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The Impact of Various Economic Factors in accessing Finance within the Business Sector: Cases from UK Financial Services Companies

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Abstract
This paper investigates the impact of various econmic factors such as inflation, interest rate, financial crises, and government regulations on the access to finance in the business sector specifically considering the financial experts' persepctive operating in the UK financial services companies. The study examines the relationship between variables of interest in post recession period. Total five out of top fifty British Financial Services' Companies were selected through convenience sampling. Addtionally, 38 respondents were selected through purposive sampling, based on their knowledge, level of management, and experiences in the sector. The findings showed that interest rate, government regulations, and financial crises have signigicant relationship in accessing financial resource. Interestingly, 83% remain neutral about the relationship between inflation and raising funds.

Key words: Inflation, interest rate, government regulation, financial crises, economic factors

1. Introduction

Companies in general including large, Small and Medium-sized enterprises and start-up businesses, are the mainstay of economies in developing and developed countries, they play a significant role as the fundamental generator of revenues and job creation, and as drivers of economic prosperity, growth and innovation (Berger and Udell, 2006). However, these business entities are seemed to experience and face restrictions to access finance, mainly for SMEs and start-ups (ibid). Indeed, a number of experimental cross-country studies have demonstrated initial financial growth as one of the few sturdy determinants of an economic prosperity. Yet, maintaining economic prosperity is a complicated task. The most frequently mentioned matter facing economies in the business environment of today is the lack of financial capitals (Ganbold, 2008). Access to financial services is identified globally as a significant feature to maintain financial stability and improve markets' integrity. However, smaller firms in both developed and developing countries are struggling to access funds as a result of excessive requirements set by lending institutions, unavailability of sufficient funds to cover demand or economic strength hindering the process of raising funds for this particular businesses (ibid). Thus, it is essential to perceive the main economic factors impacting access to finance in the business sector. The present qualitative study is to investigate the relationship between access to finance and inflation, interest rate, government regulations and global financial crisis. This research paper attempts to gain a further understanding and insight of the main

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economic factors impacting access to finance within the business sector and to what extent do these variables affect the research topic. It is a discovery research aiming to contribute to the body of knowledge. The significance of this research is that it follows a qualitative approach to analyse the collected data whereas the previously conducted studies viewed the issue of access to finance from a quantitative perspective.

2. Literature Review

The accessibility and abundance of finance for businesses has been a substantial and significant subject to business individuals, policy makers and academic researchers (Berger and Udell, 2006). According to Naraine (2010), Access to finance can be broadly defined as access to financial products (e.g. deposits and loans) and services (e.g. insurance and equity products) at a reasonable cost. Access to finance was a topic of significant research interest in both developed and developing countries for many years back. The third factor is the fact that debates suggesting the positive relationship between financial development and prosperity incorporate often access to finance as a critical component. The last factor can be summarized in the lack of access to financial services in developing economies and the huge gap compared to developed economies. Yet, access to financial services and the use of financial services are often get confused, while the use of financial services is ruled by demand along with supply, access to financial services indicates the supply of services (Ganbold, 2008).

Although access to finance has been an interesting research topic for many years, the academic research and literature have mainly focused on the issue of access to finance for Small and Medium sizes Enterprises (SMEs). Hughes (1997) argued that the proposal that small enterprises run into exceptional market failure within the credit market has gained more popularity and turned into a deeply established proposal within business individuals and policy makers in the marketplace in the UK. Besides, lending institutions often exclude SMEs from their financing plans due to their deficiency of loan track record and security (ibid). It is therefore related to the size of the company and complies with the "Growth Cycle Theory" of SMEs raising fund which argues that access to finance is strongly correlated with the size of the company (Gregory *et al.*, 2005).

Inflation, as a concept had been an economic and financial concept that many authors have reviewed in their research, yet there is a general agreement on the definition of the term. Mises (1949) was one of the first authors to define inflation. He argued, "*The term inflation was applied to signify cash-induced changes resulting in a drop in purchasing power"*. This definition was supported by many authors as Flemming (1976) who have viewed the rate of inflation as the variation in the overall level of prices in the economy. Inflation is the increase in the overall price level and continually drop in the purchasing value of money (Bronfenbrenner and Holzman, 1965; Vane and Thompson, 1979).

The major determinants of inflation can be explained from the perspective of the two central schools of thought. Starting with Milton Friedman, the American economist who formulated the monetarism theory in 1956, who claimed, *"inflation is always and everywhere a monetary phenomenon"* (Friedman and Schwartz, 1970). On the other hand, the Neo-Keynesians and the other Anti Monetarism suggested the demand for money is unpredictable and it is drastically correlated with supply. Furthermore, a research which has been conducted by Bulman and Simon (2003) to examine the relationship between inflation and Productivity levels in Australia, the research found a positive relationship between the two variables. Another research of Stiglitz and Greenwald (2003) has suggested that ordinary inflation cannot affect the

correlation between money supply growth and inflation.

According to Petersen and Rajan (1994), interest rate is defined as the cost of borrowing money from a lender. The relationship between access to finance and interest rate cannot be neglected. The two economic factors are correlated at every stage of a business life cycle. Bawuah*et al*. (2014) has shed light in his research on the impact of interest rate on access to finance for SMEs, he claimed that there exist an enormous concern amongst SMEs regarding how they might finance their operations, he added that the contending concern that goes along with the issue of access to finance is the high interest rates required by lending institutions. A study on the credit channel mechanism of monetary policy emphasises the relationship between interest rate and access to finance, an increase in the rates of interest drives a decrease in the levels of internal and external available finance required by companies to fill their credit needs (Bernard *et al*, 2014). The credit channel is believed to be significantly important for SMEs as this category of companies are most likely to struggle to raise funds (ibid).

The abovementioned thought is consequential with the findings of Gertles and Gilchrist (1994) that illustrate the disproportionate impacts of high interest rates on smaller US construction and industrialisation companies. The progressively increasing interest rate restricts smaller companies to minimise inventories, suffer the drastic drop in sales level and experience high production cost which eventually harm their turnover and development. Conversely, as argued by Ehrmann (2000), larger companies have the expertise and force to maintain debt levels, enhance inventories and confront the significant drop in their profit margin and expansion. The outcomes of progressively increasing interest rate on loans can be clearly observed in the balance sheet of these smaller companies. The high interest rates affect the companies' balance sheets by weakening its assets value and boost liabilities based on the fact that smaller companies chiefly own long-term physical assets yet short-term liabilities. The present discrepancy between assets and liabilities indicates the positive correlation of current cash flows and interest rates, as the interest rates surge the current cash flows experience sharp drops. Moreover, the drops of assets' present value are significantly related to liabilities' present value, which therefore turns the company into a less creditworthy company and decreasing its capability to access external funds. A research of Greenwood (2003) revealed that the investment process of a company is substantially sensitive to interest rates when the level of maturity mismatch is significantly higher. The latter relationship is more prominent conspicuous within financially restricted companies.

The lending institutions or providers of funds explain the high interest rates by the increasing administrative costs of defaulters and the unpaid loans which therefore elevate the cost of lending funds leaving the credits income constant without any symmetrical increase (Saunders and Cornett, 2007). As a result of credit defaulters, the resources of lending institutions and fund providers dwindle which consequently reduce the level of confidence of lenders and harm the credit record of customers. The direct outcomes of loan' embezzlement are that credit providers determine a higher risk premium for less trusted firms enabling them to cover the additional risk associated with the loan. Thus, it becomes even more challenging for smaller companies to access to finance since lenders are progressively increasing the interest rate.

With the most spectacular global banking collapse in the last decades began to hit the US economy in the 3rd quarter of 2007 (exactly on the 9th of August 2007), economists suggested that companies access to funds will be a first prey (Valverde*et al*, 2012). Authors and economists have started to evaluate the

devastation produced by the financial crisis of 2007 using the progressively increasing amount of data available in regards of the banking collapse. Researchers have allocated much of their exertion to investigate which institutions are the main responsible for the financial crisis? Which institutions will be affected the most and how larger companies will relatively plan and work to face this vicious issue? On the other hand, comparatively less exertion has been allocated by researchers on smaller companies and how they will survive the contraction of fund provided by their lending institutions.

Despite the amount of existing analysis of the impacts on the growth of the financial market and the genuine function of the institutional environment (World bank, 2001), evidence is still insufficient regarding the restrictions to access finance. The existing evidence provides an overview on the most binding restrictions. It is evident that there exist several aspects of general growth across many nations, yet government regulations remain a very critical element driving either economic prosperity or failure. An exceptional example can be seen in the case of Brazil, the governmental constructive regulations to partially control the market has played a critical role in the level of access to finance among companies in the country. Glaessner*et al*, (2004) indicated the extension of supervision and control of South African state on banks to include microfinance institutions as the main factor which decreased the capacity of these institutions to provide their lower-income customers with profitable and convenient financial services. Governments are arguing that such regulations are intended to protect both the lending institutions and their customers against fraud and risks related to the sector, however these overly complicated regulations are proven not to be effective in less developed economies given the deficiency in the capacity of control and supervision which results in hindering access to finance (Barth *et al*, 2005).

3. Research Methodology

In an attempt to investigate to what extent do the economic factors (naming interest rate, inflation, global financial crisis and government regulations) impact access to finance and examine the relationship between access to finance and the research variables, a qualitative research in undertaken to answer the research question. The qualitative approaches to research were the most appropriate choice to conduct this research based on their worldview being holistic and the believes that reality is not fixed and cannot be generalized, also the reality can vary from an individual to another subject to their perception (Ross, 1999). Total 38 interviews with experts were conducted in this study. In addition, the sample size used to collect primary data in favour of this research consists of professionals and experts in the financial field, the targeted population are members of the corporate finance team of five (5) UK financial services companies, ranging in the top fifty accounting and financial advisory firms in the UK. The diamond model used by Faizan&Haque (2015) for case study adopted in this study to form theoretical framework. The targeted respondents were from the operational, middle management and senior management level to investigate the research problem and gather accurate responses regarding the topic.

The present research falls under the Socio-Anthropological as it is aiming to explain relationships. The Interpretivism or Constructivism research paradigm has been selected since the research is based on a qualitative analysis to demonstrate the relationships between access to finance and economic factors from the own perspective and opinion of our chosen sample. This research engages into an empirical analysis and employs a process leading to well-defined outcomes. Therefore, the ontology is relativism, epistemology is subjective and the qualitative research methodology is to be adopted to serve the aims of

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this research. In addition to that, the study follows an inductive approach.

The targeted respondents are employees and directors of selected financial services companies, London branches mainly focusing on three different departments (Entrepreneurship, Tax services, and Corporate Tax). Using my own networking and connections, Researcher gained access to these companies and potential participants were approached using probability and purposive sampling technique to diversify sample and give employees from different departments and different management level an equal chance to participate in this survey. An email was sent to the HR departments of targeted companies seeking permission first before taking any further steps in distributing the questionnaire and collect data. Through the email, the purpose of the research has been stated clearly and the process of collecting data started straight after receiving the positive responses. In addition to that, as part of the ethical consideration, the responses were collected, stored and analyzed in a way that assures the anonymity of participants. The collected data has been coded to categorize data with similar meaning. Additionally, Microsoft Excel software was the chosen analytical software to analyze the collected data based on the variety of statistical techniques the software provides. The collected non-standardized data was classified into categories to ease the analysis process. Also, a filter was used to define each response set.

4. Findings and Discussions

As stated earlier, members of the corporate financial team of selected companies were used for the purpose of this study. One-third of the respondents employed were females (roughly 34%) while the remaining two-thirds were males (66%). The position levels of the targeted population were mainly from operational, middle management and senior management levels. However, this study excluded participants from top-level management due to the difficulty to gather responses from this category of employees and the length of this process. Additionally, 50% of the targeted population operates at the Middle Management level, 33% are senior managers and 17% are working at the Operational level.Based on the responses given by research participants, it can be observed that the position level of an employee does not reflect their variations of responses or their own perception of access to finance since a variety of very similar responses were obtained from employees operating at different levels.The analysis began by considering whether access to finance within the business sector is impacted by economic factors naming interest rate, inflation, government regulations and the global financial crisis. Initially, the respondents were given a question to express their personal opinion about the major economic factors that affect access to finance. At this stage, responses were gathers, coded and categorised into 4 main categories including *"Barriers created by banks"*, *"Barriers created by the economic system"*, *"The elevated level of lending fees"* and *"High level of risk"*.

Category	Code	Frequency	Frequency Distribution
Barriers created by banks	1	15	39%
Barriers created by the economic system	2	12	33%
Lending fees are elevated	3	7	17%
High level of risk	4	4	11%
Total		38	100%

Based on the data collected, 39% of the respondents believe that barriers created by banks are the major factors hampering firms to raise finance. They suggested that different determinants are affecting access to finance as *"accessibility and availability of funds", "banks capital adequacy levels", bank lending requirements", "size of requirement"* and *"the quality of credit"* are the main hurdles to get a bank credit. Furthermore, 33% of respondents opined that barriers emerging as a result of the economic system have the main impacts on access to finance. Variables as *"Strength of the economy", "Money supply", "levels of return and yield available"* and *"Microeconomic issues as gearing levels"* were among the responses given.However, elevated lending fees and high level of risk associated with credits scored 17% and 11% respectively, *"interest rates"* and *"inflation rate"* are viewed to have a significant impact on raising funds, and finally, *"market uncertainty"* and *"attitude to risk"* are considered to have significantly less impact on accessing finance.

The study also examined whether the economic crisis restricts raising fund in the business sector. Evidence arising from the collected data demonstrates that 71% of respondents believe in the existence of a positive relationship between access to finance and economic crisis. Arguments were given that the mainstream banking activities in general including credit services have been impacted by recession and regulation. Hence, the latter gave an opportunity for alternative finance providers to expand and help filling the gap in the market. As a result, new funding practices have emerged as Peer-to-Peer and Crowdfunding. Indeed, if banks are making less profit during financial crises, companies will struggle to access finance due to the lack of a liquidity backstop (Mora, 2011). Similarly, during such periods when the business angles are more concerned that the economy is faltering, they become more reluctant to lend, especially to start-ups and SMEs. On the other hand, 29% of the respondents believe that there are no significant impacts of the economic crisis on access to finance. They argued that following 8 years of aggressive monetary policy, specifically designed to improve credit availability, the supply of loans is no longer appear to be an issue. Additionally, governments and central banks may choose to stimulate the economy by encouraging banks to lend SMEs and start-ups. Venture capitalist and private equity firms see the crisis as an opportunity to expand their customer base. Thus, the competition between banks and alternative finance providers provide companies with an advantage over economic crisis (Block and Sandner, 2009).

The next phase of the questionnaire sheds light on the main motives for companies to access finance. According to the data collected, acquiring capital equipment or vehicles scored 23% of overall respondents, which make it the most common motive to access finance in our population. This indicates that the present research aligned with the finding of Stölzle and Elbert (2013) suggesting that capital equipment is the most significant purchase among businesses. In addition, buying another business along with fund expansion were the second most popular motive to access finance scoring 19% each followed by working capital, buying or improving another business and research and development with a score of 12% each. These findings provide an explicit idea of what the accessed funds are spent on and spending priorities of businesses. Thus, it can be observed that businesses require credits mainly to reinforce their production capacity by acquiring assets, machinery and enhance their position in the marketplace.Concerning the most popular source of finance amongst companies, the majority of respondents (27%) selected Bank loan as the most popular source of business financing. Personal funds and Business angles were the second most popular sources of finance scoring 18% each followed by Retained earnings and Venture capitals with 9%

of responses each and only one response for Government grants (5%). However, the respondents completely ignored the short-term funding option “Bank Overdraft” which proved its inadequacy based on a number of restraints associated with the funding option such as the limited amount of loan, the high interest rate applied that is well above the bank rate base and its short-term financing character.

Although the bank loan is a popular source of finance among companies, SMEs and start-up businesses are still struggling to obtain bank funding. Banks and most commercial lenders nowadays are requiring a positive record track, a solid and reliable business plan and an excessive number of collaterals, which restrict their ability to raise funds. Therefore, some respondents argued that alternative sources of finance for smaller firms are now available naming Crowdfunding, Peer-to-Peer lending and the new British Business Bank. The British Business Bank itself injected the market in 2014 with £890 million to be lent to smaller firms. Additionally, the emergence of new digital lending platforms (as peer-to-peer and crowdfunding) has made £1.3 billion available and easily accessible for small businesses to lend (Young, 2015).

Among all the responses collected, *“There are no obstacles”* answer choice scored 0%. Therefore, this supports the findings of Laeven and Woodruff (2007) suggesting that access to finance is among the most concerning business environment’ aspects. Yet, according to the data collected, insufficient collateral or guarantee is considered as the biggest obstacle facing companies to raise their funds with a 46% of responses. At this level, this result supports the findings of Agyapong*et al*, (2011) who suggested that the availability of collateral is considered as an important aspect on whether to accept or reject a loan application by loan managers in banks. In addition, the elevated interest rates represent the second concern of firms willing to apply for loans with 23% of overall responses. The reduced control over firms is also seen as an obstacle by 15% of our chosen population, while the availability of funds has scored less compared to other variables (only 8%). Additionally, trying to perceive the main obstacles faced by firms to access funds, a respondent claims the investment readiness, quality of business plan and model and the quality of management team may also impact access to finance. A poor and weak loan application may result in a rejection regardless the financial obstacles.

The present research explores the impact of the research variables (Inflation, Interest Rate, Government Regulations and Financial Crisis) on access to finance in the business sector. From the table above, it can be clearly seen the representation and intensity of responses towards Major effect and Moderate effect. Yet, not a single response received throughout the process of data collection claiming the non-existence of a relationship between research variables and access to finance. Additionally, starting with the impact of inflation rate on access to finance, only 17% of respondents suggested that the progressively increasing inflation rate have a moderate effect on access to finance, while the remaining 83% of respondents remain neutral. This explains the weak, but existing relationship between inflation and access to finance. There is an argument suggesting that companies, especially SMEs, are using their Commercial Real Estate (CRE) as collateral to obtain funds. Therefore, if the inflation rate results into a fluctuation in CRE prices, their access to external funds will be affected since there is a high level of risk associated with their borrowing collateral.The interest rate levels have a significant impact on access to finance according to the present survey. The overall responses on the impact of interest rate on access to finance were split between Moderate and Major effect. While 83% of respondents viewed that interest rate has moderate effects on

access to finance, 17% viewed this effect as a major effect. Indeed, the relationship between access to finance and interest rates is strong. The argument is that when microfinance institutions fix a lower interest rate, the potential demand for financial credits will increase dramatically. However, when interest rates are set to be significantly high, it drives borrowers into over-indebtedness as they cannot cover the lending costs, as a result, it becomes a necessity to search for alternative sources of finance.

Similar to interest rate, government regulations significantly impact access to finance according to the present survey. At this level again, the overall responses on the impact of government regulations on access to finance were either "Major effect" or "Moderate effect". A total of 67% of respondents view that the government regulations have a moderate effect on raising funds, while one-third of respondents suggest that the effect in major. Based on these results, government regulations can affect firms' access to finance in both ways. This could be accredited to the government's intervention in the financial market to ensure economic stability of the country. As a result, new government regulations may affect access to finance in both ways. According to Yip (2016), the designated three financial platforms announced by the British government will impact to a large extent the level of access to finance by SMEs and start-up businesses by providing the rejected companies for finance by microfinance institutions with a referral to an online finance platform. The findings of the present study support the previously conducted empirical studies on this subject as Rigby and Ramlogan (2013).

According to the survey, financial crisis also has an impact on access to finance. About half of respondents viewed that credit crunch has a moderate impact on access to finance (50%), 17 % describe the effects as a major impact, while 33% remain neutral. Although one-third of the population is neutral, 66% of respondents believe in the existence of a relationship between credit crunch and raising funds. The results of the survey supported what is already known in this particular area. The impacts on a credit crunch can be observed on the microeconomic and macroeconomic indicators. While these economic indicators are regressing as a result of the crisis, the deterioration of the economic system can be observed. Therefore, the economic regression directly affects all businesses operating within the economy including banks and alternative lending institutions. With an easy and more accessible finance, the respondents believe that the business sector will improve. As a result of an easier access to finance, new innovative businesses will emerge and the existing ones will expand which will certainly aid growth and drive an economic prosperity to the country. However, access to finance needs to be regulated correctly. Fund provider should use sensible due to the diligence procedure taken to ensure that capitals are lent to businesses with a strong business plan, strong management team and a strong desire to succeed. Providing finance to poorly managed businesses will undermine the business sector in particular and generally harm the economic system.

5. Conclusion

There exists relationship between access to finance in the business sector and Interest rate, Inflation, Government regulations and financial crisis separately. Interestingly, the level of experience and the business sector where our chosen population is operating gives these findings further reliability and accuracy. The accessibility and availability of finance, banks' lending requirements, credit quality, the strength of the economy and elevated interest rates on loans are the major hurdles faced by businesses willing to raise funds. Furthermore, the financial crises are seen to have a moderate impact on access to finance. On the other hand, such a rough situation can create a strong rivalry between alternative fund providers to emerge and expand

their customers' base. Financial crises are viewed venture capitalist and private equity firms as an opportunity to expand. Thus, the relationship between financial crises and access to finance cannot be neglected.

The analysis conducted through this study refers to a positive relationship between inflation and access to finance. High inflation levels can affect the value of commercial assets of companies, which are mainly used as borrowing collaterals. Consequently, banks may reject loan applications as a result of the risk associated with borrowing collaterals. This study revealed a consensus on the strong and positive relationship between access to finance and interest rate. The, government regulations are proven to have a strong relationship with access to finance. Laws and regulations issued by governments can affect access to finance in both ways. The role of governments in the financial markets is theoretical. Yet as a higher authority, governments may issue new laws as to maintain the economic prosperity and advancement of a country which may implement harmful impacts on the business sector in general and restrict access to finance.

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