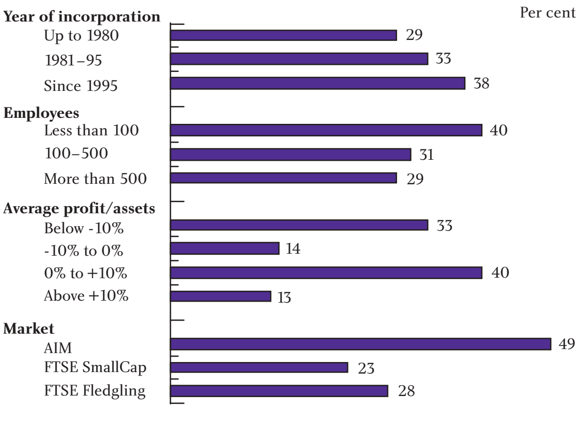
(1) The authors are grateful to Shiona Davies and David Chilvers of Continental Research, who conducted the survey and who provided helpful comments on the article, and to Emma Murphy of the Bank's Financial Industry and Regulation Division and Clive Jackson of the Bank's Macro-Prudential Risks Division for their assistance in the survey design.
(2) See Kearns, A and Young, J E (2002).
(3) See Cahill, J M and Whitley, J D (2003).
(4) See in particular HM Treasury (1998), DTI Innovation Unit (1999), CBI (2001) and Jaffe Associates Ltd (2002).

group of SQCs and by asking a more detailed set of questions about their current usage of different financing instruments and their longer-term access and attitudes to different types of debt and equity finance. The definition of SQCs used in the survey includes those non-financial companies(1) with a full listing on the London Stock Exchange, whose market capitalisation is below that of companies in the FTSE 350 index (in other words, companies in the FTSE SmallCap and FTSE Fledgling indices), and those companies quoted on the Alternative Investment Market (AIM). As at 31 January 2004, some 1,110 non-financial companies were included in the SQC sector on this definition.

The survey was carried out for the Bank by Continental Research. They conducted telephone interviews with the main financial decision makers in 257 SQCs, generally at Finance Director level, during the period 4 February to 31 March 2004. Companies were selected to provide a representative sample by industrial sector, region, size, profitability and age. Results were grossed up using a weighting scheme based on the full distribution of non-financial SQCs by size, sector, age and profitability. This procedure was designed to ensure that any skew or bias in the make-up of the sample was adjusted so that the results reflected the true population. In what follows, responses to questions are expressed by reference to percentages of this weighted base of the sample companies.

Charts 1 and 2 summarise the key characteristics of the companies covered. It should be noted that the sample can be roughly divided into three subgroups by size,

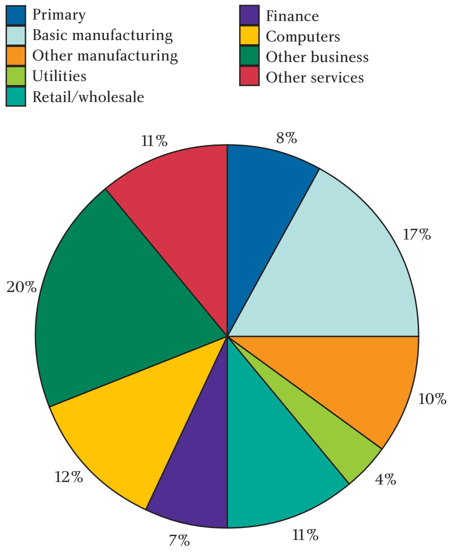
Chart 1
Weighted profile(a) of SQCs by age, size, average profit/assets and market



Sources: Bank of England and Continental Research.

(a) Sample results were weighted to correspond to the distribution of non-financial SQCs by size, sector, age and profitability.

Chart 2
Weighted profile(a) of SQCs by sector



Sources: Bank of England and Continental Research.

(a) Sample results were weighted to correspond to the distribution of non-financial SQCs by size, sector, age and profitability.

whether that is measured by sales turnover, market capitalisation or number of employees, corresponding to small, medium-sized and large SQCs. The sample is fairly evenly divided between profitable and loss-making companies and also includes a range of companies by year of incorporation.

The survey included questions on shareholder and board composition; dividend policy; access to and types of debt finance used; attitudes to debt finance; liquidity policy; access to equity finance; and attitudes to equity finance. These are covered in turn in what follows.

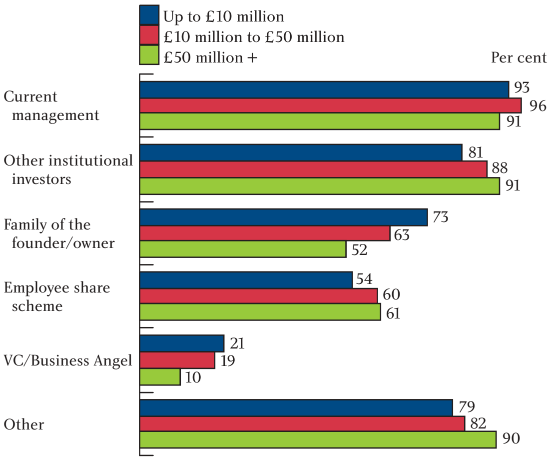
Shareholder and board composition

Shareholders include current management and institutional investors in the great majority of SQCs (94% and 87% respectively), but the family of the company founder or current owner also features in 64% of cases. This group tends to be more important the smaller the company (see Chart 3). Venture capitalists and business angels are much more important in the financing of private companies, often using flotation as a means of realising their investment. They appear as shareholders of only 17% of SQCs and are more important for smaller companies.

On average, SQCs have six board members, varying from five for companies with market capitalisation below £10 million to seven to eight for those with market

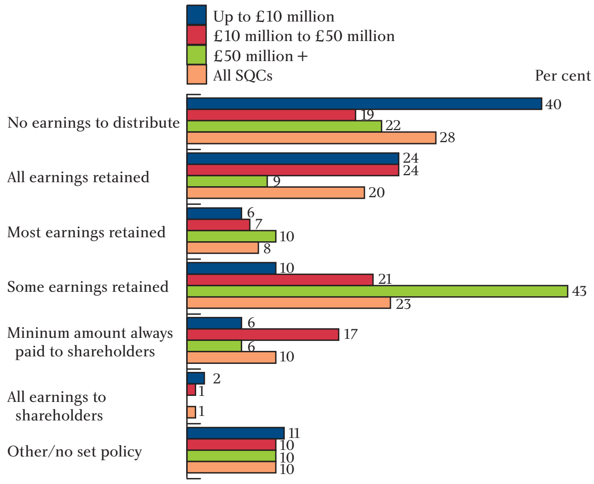
(1) Banks, investment firms and insurance companies are subject to rather different financing constraints compared with industrial and commercial companies, so all companies in the financial services sector are excluded from the sample.

Chart 3
Shareholder composition of SQCs by company turnover



Source: Continental Research.

Chart 4
Dividend policies of SQCs by company turnover



Source: Continental Research.

capitalisation above £50 million. The average number of non-executive directors at SQCs is three and this number also varies positively with size of company.

The survey provides little evidence that board composition has any effect on financing, although smaller boards seem less likely to shop around for debt finance and are more concerned about the regulatory burden involved in raising equity. Later questions on attitudes to debt and equity finance (see below) did not elicit any particular indications that the composition of the shareholder base affected preferences for or against particular types of finance, except on some issues for SQCs with significant family shareholdings.

Dividend policy

Some interesting differences emerged between SQCs when asked about their dividend policy (see Chart 4). Overall, nearly half either have no earnings to distribute (28%) or have a policy to retain all their earnings (20%). Both these proportions are inversely related to company size. Newly incorporated companies (post-1995) are more likely either to have no earnings to distribute (39%) or to retain all earnings (31%) than the oldest SQCs (up to 1980) (where the corresponding proportions are 18% and 7% respectively). SQCs with an annual turnover of more than £50 million are most likely to pay dividends: some 59% do so, compared with 24% of SQCs with an annual turnover of less than £10 million.

Dividend policy is closely related to underlying profitability and on average the smallest and (particularly) youngest SQCs tend also to be the least profitable. As many as 72% of SQCs incorporated since 1995 are currently loss-making, compared with only 18% of SQCs incorporated prior to 1981. The differences in dividend policy by size of SQC noted above also appear to apply in a comparison of the SQC sector in aggregate with larger quoted companies (LQCs), defined as FTSE 350 companies. The Bank's previous work has found that SQCs have on average been less profitable than LQCs over the past 30 years, but have retained a much greater proportion of their (lower) earnings.(1) This may help to explain why SQCs tend to have lower gearing than LQCs: notwithstanding their relatively low profitability, greater retentions mean they are still able to have proportionately more recourse to internal rather than external finance.

Access to debt finance

The Bank's previous work on the provision of finance to SQCs found no evidence of any general problem with access to debt finance, although some SQCs appeared to face barriers in access to longer-term debt.(2) Clearly, by reasons of their size and the fact that most SQCs are not rated, they have much less access to bond markets than do FTSE 350 companies. There were also some suggestions from the Bank's earlier work that banks were less willing to extend them long-term loans except on a secured basis, although there was evidence that this also reflected SQCs' own preferences for shorter-term finance, which could be renegotiated more frequently.

The current survey throws further light on these issues. Companies were asked to what extent they regard

(1) See Cahill, J M and Whitley, J D (2003).
(2) See Kearns, A and Young, J E (2002).

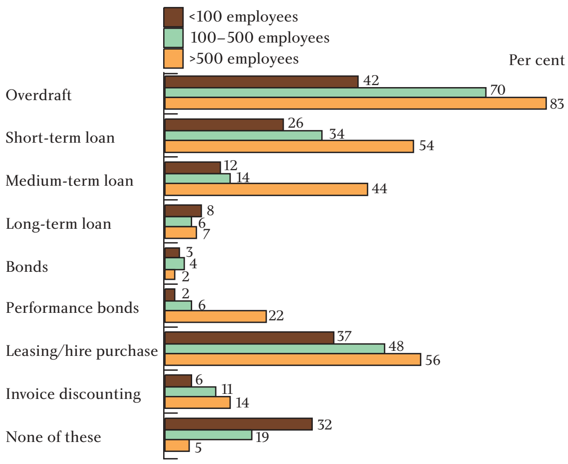
themselves as debt-constrained. This was defined as a situation where the plans they have for the company cannot be achieved because the debt finance required cannot be put in place. The proportions regarding themselves as not at all, slightly, somewhat or definitely debt-constrained were 63%, 14%, 17% and 6% respectively. There are no significant differences by size of company, but loss-making companies are, perhaps unsurprisingly, more likely to regard themselves as more debt-constrained. Some 87% of the SQCs claiming to be definitely debt-constrained are unprofitable (compared with 47% of the whole population). None of the definitely debt-constrained SQCs are old-established (ie incorporated prior to 1981); 44% were incorporated between 1981 and 1995 and the other 56% since 1995.

Companies were asked to give reasons for the extent to which they are debt-constrained. The responses tend to support our earlier conclusion that access to debt finance is not a major problem for SQCs in aggregate. The largest groups of companies were those reporting no or few problems, either because they are cash-rich or because they have never been turned down for finance. This may indicate that recent improvements in corporate profitability have eased financing constraints on SQCs. A small minority did, however, report that it is still difficult to raise finance in their sector or that they are constrained because they are making losses or because lenders are unwilling to lend or seeking to tighten lending terms and conditions. The small number of such companies makes it difficult to draw strong conclusions on whether they exhibit any common characteristics, but overall this does not appear to be the case.

As in the Bank's earlier survey,[(1)] overdraft finance was once again quoted as the most common form of debt instrument used, with 62% of SQCs saying they have an overdraft facility. Larger (see Chart 5), older-established and more profitable companies are more likely to have an overdraft facility than smaller, newer and less profitable ones. Only 24% of SQCs with an overdraft facility said they are currently using at least half of it and some 42% claimed to be making no use of it at all. The proportion of all SQCs actually borrowing on overdraft at the time of the survey was therefore only 36%. A fair proportion of those not using their overdraft facility are likely to be cash-generative companies, but the low current usage could also reflect recent improvements in corporate profitability, which might mean that more companies are currently able to finance working capital and investment plans from internal finance. Other factors that might explain the relatively low usage of overdraft facilities are seasonal issues and the existence of some companies whose working capital or investment needs are so modest that they do not need to make use of their overdraft (ie their facility is largely a contingency provision).

As for term loans, like the previous Bank study the current survey finds much greater usage of short-term bank loans (less than five years by original maturity) than medium-term loans (six to ten years by original maturity) and especially long-term loans (more than ten years). As with overdraft facilities, both short-term and medium-term loans are more likely among larger (see Chart 5), profitable and more established companies. Long-term loans seem to be uniformly rare among all types of SQC, although they are most common at old-established companies. Leasing and hire purchase are much more heavily used by SQCs than invoice finance (usage rates are 46% and 10% respectively). Some 56% of those using leasing say they do so because it frees up banking facilities for other uses, while only 12% say they do so because bank finance is not available. Invoice finance appears more likely to be a substitute for bank finance if that is less easily accessible: some 19% of SQCs that are definitely or somewhat debt-constrained use invoice finance, compared with 10% of SQCs overall.

Chart 5
Types of debt finance used by SQCs, by size of company



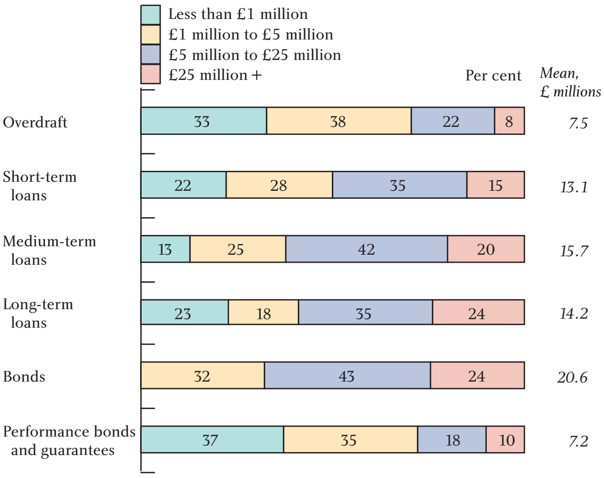
Source: Continental Research.

Companies were asked about the size of or amounts outstanding under differing borrowing facilities. Mean

(1) See Kearns, A and Young, J E (2002).

borrowing[1] is greatest for bond finance and lowest for overdrafts, with term loans generally in between (see Chart 6). Over 70% of SQCs with an overdraft facility have one of less than £5 million, while only 8% have a limit of more than £25 million. Unsurprisingly, larger companies tend to be able to borrow most on overdraft: for example, of FTSE SmallCap companies that have an overdraft facility 20% have one of more than £25 million.

Chart 6
Amounts currently owed by SQCs[a]



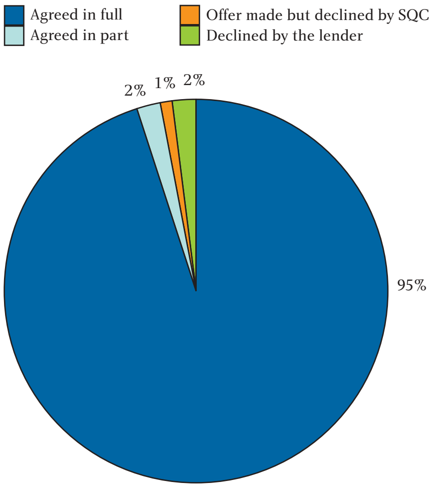
Source: Continental Research.

(a) Percentages relate to SQCs with corresponding debt facility or instrument.

Some 26% of SQCs currently have no borrowings. The proportion of non-borrowers varies inversely with size, ranging from 42% of SQCs with an annual turnover of less than £10 million to 22% of those turning over between £10 million and £50 million and 12% of the high-turnover companies. An investigation of the characteristics of these companies and their replies to other questions suggests that this group is composed of two very different types of company: those who have no need or do not wish to borrow, either because they are cash-rich or risk-averse; and those who do find it difficult to access debt finance, mainly because of relatively poor performance. The former group seems to be larger—for example, 46% of non-borrower responses on the availability of debt quoted being cash-rich or having all necessary facilities in place, while only 16% quoted supply-side issues such as lender unwillingness, sectoral constraints or being loss-making.

Some 60% of SQCs overall have applied for new debt finance or had existing facilities renewed in the past two years. These were more likely to be larger, profitable, old-established companies in the retail/wholesale sectors; applications from smaller, loss-making, newer, manufacturing companies were less common. As many as 95% of those who have applied in the past two years for debt finance have had their application approved in full (see Chart 7). And not all loss-making companies appear to be constrained; although a majority of the most unprofitable SQCs has not recently applied for debt finance, a remarkable 89% of those that have said their application was approved in full. This does not indicate that banks engage in credit rationing by quantity rather than price in financing SQCs.

Chart 7
Outcome of recent borrowing applications by SQCs



Source: Continental Research.

Attitudes to debt finance

Statistics on, for example, gearing levels cannot determine whether these differ because of supply-side constraints on the provision of finance or whether they mainly reflect demand-side factors, perhaps associated with the degree of risk aversion. The survey attempted to throw some light on this by seeking to gauge companies' attitudes to debt finance.[2] The responses are summarised in Table A. There were relatively high levels of agreement with the propositions that banks are willing to lend more if required and that companies' plans have never had to be changed because debt finance could not be agreed. Companies also generally acknowledged that they can shop around until they obtain the debt finance required. There were lower levels of agreement with the propositions that it has recently become more difficult to get good deals from

(1) The figures quoted for mean borrowing on overdraft in the text and in Chart 6 relate to the size of the overdraft facility rather than the amount actually borrowed.
(2) Data in this section and in Table A refer only to SQCs that are currently borrowing or that have borrowed in the past two years (199 out of 257 respondents).

banks or that it can be a real struggle to obtain necessary finance. These replies suggest that SQCs in aggregate do not face widespread supply constraints in accessing debt finance, as does the fact that 78% of SQCs said they had received in the past two years an unsolicited approach from banks they did not use about providing the company with banking services.

Table A
SQCs' attitudes to debt finance

	Average score	Strongly agree	Strongly disagree	Index
SQC has firm views on amount of debt incurred	7.8	70	5	+65
Banks willing to lend more if required	6.5	46	20	+26
Never had to change plans because debt finance not agreed	6.5	54	29	+25
Prefer to remain loyal to small number of finance providers	6.3	40	16	+24
Shop around until get deal required	6.2	35	14	+21
Prefer internal to external finance	5.5	27	31	-4
Recently more difficult to get good deal from banks	4.7	16	38	-22
Banks proactively provide advice	4.6	11	36	-25
Although always get finance, can be struggle	4.2	12	49	-37
Too highly geared to raise further finance	3.0	10	72	-62

Notes: Average score is average of range of responses from 1 (least agreement) to 10 (most agreement). 'Strongly agree' covers percentage of responses in 8–10 range; 'strongly disagree' covers percentage of responses in 1–3 range. Index is 'strongly agree' less 'strongly disagree'.

Source: Continental Research.

The evidence on the demand side is less clear-cut. Across all types of SQC opinions were fairly evenly divided when asked whether their company preferred to fund internally or rely on external finance. The lowest level of agreement was recorded for the assertion that companies are currently too highly geared to raise further debt finance, again across all types of SQC. This is consistent with the fact that the recent rise in gearing to very high levels by historical standards is concentrated among LQCs rather than SQCs. It does not point to any particular aversion among SQCs to debt finance on prudential grounds.

Although there is little indication that SQCs overall feel they need to reduce gearing on prudential grounds, some 37% said they are currently borrowing less than in recent years, compared with only 23% borrowing more. The excess of those borrowing less over those borrowing more is greater for unprofitable than profitable SQCs, and is also significantly more marked for manufacturing than for other companies. This appears broadly consistent with official data suggesting that manufacturing companies overall have been repaying bank debt in recent years. It may reflect either a lack of demand for external finance, perhaps associated with declining activity in the manufacturing sector, or that a larger proportion of companies in that sector is seeking to improve their balance sheets.

The Bank's past contacts with SQCs noted a relative aversion among them for secured borrowing, which was thought to restrict business options. But the previous survey evidence suggested that the banks tend to require security, especially on longer-term loans to SQCs. The current survey confirms this latter point, with only 18% of those SQCs that borrow doing so on an unsecured basis. Very profitable companies(1) appear more able to borrow unsecured (some 40% of such borrowers do so, although the sample size in this case is small). In general some 59% of SQC borrowers provided a fixed charge on debt facilities and almost as many (58%) provided a floating charge. Security seems to be more valued by banks than covenants: only 52% of SQC borrowers are subject to an interest cover covenant, 43% provide a capital gearing covenant and 40% a material adverse change (MAC) clause. Some 26% of borrowers are not subject to any covenants and surprisingly this proportion is higher among the smallest companies by sales turnover (50%) and among the heaviest loss-makers (41%). This perhaps suggests that banks are more likely to insist on security when lending to riskier SQCs, which in turn may make them unduly relaxed about the degree of covenant protection.

Liquidity policy

Replies to the questions on SQCs' liquidity policy may throw further light on the extent to which their relatively low usage of longer-term debt and modest overall gearing (compared with FTSE 350 companies) may reflect a conservative financial policy and high degree of risk aversion. The Bank's previous research found that SQCs generally hold more cash than do other companies.(2) The current survey points to high cash holdings(3) relative to total assets at smaller, less profitable, newer SQCs. Some 18% of SQCs in aggregate hold more than half their total assets in cash, but this proportion rises to 33% for companies with a turnover of less than £10 million, to 32% for companies with a profit/assets ratio below -10% and to 30% for companies incorporated since 1995. But it is unclear whether holding cash represents a conscious decision on the part of these SQCs: some 82% of sample respondents did not know whether their company has a specific

(1) 'Very profitable' means average profits/assets over the past three years were greater than 10%.
(2) See Cahill, J M and Whitley, J D (2003).
(3) 'Cash' is defined to include balances in current and deposit accounts, including money market accounts, irrespective of whether these accounts were interest bearing or not.

policy on holding cash. When prompted, 72% said it was to finance working capital and 58% to finance future investment. Risk aversion might be a factor among the 47% of SQCs who said they hold cash as a buffer against adverse trading conditions and the 19% who quoted a reluctance to borrow as a reason for holding cash. These latter proportions do not vary substantially among different types of SQC. They suggest that liquidity policy is guided principally by debt aversion at only a minority of SQCs.

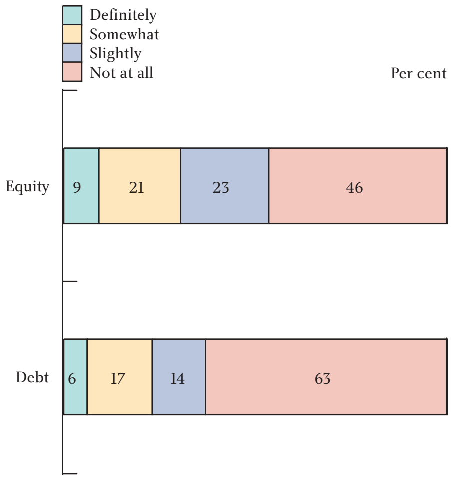
Access to equity finance

Turning to equity finance, recent studies have concluded that SQCs can face significant barriers in raising such finance. This has been variously ascribed to secondary market illiquidity in SQC shares, consolidation in the fund management industry leading to a lack of interest in and research on smaller companies, and a desire on the part of existing owners not to dilute their equity stakes. But, as also noted above, if equity finance were indeed difficult for SQCs to raise, their gearing levels should, if anything, be relatively high in consequence. That does not appear to be the case.

The survey does not provide any very strong evidence that there are major barriers to raising equity finance for the broad majority of SQCs, but it does point to difficulties for a minority of companies. More than two thirds of SQCs said they are either not at all equity-constrained (46%) or only slightly constrained (23%).(1) There were no major variations by company size, other than a rather greater proportion of FTSE SmallCap companies (59%) saying they are definitely not equity-constrained than AIM (45%) or FTSE Fledgling (37%) companies.

Nonetheless, that does leave a significant minority overall claiming to be definitely (9%) or, more commonly, somewhat (21%) equity-constrained, and these proportions are above those claiming they are definitely or somewhat debt-constrained (see Chart 8). Indeed, nearly 80% of SQCs that claim to be definitely or somewhat debt-constrained say they are also definitely or somewhat equity-constrained. This suggests, as does the earlier evidence, that a minority of SQCs face general difficulties raising all types of finance, mainly because of their relatively poor performance.(2)

Chart 8
Proportion of SQCs feeling debt or equity-constrained



Source: Continental Research.

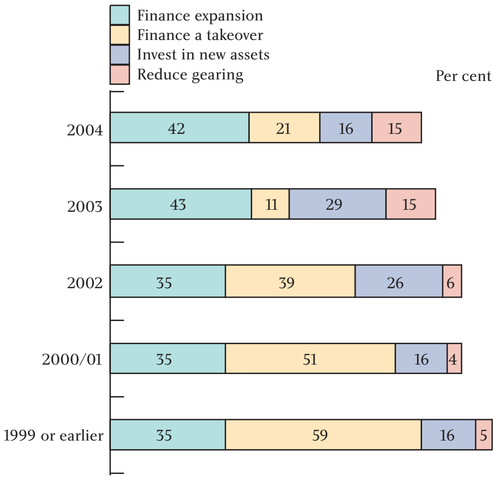
The reasons given for the existence of equity constraints, like those underlying debt constraints, reflect a mix of lack of demand by the company (eg in the case of equity finance because of shareholders' fears of dilution) or lack of supply (in the case of equity finance because of a perception by the company that it is out of favour with potential investors or because the company's share price is depressed). However, the most frequently cited reasons were on the supply side.

When asked about the number of secondary market equity issues made in the past ten years (or since flotation if that was more recent), further support is provided for the notion that the majority of SQCs currently faces no major difficulties in raising equity finance, while a minority generally does not seek or finds it difficult to access equity, for either demand or supply-related reasons. Some 53% of SQCs have made two or more secondary equity issues in this period, but a significant number (28%) have not made any. The proportion of companies raising equity to finance expansion or to invest in new assets (see Chart 9) has increased in recent years, perhaps suggestive of some current and prospective recovery in investment spending. It is consistent with the point made in the Bank's latest *Inflation Report* that the financial climate has become more supportive of corporate investment, with the recovery in equity prices and the reduction in corporate bond spreads since early 2003.(3) The proportion raising equity to reduce gearing has also

(1) 'Equity constrained' is defined as the company feels that plans it had could not be achieved because the appropriate amount of equity could not be raised, for either internal or external reasons.
(2) The survey did not investigate the possibility that causality may also run the opposite way, ie some companies may perform poorly partly because of their inability to access finance (or the right form of finance).
(3) See Bank of England (2004), pages 14–15.

increased, suggesting that balance sheet adjustment has been a motivating factor for a small number of SQCs. Not surprisingly, in view of the decline in M&A activity in recent years from the levels of the 1999–2001 boom, the proportion of SQCs raising equity to finance a takeover has fallen substantially (although there are signs of some revival this year).

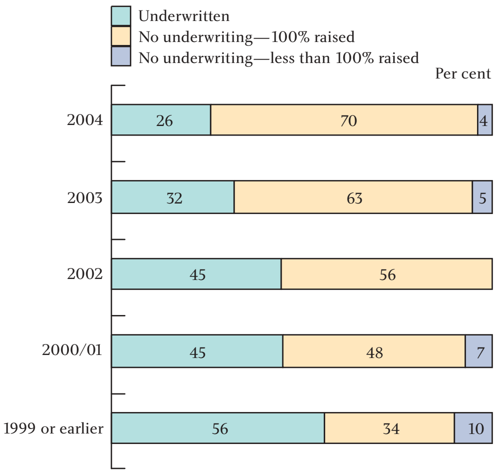
Chart 9
Main reasons for SQCs' most recent equity issues, by year



Source: Continental Research.

If SQCs faced major problems in raising equity finance, it might be expected that they would opt for any issues to be underwritten (although underwriters might be wary, for the same reasons, and raise their charges). In fact, the proportion of equity issues by SQCs that were underwritten fell from over half in 1999 to only a quarter so far in 2004 (see Chart 10). This certainly reflects to some extent the decline in M&A-related issues, for which certainty of proceeds is required. But it does not provide much support for the thesis that there exist

Chart 10
Equity issuance by SQCs, by year



Source: Continental Research.

major barriers to SQCs in general raising equity finance, especially given that 92% of non-underwritten equity issues did in fact raise 100% of the intended proceeds. The proportion of total secondary market issues that did not raise all the intended proceeds has also fallen between 1999 and 2004. In the small number of cases where this happened, it was attributed to market conditions and a lack of suitable investors, but in most cases it nevertheless was said to have had no or minimal effect on the company.

Attitudes to equity finance

The survey asked a number of questions designed to tease out SQCs' attitudes to equity finance. These are summarised in Table B and provide some guidance on the relative importance of supply and demand constraints on raising equity. Interestingly, the comment that elicited the most agreement was that the costs of an issue are off-putting. This suggests that another reason for the decline in the proportion of underwritten issues is a desire to save on the costs.

Table B
SQCs' attitudes to equity finance

	Average score	Strongly agree	Strongly disagree	Index
Costs of issue off-putting	6.4	36	17	+19
Being listed means can raise other finance more easily	5.8	26	19	+7
Markets feel amounts wish to raise too small	5.2	20	31	-11
Better ways to raise finance than share issue	5.1	12	24	-12
Existing shareholders reluctant to issue more shares	4.8	17	34	-17
Current market conditions mean less likely to consider	4.8	21	41	-20
Markets do not like as company not fast-growth	4.2	15	50	-35
Markets do not like sector	4.2	13	48	-35
Markets do not like due to dominant shareholder base	4.2	15	53	-38
Directors reluctant to issue more shares	4.1	12	49	-37
Put off by regulatory requirements	3.9	10	51	-41

Notes: Average score is average of range of responses from 1 (least agreement) to 10 (most agreement). 'Strongly agree' covers percentage of responses in 8–10 range; 'strongly disagree' covers percentage of responses in 1–3 range. Index is 'strongly agree' less 'strongly disagree'.

Source: Continental Research.

Other evidence does not point to major demand constraints on issuing equity. Fears of dilution on the part of existing shareholders do not appear to be widespread: only 17% of SQCs strongly agreed that existing shareholders are reluctant to issue more shares, whereas 34% strongly disagreed. However, among companies with a family shareholding above 30% of the total, 29% strongly agreed that their shareholders are reluctant to make further issues. This may reflect greater concerns on the part of family shareholders about dilution. An even smaller overall proportion (12%) of SQCs strongly agreed that directors are reluctant to issue more shares, although, again, the proportion was higher (24%) among those with a large family shareholding. There was general acknowledgement that being listed enables other forms of finance, including debt, to be raised more easily.

Turning to possible supply constraints, there was generally substantial disagreement with propositions asserting the importance of factors traditionally regarded as a brake on SQCs issuing equity, although unfortunately the survey did not include a reference to secondary market illiquidity among these (though, unprompted, only 3% of respondents cited illiquidity as a reason for being equity-constrained). The proposition that attracted most support was that the amounts SQCs seek are thought to be too small to interest the equity markets. This could be consistent with the consolidation trend in the fund management industry. Concerns that the market may not favour SQCs with dominant shareholder groupings seemed less acute: only 15% strongly agreed that this is an obstacle to raising equity, although this rose to 31% of companies where there was a family shareholding of more than 30% of the total. The proportions strongly agreeing that various market obstacles to SQCs based on their sector, lack of growth or current conditions are major deterrents varied between only 13% and 21% of SQCs.

Companies were also asked whether they had considered delisting or moving to another market. Replies to this question were perhaps indicative of more dissatisfaction than the other responses. FTSE Fledgling companies appeared to be the most discontented: some 62% had considered one or both of these options, compared with 44% of FTSE SmallCap and 34% of AIM companies. This may indicate that the very smallest companies on the official list perceive the fewest advantages from being listed; certainly, the costs of listing and the associated regulation were argued to be more of a deterrent than falling share prices or small size themselves. Such companies may view the lower costs and less extensive regulation of the AIM market as significant advantages.

The absence of major concerns about difficulties in raising equity finance also arose when SQCs were asked about their plans over the next two to three years (see Table C) and about how they would finance any major new business opportunity. The most popular idea amongst future plans was to issue more shares: some 62% of companies said they might do that in that period. The smallest companies were particularly likely to want to issue more shares. Medium-sized and large SQCs, by contrast, were more likely than small SQCs to want to buy back shares. Also, newer firms were more likely to want to increase their equity base than older ones.

Table C
SQCs' financial plans in the next two to three years

Per cent

		Number of employees			Year of incorporation		
	All SQCs	<100	100–500	>500	Up to 1980	1981–95	Since 1995
Reduce current debt	39	29	46	47	43	39	37
Increase current debt	45	47	36	53	48	47	42
Issue more shares	62	78	46	56	51	64	68
Buy back shares	24	17	33	25	30	23	21

Source: Continental Research.

When asked about how a major new business opportunity(1) would be financed if it arose tomorrow, some 52% said it would be mainly through an equity issue, compared with just 23% who said it would be mainly by increasing debt finance. Neither supply nor demand factors were quoted as possible obstacles to taking advantage of such an opportunity. Only 7% of SQCs thought they would struggle to raise the external finance needed, while only 2% said they would not want to take on more debt at present and only 1% said directors or shareholders would not sanction an increase in debt or a share issue in the event of such an opportunity. This also does not point to any substantial equity or debt aversion on the part of SQCs.

Conclusions

This article has reported the results of a comprehensive survey designed to answer questions and test hypotheses concerning the financial policies of a wide cross-section of mid-market companies in the United Kingdom. It suggests that the broad generality of UK smaller quoted companies is not currently experiencing any major difficulties in accessing either debt or equity finance. They appear to be able to rely on banks and equity investors to meet their financing needs, although generally security has to be offered to banks and loans tend to be of shorter maturity than for LQCs. Companies have rarely had to alter their financial strategy because required finance was not forthcoming, and most have confidence in their ability to finance a major new business opportunity should it present itself. In such circumstances, more would opt for equity than debt finance, suggesting that financial policy tends to be

(1) 'A major new business opportunity' is defined as one for which the company would need to raise external finance.

more conservative than at larger companies, perhaps motivated by greater aversion to the risks of heavy borrowing. But only a minority of SQCs seems deliberately to hold cash because of an aversion to borrowing. The survey also suggests that only a small minority of SQCs appears to face problems in accessing all types of finance, mainly in consequence of their relatively poor performance.

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