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The selection, Based on Habit, of SME Financing in an Increasingly Diverse Market

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Over the past 10 years, different types of financing have become available in the Netherlands. It is now possible to combine bank loans, crowdfunding loans and risk capital. Moreover, fintech applications lower the threshold for applications and reduce response times from weeks to just days or even hours. Fraser, Bhaumik and Wright (2015) point out there is a lack of knowledge of the cognitive process involved in selecting SME financing. This paper looks into the selection process financial advisers use, against the backdrop of the growing range of funding possibilities. To assess this process, we try to understand dominant habits and related heuristics.

Within our explorative study, 19 experienced and independent SME financial advisers were interviewed. The questions address their knowledge, skills, experiences and choices in the selection process on the financing or refinancing of working capital and growth. Taking a grounded theoretical approach, we use Atlas TI to label all answers and statements step by step. The findings suggest a strong bias of decision-making towards the more traditional banking products. Yet advisers state they are aware of, and familiar with, other solutions. We have also found that fintech solutions are hardly used to prepare financing solutions up front. Financial advisers estimate the likelihood of acceptance by a few financial providers they know well within their personal network.

We suggest that there is a behavioural approach to financing in the day-to-day decisions made by financial advisers. As long as automated selections are not fully transparent and are unable to combine all types of financing up front, financial advisers will be guided by habit or by availability, confirmation and affect heuristics, rather than looking for new financing solutions and combinations.

INTRODUCTION

This qualitative study seeks to produce insights into how financial advisers settle on a particular recommendation. These insights may be based on academic theory, but also on knowledge and experience that cannot be traced back directly to existing theories. The aim is to gain insights into how professionals—in this case financial advisers to small-to-medium-sized enterprises, or SMEs—come to a decision on financing. To what extent are one and another convention or custom involved, and how do these relate to conventional economic theory? To answer this question, we describe decision-making processes and link this description to recent heuristics-related academic insights into behaviour. In the process, we also show the possibilities—and the *im*possibilities—involved in tracing heuristics.

Very little is known about the choices made by advisers in financing SMEs (Fraser *et al* 2015). Financing theory offers some general insights, which have been tested for the most part at large companies. On the one hand, there are the neo-classical economic theories such as pecking-order theory and growth-cycle theory. They start with the basic assumption that a selection process takes place on the basis of 'rational' economic considerations. In this connection, 'rationality' means a certain economic logic in accordance with which those involved choose the best economic solution—a solution that offers an actor the highest value at the lowest cost. We speak of 'rational' or 'economic' considerations when explicit reference is made to those requirements of financiers that are formulated in economic terms, such as solvency, profitability and liquidity. The word 'rational' is also used here in everyday usage when reference is made to an economic consideration. This 'rationality' is discussed in detail in the interviews we have conducted with advisers and is explicitly referred to in the interview protocol (see Appendix 1).

On the other hand, there are finance- and social-psychology-related behavioural theories on how people come to decisions (Simon, 1965; Kahnemann, 2012). These theories focus on the limitations of 'rationality' and on unconscious bias in decision making. On this view, advisers use 'non-rational' maxims or 'rules of thumb' based on their knowledge and experience, and behaviours are determined by habits and conventions that people are often not even aware of. 'Non-rational' thus refers, in particular, to decisions for which it is difficult for the parties concerned to provide an economically logical argument. In our analysis, we look at whether advisers give similar answers and make choices that attest to certain 'customs', without this being particularly ‘logical' from an economics standpoint. For example, we notice at one point that some advisers prefer to call a bank first when it comes to financing issues, regardless of the type of application involved. This is not always logical or rational, because for some applications financiers other than a bank are more suitable. It is, rather, a habit, whereas if the adviser had first made an economically logical assessment, they might have called another party.

These habits are referred to as *heuristics* in socio-psychological theory, but also in behavioural finance. They are rules of thumb—behavioural guidelines that the professional applies, based on knowledge and expertise they have gained, combined with their own experience. These decision-making rules are usually based on certain conventions and routines, and often depend on the organisation or sector involved. These heuristics lead to certain dominant ways of doing things.

Heuristics are not necessarily 'irrational'. Many customs are also 'economically logical', for example because they save time or are easier. Someone wants to pay for speed instead of being helped as inexpensively as possible. Habits become irrational only when they have not been thought through properly, such as in a case where speed is not important, but decisions end up costing more than they should because they are taken in a hurry all the same.

In order to grasp decision-making processes, we make use an 'abductive’ methodology (Alvesson and Sköldberg, 2009), which means that we analyse an issue both inductively and deductively. Inductive is that we gradually process interview data into categories of concepts through coding. In and of themselves, these concepts quickly become rather meaningless. What does it mean if the word *bank* is mentioned most often in a particular context? The deductive side of our study is the found in the use of theoretical assumptions. By saying something about people's behaviour in general—that is, by making a number of theoretical assumptions beforehand—we can put the data in context. Through insights about heuristics from Simon, among others, we can search deductively—guided by propositions and descriptions—for expected patterns. In our discussion we will combine these two forms.

The rest of this paper is structured as follows. First. we will discuss existing theory. We will then present four propositions. We will then set out in more detail our method of working and our approach to data collection. We will then discuss the results. Finally, we will discuss the theoretical and practical contributions of this research, as well topics for future research.

THEORY ON SME FINANCING AND ON DECISION-MAKING

This section describes the current state of knowledge on SME financing and on decision-making. These insights are brought together in a number of propositions. First, we look at the nature of loan applications by SMEs and at the role that advisers play. We will then discuss briefly what theory has to say about financing, including the financing of SMEs. It is here that we will look in particular at pecking-order theory and life-cycle theory. After that, we will discuss decision-making processes.

Limited insights into SME financing

There is very little knowledge about how the structure of SME financing comes into being. In particular, academic research has been done on large companies that have their own treasury departments, as they are called, which coordinate a company's various forms of financing.

There are no treasury departments in micro, small or medium-sized enterprises. Many entrepreneurs lack financial knowledge, and if the company already has a financial department, the accountants are usually primarily responsible for accounting. They often lack knowledge of financing (Van der Veen, Van Teeffelen, Ibrahimovics and Lentz, 2015).

In addition, financial decisions are complex because social, behavioural, and financial factors play a role (Romano, Tanewski and Smyrnios, 2001). In addition, SMEs have greater barriers to overcome in gaining access to financing because of high information asymmetries, agency risks, insufficient collateral and small transaction volumes (Artola and Genre 2011; Ferrando and Griesshaber 2011; Van der Veen, Van Teeffelen, Ibrahimovics and Lentz, 2015; and Rauwerda, Van Teeffelen, and De Graaf, 2016).

The academic literature outlines the aspects that are important in arriving at the right choice of financing. Two theories are important here: pecking-order theory and growth-cycle (or life-cycle) theory. Many publications combine these theories in explaining the availability of credit to companies (Gregory et al. 2005; Berger and Udell, 2006; and Beck and Demirguc-Kunt, 2006).

Pecking-order theory

The most important theory that is relevant to SME financing is pecking-order theory (Myers, 1984). It assumes that borrowers have an order of preference when it comes to choosing sources of financing. First of all, preference is given to the use of internally available resources, followed by short-term debts and long-term debts, and ultimately share capital. The simple logic behind this is that the use of one's own money is the cheapest ('does not cost’ money), that interest must be paid on the bank's money, and that shares are even more expensive, because it will keep costing part of the future profits ‘forever’. One refinement that has emerged from pecking-order theory involves the use of friends, family and fools as first providers of venture capital as a company is starting up (Kumar and Rao, 2015).

The empirical literature tests pecking-order theory by means of databases with information from annual reports of corporates or medium-sized enterprises, in which public company data are available (Chittenden, Hall and Hutchinson, 1996; Frank and Goyal, 2003; Mina, Lahr and Hughes, 2013). Results based on analysis of this data support pecking-order theory. This theory is quite general and can be applied to small enterprises only to a very limited extent. For example, pecking-order theory focuses on three main categories—one’s own money, loans, and share capital—while around 40 different secondary forms of financing can now be distinguished (Rauwerda, Van Teeffelen and De Graaf, 2016).

Growth-cycle theory

It is unclear, both in practice and in theory, how the different forms of financing interact with each other, especially if something changes in a company’s development. In this respect, growth-cycle theory (Berger and Udell, 1998), offers a number of insights over and above those to be had from pecking-order theory. This theory states that there is a financial growth cycle in which the financial needs and the financing possibilities change as the company grows. The explanation given for these developments is that, as the company grows, more information, that is itself more transparent, becomes available. This means that 'younger' companies are more dependent on insider finance, supplier credit and/or financing from angels. This allows access to venture capital and medium-term loans, followed later on by listed equities and long-term debt. The company is more experienced, and the information has become more transparent. It should be noted that, in the Anglo-Saxon research world, the role of banks is smaller than in Europe (see Duffhues, 2006; ELI, 2011), where bank loans or credits predominate (Van der Veen, Van Teeffelen, Ibrahimovics and Lentz, 2015; and Moritz, Block and Heinz, 2016). Empirical research has led to support for important components of growth cycle theory in medium-sized and large enterprises (Gregory *et al*, 2005; Mac an Bhaird and Lucey, 2011; and Robb and Robinson, 2014).

SMEs and their advisers

In order to understand SME financing properly, there is a lack of insight into another important link, namely the adviser who helps entrepreneurs to make financing decisions. In the Netherlands, almost two-thirds of entrepreneurs use a financial adviser—usually an accountant (Van der Veen *et al*, 2015). What is striking is that the involvement of a financial adviser has no effect on the chances of success of getting financing (Van der Veen *et al,* 2015). The reasons for this are not clear. There is a knowledge gap around the role of an adviser in financing and of what added value they bring. This gap is also recognised in the literature on SME mergers and acquisitions (see Van Teeffelen, 2012; and Van Teeffelen, 2018).

Financial decisions and heuristics

There is a greater need to understand financing decisions (Fraser, Bhaumik and Wright, 2015; Mina et al., 2013). According to Fraser et al. (2015), two other aspects are important: how can financial products be combined, and what is the impact of one or another combination on the company's performance? In order to meet this need for SMEs, it is necessary to understand the financing decisions of financial advisers, because they are the only ones who can be seen as specialists in this field. We are currently lacking insights into what the decision-making process looks like.

In behavioural sciences, however, a lot of research has been done on decision-making processes in general. Recently, a lot of attention has been paid to the role of cognition and perceptions and how they influence behaviour—also known as behavioural finance. It is well known, for example, that new knowledge (cognition) can only be made serviceable if it is accompanied by a change in habits and is in line with socio-emotional needs (Cohen, 2007).

In order to investigate the interaction among knowledge, attitude and behaviour, a lot of attention has been paid in recent years to the role of heuristics, rules of thumb, or decision-making rules (see, *e.g.,* Kahnemann, 2000). Professionals use relatively simple maxims to determine what is and what is not possible in a certain situation. These maxims reduce a complex assessment to a simple rule.

The best-known heuristics are:

- Affect heuristics: people are swayed by something that feels good.
- Availability heuristics: people opt for 'obvious' choices.
- Confirmation heuristics; people are swayed by factors that seem to confirm their prejudices.

Simon (Koumakhov, 2009, 2014) states that heuristics form at an individual level, in close interaction with the environment (the institutional context). Within that context, the organization to which people are connected colours the heuristics in a unique way. This is often embodied in specific instruments, but also in policy and even in symbols and rituals. Heuristics are built on cognitive insights, emotional preferences, and habits (Cohen, 2007).

This means that each person makes their own decision-making rules, especially when they have to make decisions that do not come up that often. Everyone will follow automated processes such as driving a car in more or less the same way, but people buy cars in many different ways. The same applies to decisions taken by professionals such as financial advisers to SMEs. In a complex environment, professionals develop rules of thumb and behaviour that follows from them.

In this study, we will use a broad definition of heuristics, namely the *use* of 'concepts', 'artefacts' or 'forms of thinking' in the search process that is known as decision-making. Artefacts, abstractions but also stories that are of help in coming to decisions play a major role in decision-making. This often leads to concrete documents such as a contract or a management control system. This definition of 'heuristics' is broader than the one Simon (1965) used himself. He talks about heuristic approaches and heuristic models, by which he means formalised processes, such as in the field of operational research**.** We also differ from Kahnemann (see 2002, for instance), who in the 1970s, together with colleagues, narrowed the concept down to a number of psychological categorisations related to biases. They do not discuss the possibility that at the same time different stories and logics can be forged into a single outcome within social processes.

As Simon puts it, decision-making is determined by: (1) the role (outlook) of an individual decision-maker, views on (2) the organisation and (3) mental models reflected in sector standards and society, or institutional values (Koumakhov, 2009, 2014). These views converge in heuristics. So, depending on the role-based outlook someone has, they occupy a place in their environment—for example, in the world of SME advisers. This 'place' is coloured by the organisation for which he works. For example, an individual sees him/herself as an accountant (role) for companies in a region, and depending on which office they are in, they will place a certain business emphasis on this (see Table 1.).

Table 1: Simon's understanding of routines and conventions related to heuristics

Level of analysis	**Assumptions hidden in heuristics (habits)**	**Examples of heuristics**
adviser (decision-maker)	Role-based outlook	A certain (implicitly methodological) way in which individuals deal with, say, a product supplied by the professional group

Context	Mental model	An agreement—perhaps a policy agreement—in a professional group or sector, for instance: How do we, as advisers, relate their behaviour to regulations, if there are any?
Organisati on	Social and organisational identification	The business model of an adviser (in which the role-based views of individuals involved, and the institutional context, are incorporated)

Simon's 'routines' are linked to cognitive knowledge and emotions and, taken together, can constitute a heuristic. According to Cohen (2007), Simon was wrong to pull routines, cognition and emotions (hands, head and heart) apart from one another, and this has led to the idea that, given the right cognitive model—or the right knowledge—the emotions and the routines can be managed.

Simply put, this means that decision-makers are guided (1) by their own role-based view ("A good adviser does x and y"), (2) by what they think about a certain sector and about that sector in society and (3) by what their organisation's role is in it. A bank employee who does work similar to that done by an account manager at a leasing company may have the same role-based view and the same idea of a sector, but will still behave differently, simply because their organisation asks them to.

Propositions

To get insights into how financial advisers to SMEs make decisions, we will look into which decision-making rules they use in their advisory process. What are their views on financial products, on a given company, and on the advisory process? What can be traced back to economic or other knowledge (as this knowledge is reflected in economic theory)?

And how do these cognitive insights relate to their attitude to certain products? Can we identify certain preferences, or particular behaviour? One adviser can spend a lot of time on a good relationship with the client, while another focuses mainly on the right technical solution for them. And what is the role of tooling in this process? At the moment, a lot of attention is being paid to 'fintech', technical solutions that make financial services cheaper and faster. Will this new technology lead to a different advisory process?

Almost all of these are new and open questions that must therefore be examined qualitatively through interviews in which the advisers reflect on their working methods.

We see four areas that determine the daily behaviour of advisers. In their (1) daily activities they use (2) certain instruments, whereby, as people, they have (3) certain knowledge and skills and (4) a certain attitude. In order to systematically address all these themes (and then be able to analyse them systematically), an interview protocol has been drawn up (see Appendix 2). We assume in advance that advisers use a wide range of decision-making rules that can be linked to a specific organisation and context. We also look at the three well-known heuristics we mentioned earlier (affect, availability, and confirmation heuristics).

In order to link the results of our research to insights into decision-making, we have drawn up a number of propositions.

<u>Proposition 1 Advisers use maxims, rules of thumb or heuristics.</u>

If this proposition is correct, there are many views and preferences for certain financing instruments, and these cannot be traced back to knowledge that has been set out in scientific insights or otherwise has a clear economic logic. These may, for example, be insights that say something about an adviser's preferred form of financing, or a prejudice about a sector or about behaviour presumed to be required on the part of the adviser or the entrepreneur.

We also assume that financial advisers see themselves as officials with a specific role and a particular code of conduct to follow. This means that there is a certain agreement about the instruments that the advisers put forward to the entrepreneur. This brings us to proposition 2.

<u>Proposition 2 Opinions on financial instruments are divided</u>

Thus, we assume that there is a kind of communal opinion, a shared agreement on what 1. knowledge and skills, 2. what attitude, 3. what activities and 4. what tooling are needed for the various financing instruments such as bank credit and crowdfunding.

In a free market, advisers should disagree on their preferences for one or another form of financing. After all, organisations differ in their working methods, and each company differs from colleagues and competitors. Here we expect differences in the subfields, because otherwise every adviser would be exactly the same. By positioning the proposition in this way, we gain insights into where the differences lie, and in which areas advisers distinguish themselves. We assume that the organisation they work for has a certain influence. And this brings us to proposition 3.

<u>Proposition 3 The opinions of advisers on financing instruments are influenced by the organisation they work for.</u>

In addition to the instruments themselves, the method of working can also differ, and is related to attitude, activities and tooling. This brings us to proposition 4.

<u>Proposition 4 The opinions of advisers on the right way of working or the right process are influenced by the organisation they work for.</u>

Propositions 3 and 4 can make it clear whether it is mainly the working method that advisers use that distinguishes organisations from one another, or whether advisers also have completely different 'knowledge' to offer. Within the dominant economic theory, all financial instruments should have the same function (Ansari *et al,* 2010) and mode of application. This means that advisers who have the same level of knowledge can differ (and thus compete) only based on the working methods they use. Analysing the data with these propositions can make it clear whether this assumption is correct.

METHODOLOGY

This is an exploratory study in which we work with abduction, combining inductive and deductive approaches. Financial-economic decisions are described as openly as possible and, to the extent possible, irrespective of theoretical assumptions. An interview protocol has been used for this (see Appendix 1). We then analysed the results on the basis of a number of propositions. We describe this process in detail below.

Through our analysis, we want to gain insights into what the decision-making process of advisers looks like, and we thus make use of the concept of heuristics. It is not possible to inquire directly about habits and routines, because people are usually only slightly aware of this. In addition, we do not know what the decision-making process for financing decisions will be (Fraser, Bhaumik and Wright, 2015; and Mina et al. 2013). Therefore, we cannot indicate in advance what these habits might be. In addition, the research into heuristics was done mainly in an experimental setting in which a well-defined group was asked to answer a clearly defined question, and in which little research on heuristics was done in practice (Loock & Hinnen, 2015).

In order to get a clear picture of habits, we have made a distinction between considerations that attest to a step-by-step process through the use of economic information such as solvency, and behaviour that is guided by habits and preferences.

In order to trace these considerations, habits and choices, a strict interview protocol has been drawn up with open, neutral questions. The researchers used this interview protocol to conduct the interviews, and also followed the sequence of topics and questions.

In order to get insights into the knowledge and skills of financial advisers to SMEs, we followed a number of steps that are common in qualitative analysis (Patton, 2002; Hsie and Shannon, 2005). In the construction and codification that we use, we follow a number of phases. In five iterations, codes have been designed. They have then been converted into concepts, which have been grouped into categories to finally be aligned with Simon's theory on heuristics (1965). There had to be agreement at all times between all the researchers involved.

1. Group interviews: In three group interviews, we talked to groups of 12 to 35 advisers about their work. Advisers in financial companies—that is, those that sell financial products themselves; advisers who, among other things, give advice on financing, and those who advise exclusively on financing.
2. Based on this, an initial description of the advisers' working method followed. This showed an important difference among these groups. In order to arrive at an unequivocal group with a similar decision-making process focused on financing, it was decided to focus only on advisers who mainly provide financial advice without

being part of a company that itself provides financing. This led to 15 interviews with financial advisers to SMEs. These were independent advisers as well as advisers who had joined small as well as large consultancies.

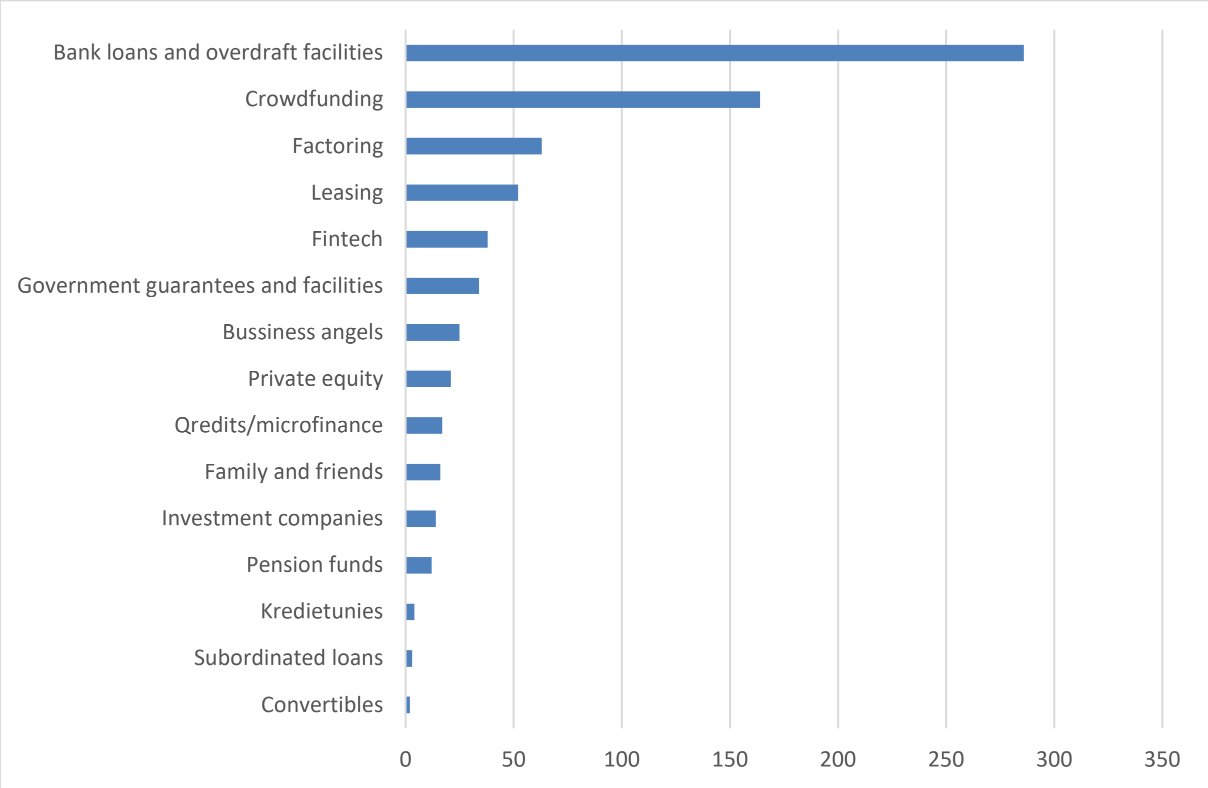
3. There were three brainstorming sessions, each with five researchers, of which one session was with representatives of three independent financial consultancy firms, to settle in advance on the cluster of funding topics. The choice was made for these four clusters: 1. the financing objective, 2. financiers and financing possibilities, 3. the risks associated with financing and 4. the process (moving from financing needs through advice to the application for financing, and acceptance by the financier).
4. Based on this, an initial step-by-step plan and interview protocol have been developed on what the decision-making process an adviser uses might look like.
5. The step-by-step plan and the interview protocol were discussed by the researchers who conducted the interviews. This led to a definitive protocol. Four themes were discussed with the advisers, namely (1) knowledge and skills, (2) attitude, (3) activities and (4) tooling. The interview protocol can be found in Appendix 2.
6. Interviews were conducted by five researchers from Utrecht University of Applied Sciences (Hogeschool van Utrecht) and Amsterdam University of Applied Sciences (Hogeschool van Amsterdam). At the same time, students from Rotterdam University of Applied Sciences (Hogeschool van Rotterdam) also conducted interviews.
7. The interviews have been transcribed. In the end, 15 of the researchers' interviews were used, and 4 of those done by the student groups from Rotterdam University of Applied Sciences. The interviews are comparable, in the sense that all questions from the protocol were systematically gone through, and follow-up questions were asked in cases where the answers were not clear.
8. The researchers settled on the codification for the qualitative analysis on the basis of the four themes that were settled on during the brainstorming sessions in step 2, namely the financing objective, the financiers, the risks involved, and the process. These themes were also settled on as group codes in Atlas TI. In addition, three codes were defined with regard to heuristics: affect, availability and confirmation.

9. The analysis is being carried out using the Atlas TI software programme, in which the group codes are further elaborated on through the use of a list of codes. The researchers first analysed three transcripts. Of these, 75 codes were defined around the four themes: the financing objective, the financiers, the risks involved, and the process. The cross-comparison left 62 codes with unambiguous definitions. After this step, the remaining 16 transcripts were analysed. Based on this coding, a code-co-occurrence analysis was carried out, in which those connections that occurred frequently were further analysed.
10. The results of this analysis were then related to the propositions. With the help of code-co-occurrence analysis, we investigated whether the different propositions could be confirmed or rejected.

Analysis and results

In the interviews with financial advisers, financing by banks was the form that was mentioned far and away the most frequently (286 times) (see Figure 1). There is a strong preference for this method of financing as a starting option. Then there are loans and revolving-credit facilities. In addition to bank financing, factoring (63) and leasing (52) are also frequently mentioned by financial advisers. Crowdfunding is frequently mentioned as a fourth form of financing (164 times), but often as a point of discussion and not as the most popular form of financing. During the interviews, a lot of opinions about crowdfunding came up. This is a point of difference from financing by banks, and from leasing and factoring, which are actually chosen frequently by SMEs and their advisers. All other forms of financing, such as microcredits (17) and Funding from Friends, Family and Fools (16), get nary a mention.

Figure 1: The number of times that financiers/financing opportunities were mentioned during interviews



*In this context, *banks* refers to both bank loans and revolving-credit facilities.

Category 1. Banks predominated in interviews

> *'Look, step 1 is almost always the bank, for reasons such as just neat pricing, good, et cetera.'*
>
> *'Well it always starts at the regular bank funding; loan, credit. I think about leasing, I think about debtor financing, factoring ...'*
>
> *'As an adviser, you need to explain more fully to older SME clients in particular that there are also forms of financing that can serve as alternatives to financing by banks.'*
>
> *'Former bank advisers have short lines of communication with the bank and consider financing by banks first.'*

Banks are also by far the largest providers of loan capital to Dutch SMEs, of which EUR 126 billion is outstanding with three big banks (Treur, 2018). Factoring and leasing are also widely used in practice and are offered by both banks and non-banks. The volume of these two forms of financing that is outstanding was more than 11 billion in 2017 (Treur, 2018). The current situation is still very similar to that which obtained in 2008. The only difference from 2008 is that the share of non-banking forms of finance is growing significantly, with an estimated €1 billion of alternative financing provided to SMEs through the end of 2017 (Treur, 2018); but it remains a niche market in view of the outstanding volume.

Given the dominance of banks as a topic in the interviews, it is interesting to look at the topics under which banks are often mentioned. Bank financing is mentioned with particular frequency in combination with crowdfunding (56 times), with the information to be provided by the entrepreneur (40 times), and with costs (38 times).

Banks and crowdfunding

Crowdfunding can be used as an alternative form of financing if banks are unwilling to offer financing, or extra financing, to a company. Crowdfunding is often seen as a working-capital loan and fits in well in a consumer market because of the marketing tool it also uses, in the form of a crowdfunding campaign. Banks nowadays usually find working-capital financing unattractive. According to some advisers, the current account with a permanent limit used to be the standard solution for working capital, but nowadays such accounts are provided hardly at all, not at all, or under very strict conditions. Working capital can be financed by crowdfunding according to one third of the advisers interviewed. Only one adviser believes that this is not possible, because crowdfunding is less flexible than bank financing.

Sometimes banks also want to join a campaign if they see that an entrepreneur is successful in obtaining working capital financing by means of crowdfunding. They see the success of a campaign as approval of the company's business plan. This gives the bank more security. Crowdfunding, together with bank financing, is not only often mentioned together, but in practice actually occurs in combination, according to the interviewees. Banks that are not interested at first sometimes suggest crowdfunding for part of the financing requirement in order to determine how enthusiastic the market is. They will then see this as confirmation of a low risk and will be prepared to meet part of the financing requirements. In fact, in this way banks would be allowing the credit assessment to be carried out by the crowdfunding market. However, banks are strict with regard to the repayment obligations of entrepreneurs on crowdfunding loans, and sometimes set certain requirements regarding the repayment obligations.

In addition, a number of banks are in the process of setting up partnerships with crowdfunding parties. Most of the interviewees are not very enthusiastic about this. They have the impression that banks are doing this mainly for show, and that, in reality, not a whole lot is going on here.

Category 2. Crowdfunding

‘What you see more and more nowadays, the bank that wants to remain involved, so the bank does a part. For example with crowdfunding, you see more collaborations of banks with crowdfunding platforms, for example.’

‘Well, what you see more and more of nowadays is the bank that wants to stay involved anyway, so that the bank does some part of it. For example, with crowdfunding, you see more collaborations between banks and crowdfunding platforms. So that in itself is a relatively obvious combination. On the one hand, I welcome this, but on the other, I do not always agree with the way this is done in terms of certainties and that sort of thing.’

‘Crowdfunding is suitable only for Business to Consumer companies, and if as an entrepreneur you want to be caught with your pants down.’

‘Entrepreneurs do see crowdfunding as something 'new and unknown’.’

‘Entrepreneurs need to be convinced.’

‘Some SME advisers have a good feel for crowdfunding, while others see it as an expensive and time-consuming alternative.

Banks and information

The interviewee often spoke about banks and their information requirements. This is an element of the advisory process that takes a lot of time. An SME often finds it difficult to provide all the necessary information and to substantiate all of its plans and forecasts. The financial adviser plays a major role in this part of the process. In general, banks and crowdfunding platforms request the same information from SMEs. However, a crowdfunding platform is often more flexible in brainstorming about how to substantiate the turnover, for instance. The interviewee felt that banks did look rather a lot in the rear-view mirror.

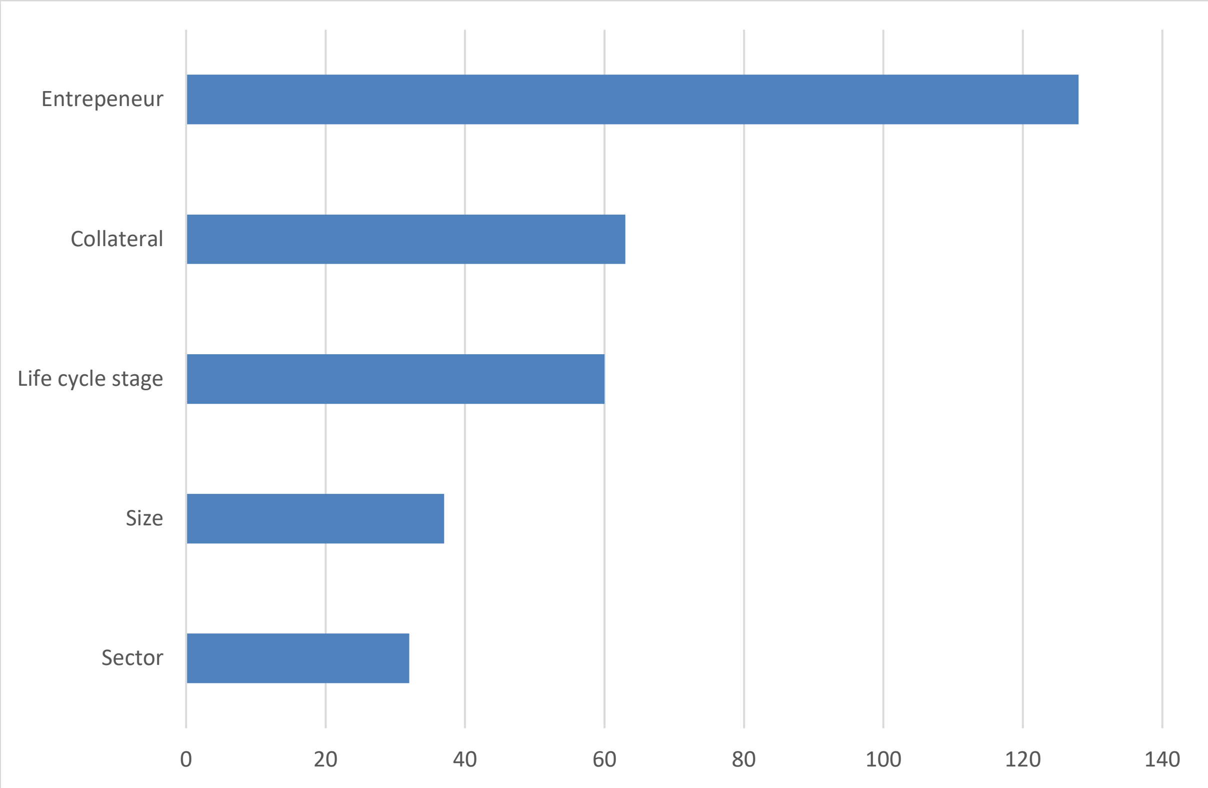
Especially in the case of smaller SMEs and smaller financing requirements, banks often look only at the historical information on a company. They also often want to be supplied in a standard (digital) format, in which hardly any forecasts can be included. This type of development significantly reduces the chances of success for smaller loan applications. Some banks also want information to be placed in a portal when applying for financing—information that then comes up directly in their systems. Financial advisers see this as a cost-cutting measure in which work is delegated to the client. If the client does not enter this information into the portal, the bank charges a handling fee.

> *"If you say, 'I want to have tons of credit with the bank', then yes, that's absolutely the standard approach."*
>
> *"...What's more, even for our intermediaries it becomes difficult to find a one-stop shop... But that's not nice if you, as an entrepreneur with a nice business, you're doing a good job, and the door keeps getting slammed in your face like that."*
>
> *"Sorry, but I just can't do anything for you here--you'll have to call our call centre for credit requests lower than 250,000."*

Information and entrepreneur

It is not only the combination of banks and information that was mentioned frequently. Information and entrepreneurs were also mentioned very frequently in combination (52 times). For all financiers, not only information about the company, but also about the entrepreneur themselves, is of vital importance.

Figure 2: The number of times the risks associated with financing are mentioned during interviews



According to advisers, the level of knowledge that entrepreneurs in SMEs have varies considerably. One entrepreneur doesn't have the first clue—often the smaller entrepreneurs—while another can arrange everything themselves without the help of an adviser. There are also entrepreneurs who are curious and who get actively involved in new developments, while others do not understand them very much and do not really want to learn about them in any detail. In addition, some entrepreneurs wonder whether parties they do not know are in fact reliable.

For an adviser to SMEs, it is important to discuss in an open discussion during the orientation phase of the advisory process, what an entrepreneur's expectations and objectives are, and what the company's situation is, what kind of product and market the entrepreneur is active in, and generally what is needed. It is not crucial that the adviser have the best financing

> *"Make sure that the funding and the financiers are a good fit for the entrepreneur."*
>
> *"...[F]or all parties--this applies to micro, small and medium-sized enterprises--for all parties, it is true that they want the best overview. So the preference is to do business with as few different parties as possible and preferably with parties where continuity is on the cards."*
>
> *"Take CrowdAboutNow, for instance. That requires a huge effort on the part of the entrepreneur themselves, because they have to grab the bull by the horns and get their network all fired up, and that's certainly not something that every entrepreneur can pull off that easily." So sometimes you think it might suit you, but then the entrepreneur sees that they themselves are not at all interested in doing things that way. And I've had entrepreneurs where I thought, well that'll be a perfect fit for you, the whole crowdfunding thing, but then it turned out later that, "Well, we're actually after a quick form of financing and we don't want to have to put too much effort put into getting it."*

solution. It *is* crucial that the entrepreneur be able to choose the financing solution that best suits them. The adviser can advise the client, but it is the client who ultimately decides what they want.

Advisers to SMEs indicate that it is important that they know what type of entrepreneur they are dealing with, as well as what kind of motivation, vision and mission, but then also what their needs and preferences are. One entrepreneur cannot stand banks, while another's just the opposite. According to advisers to SMEs, some entrepreneurs, often the older ones, find it difficult to publish their data and forecasts on crowdfunding platforms. They think this is sensitive information from the competition standpoint. In addition, a crowdfunding campaign often costs a lot of time, energy and money that an entrepreneur must be willing to spend.

For a financier, it is important to know an entrepreneur's age, education and experience, and whether they already have a strong track record or are just starting out. Any experience as an employee is fundamentally different from being in business for oneself. In addition to information about clients and competitors, lenders also want to know how an entrepreneur has built up their new or existing business, and what they have done to that end—or perhaps they have been a bit passive. Some advisers also take their clients to the financier so they themselves can tell them all about their company and show their enthusiasm. Advisers want to show that entrepreneurs with SMEs have a good understanding of how business works, and that they know what they are talking about. These aspects of the entrepreneur are reflected in both a financier's attitude and how much the financing they offer costs.

Entrepreneurs often know what they are strong in, but they are often not focused on their weaknesses. To be successful, an application for financing should be able to show both an entrepreneur's strength, but also how they can come to grips with their company's weak spots. One adviser said this is also an important reason why some entrepreneurs are unable to get financing: when it comes to their business, they do not have all their ducks lined up in a row. This adviser also said it is always possible to get a loan if you, as an entrepreneur, can offer an exit option and a good rate of return to a financier, whether the financier is a bank, a private-equity entity, or some other investor. Requests for financing that demonstrate too little pragmatism and betray too much opportunism on the part of an entrepreneur have no chance of succeeding.

Banks and costs

Banks have the advantage of being able to offer a low interest rate and high volume to the market. This gives them a huge amount of power when it comes to financing SMEs. An entrepreneur and their adviser will always look to a bank for financing in the first instance. This is the most inexpensive way of securing funding. That is generally the perception of the market. And the interviews show that in most cases the bank is the cheapest option. If financing by a bank is possible, this is also recommended by financial advisers.

Nevertheless, it still happens that a bank charges relatively high rates for a bank loan (from 9 to 12%), and that means that other forms of financing, such as crowdfunding, are hardly possible, if at all. The costs a bank charges cannot be separated from a lack of flexibility on the bank's part, or from the speed with an entrepreneur wants their application to be processed.

Category 3. Costs as the most important factor to consider

> *'Factoring ... ..That is expensive, that is an expensive form, but you do get cash immediately, you immediately get liquidity.'*
>
> *'Banks are inexpensive and fast compared to the other possibilities.'*
>
> *'Factoring is a rather expensive form of financing.'*
>
> *'Financing by banks seems cheap, but as the risks increase, the rate increases and comes close to the other forms.'*

Banks and leasing

Leasing is reasonably straightforward and suitable for the co-financing of investments in machinery and transport. An adviser spends relatively little time on a lease application. Leasing is also easy to combine with bank financing. It is one of the first options advisers will mention (along with banking, crowdfunding and factoring) when it comes to the well-known financing products. Leasing is also offered by the banks themselves.

Banks and life stage

Banks are keen to offer financing where the business model, and the entrepreneur, have a demonstrable track record. They are looking for predictability and a pattern of recurring turnover.

So they are much more cautious with start-ups. Only start-ups with that special something can expect to be financed 100% by a bank. Start-ups are often better off with crowdfunding, private equity/venture capital, possibly leasing in the case of machines, and Family, Friends, and Fools. The proportion of bank financing increases with the maturity of the company.

‘Starters are often better off with a crowdfunding platform than with a bank, but if it is a starter with a silver lining' then you can use also a bank deposit.’

‘Banks and starters that is not really the logical combination anymore.’

‘I often use factoring, especially for high-growth businesses.’

‘When it comes to entrepreneurs who have a very flexible demand for working capital, I will soon look at debtor financing, because that changes with the growth or shrinkage that takes place.’

Banks and criteria

Banks and the criteria they set for an SME client were mentioned 22 times by the advisers to SMEs who were interviewed. What is striking is that most people say that the criteria that an SME has to meet in order to obtain bank financing are constantly changing.

"A credit analyst like that at the bank spends the whole day looking at applications behind closed doors. Does this guy ever get out and about?”

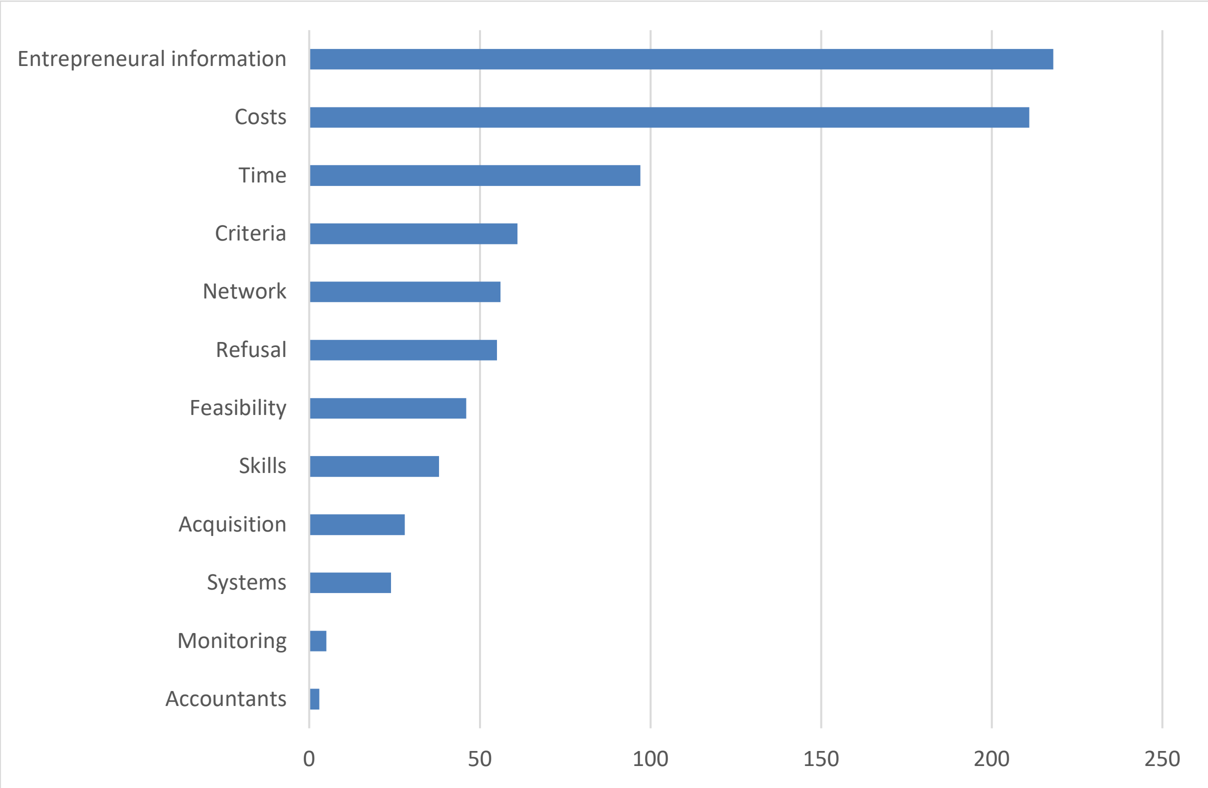
‘Refinancing is often difficult, because the big banks have agreed with each other, we do not solve each other's problems. So if you have a problem with one bank you won’t get a foot in the door at another bank.'

This is one of the most difficult things to keep up with for an adviser. Some organisations keep a central record of it for their advisers. The policy of banks in this respect is determined from the top down, and the contact persons with whom financial advisers communicate must also keep to this mandate. It may be that one bank wants to finance a sector one week, and no longer the next week. There are also major differences among banks. According to the advisers, this has everything to do with Basel, solvency requirements and the perception of risks. Banks are constantly aware of the solvency requirements of their loan portfolios. For this reason, advisers say, banks have also become stricter in their lending standards. Previously, for example, a bank would say that if a company had sufficient capital within three years, it would be willing to finance it. Banks are now saying that there must be sufficient capital at the outset.

Costs and time

The costs of advice (mentioned 211 times) and time (mentioned 97 times) are dominant aspects in the financing process. Only the information requested of the entrepreneur was mentioned more frequently (218 times). See Figure 3.

Figure 3: The number of times the elements of the advice process were mentioned during interviews



Time and costs are mentioned by the interviewee 37 times in combination. These are important considerations for the process, because the more hours an adviser must charge, the higher the costs of the advice will be. It is clear from the interviews that financial advice from an adviser to an SME is usually too expensive, especially for start-ups and sole proprietors who want to expand or need some extra financial latitude. In that case, the amount of financing needed cannot justify the costs of the advice. In addition, there is a group of SMEs that can pay a little for financial advice, but not too much. There is a group of financial advisers who can provide this in a short time with a kind of hit-and-run approach: The adviser helps the entrepreneur just once with the financing requirement, and the adviser and the entrepreneur then part ways. SMEs with a little more room for manoeuvre can afford more-extensive financial advice. There is also a group of advisers who focus on these. These advisers also take the financial structure of the company into account in their analysis, and also look towards the future financial picture: forms of financing that are opted for now will also have an impact on flexibility and the range of options in the future.

There seems. on this score, to be a kind of dichotomy in the market for financial advice. On the one hand, there is a group of advisers who focus on smaller SMEs and who use a hit-and-run approach to keep the hours they put in and the costs they incur to a minimum. On the other hand, there is a group of advisers who have a longer-term relationship with SMEs and who can assist them more extensively with advice, not only on their current financing needs, but also on the financial structure and the future of the company in question. The latter, of course, costs more of the adviser's time, and results in a steeper bill.

Rational consideration and heuristics

When analysing the codification with regard to unconscious habits (heuristics) and to their counterpart, a conscious consideration based on rational economic arguments, it is striking that the number of times interviewees refer to a rational consideration (45) is much greater than the number of times they actually make statements that can be traced back to one of the three accepted socio-psychological heuristics affect (14), availability (14) and confirmation (27). See Figure 4.

'I try to regard every question about financing as tailor-made, and to see what can help that entrepreneur both right now and in the longer term.'

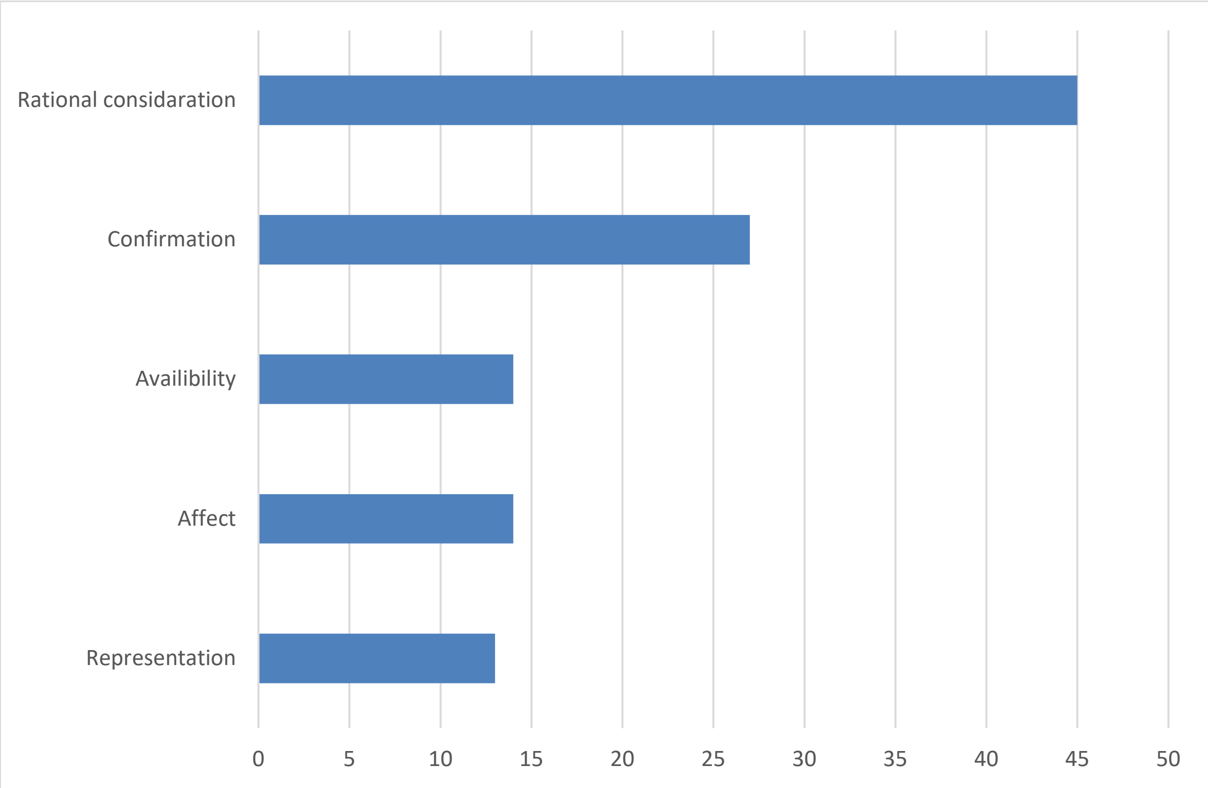
'Stacked financing is particularly interesting for growing companies.'

'Network, that is what it is all about in this world.'

'We network ourselves like crazy.'

This gives financial advisers the impression that they are always carefully considering the dozens of existing forms of financing. From the analysis of the codified forms of financing, however, it appears that the advisers are talking primarily about bank loans, revolving credit from a bank, and leasing and factoring, whether from a bank or other entity, as the most frequently chosen form. Other forms of financing are sometimes mentioned, but they come up much less frequently in advisers' repertoires.

Figure 4: The number of times heuristics and rational considerations are mentioned



Discussion

Financial advisers to SMEs seem to take a rather similar approach. They have a rather similar idea of what their role is, and of what clients and others expect of them. However, a distinction can be made between organisations. There is the hit-and-run way of working—quick advice on financing with relatively few hours spent giving advice. And there are organisations that provide financial advice, looking at the longer term, too, and that build up a relationship with the entrepreneur. More hours are spent giving advice—and thus higher costs are incurred—than in a hit-and-run way of working.

The concept of heuristics is quite difficult to put into operation. The well-known heuristics are sometimes discussed. It was stated a number of times that something must feel good (affect heuristics). Interviewees also seem to opt for the obvious in a number of places (availability heuristics) and would like to see their prejudices confirmed (confirmation heuristics).

In short, if we extend the concept of heuristics to habits and conventions, these are certainly present in the market. While this study is expressly not about banks, but about the use of different forms of financing, banks keep coming to the fore. The empirical part focused emphatically on how advisers work and how they deal with various financing instruments. We can conclude that banking products always get the first look, and that, if that does not work, the search continues. The results also suggest that what is key to SME advisers is not arriving at the optimal financing solution, but keeping their clients satisfied.

This has a number of consequences for the propositions. With regard to Proposition 1 (Advisers have rules), it appears that: Financial advisers have personal preferences based on their experiences and their network. Based on this, over time they have developed certain habits and a particular approach to financing issues. The preferences, the habits and the approach to applications for financing vary from one financial adviser to the next and are more practically focused than inspired by theory.

As far as Proposition 2 is concerned (Views are divided), it appears that different financial advisers have different views on financing tools. This is particularly the case with financing by banks. The proposition is confirmed in the case of bank loans.

On the basis of the personal experiences of financial advisers, there are in fact many conflicting views on non-bank financing. This applies, for example, to crowdfunding and factoring. One SME adviser will see it as an attractive financing instrument, while another will have reservations about the costs and the risks involved, and the chances of success. The proposition does not hold for non-bank loans.

As for Proposition 3 (It is organisations that shape insights into instruments), it is not possible to substantiate it based on the results of the present study. Advisors are not influenced by the organisation for which they work when it comes to the forms of financing to be chosen. Mutual knowledge of financial instruments and possibilities is deliberately shared and made available, and applications for funding are discussed and advice sought from colleagues. Alternatively, a two-eye principle is used. This applies to every consultant.

However, some substantiation can be found for Proposition 4 (Organisations determine the way of working). Advisers are clearly influenced by the organisation for which they work. An organisation's business model largely determines the approach that the financial advisers working there take. One organisation is focused on hit and run and can deal with a single financing request quickly and relatively cheaply. Other organisations are more focused on long-term relationships and the analysis of the financial structure of an SME and how it is organised. This is generally associated with more time and steeper costs. There seems, on this score, to be a kind of dichotomy in the market for financial advice for SMEs. The first market sector attracts smaller SMEs with smaller applications for financing and not such deep pockets. The second attracts somewhat larger and more mature SMEs, which can also use more comprehensive advice on their financial structure.

There are also a number of other points that stand out. It turns out that a financial adviser's network is very important to the work they do. It seems that this, rather than other considerations, often determines their decision. New suppliers and new technology (fintech) do not seem to be changing this situation—or to be doing so directly—even though the supply has grown, and the use of new forms of financing has been simplified by new technology. Still, new possibilities seem to be simply being missed. Advisers find it difficult to get off the beaten track. Ignorance of the products, a lack of time to study the instruments, and mistrust on the part of their clients—these are some of the reasons that may explain this.

The time aspect is perhaps the most prominent here. The financial adviser must come to a good decision in a limited period of time. This can often get in the way of an optimal choice of financing options, because the adviser can consider only a limited number of options. At such a moment, the adviser often seems to have made a well-considered choice to go down the beaten track. They can spend only a limited number of hours on any given case, in which the business case and all financial data must be properly substantiated.

Concluding remarks

Our analysis shows that there are several economically rational solutions. An economically sound solution for the SME adviser—from which they derive their income, and which satisfies their client—does not have to be the financially best solution for the client. Sometimes speed is more important (an entrepreneur may need funds quickly because, for example, the continuity of their business is at risk), and sometimes the adviser is able to spend only a very few hours on a recommendation, with the result that they cannot find the most inexpensive solution. These are all reasonable, logical economic reasons. Apparently, economic rationality depends on the context in which people live. Here Simon (1965) speaks of 'satisficing'. Economic actors do not seek the best rational solution but look for a solution that satisfies them in any event, simply because they cannot be aware of all the possibilities.

In addition, our analysis suggests that pecking-order theory is not followed by financial advisers. Financing by banks is so dominant that the freeing up of internal capital within the company, for example through leasing and factoring, is used much less often. Even the addition to pecking-order theory of Rao and Kumar's Family, Friends and Fools (2015) as a first step in financing gets nary a mention.

It seems that this process of satisficing in the financial advice given to SMEs is really important, simply because it is very difficult to understand all the possibilities and to weigh them all up *in toto*. The hours are limited, the client needs to know, and their satisfaction is more important than optimal financing. How these considerations affect each other will require further study.

We note that in the way independent advisers behave, the logic of the bank loan prevails, even in cases where other options are more appropriate, such as in securing working capital. There are many opinions about different forms of financing, but no adviser seems to have sufficient knowledge of all forms of financing to be able to solve the financing puzzle.

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Appendix 2.

INTERVIEW PROTOCOL FOR HYBRID FINANCING

Questions to about 25 advisers, some from the consortium (who visited everyone), and some from outside it:

Amsterdam, September 2017

During this interview we want to discuss four subjects (knowledge and skills, attitude, activities and tooling) in addition to the general characteristics:

GENERAL CHARACTERISTICS

1. - Type of adviser: what role does advice play, type of clients (which sector(s)) What type of business is your company in?
- o Accountancy firm
- o Consultancy
- o Alternative financier
- o Bank
- o Other (please specify):

2. In what year was your company founded?
____

3. How many people employed (the average for 2016) in full-time units (FTEs) in your company ________________ FTSs? How many of them are financial advisers?

4. How many regular customers does your company have?

5. How many one-time customers does your company have per year?

6. What role does the offering of advice play in your company?
- How many of your clients do you advise on financing?
- Are these one-off or annual recommendations?

7. How many hours does your company spend on average on a client's financing request?
- Do you work on the basis of
  - ➢ a fixed fee (subscription)?
  - ➢ a declaration of hours?
  - ➢ a commission?
- To whom do you charge the fee?
  - ➢ Client
  - ➢ Financiers/providers (commission)
- What is the success rate of the applications?
- When do you stop the process?

8. Which sector accounts for the majority of your company's turnover?

- o Retail
- o Wholesale
- o Construction
- o Transport and/or storage
- o Hospitality industry
- o Media (TV, radio), publishing
- o IT services
- o Financial or insurance services
- o Art and culture
- o Real estate, and rental of goods or leasing
- o Auditors or legal services
- o Agriculture, forestry, fisheries
- o Production of goods
- o Electricity, gas, air conditioning
- o Water or waste management
- o Education
- o Healthcare and social work
- o Recreation (sports and entertainment)
- o Other (please specify):

Assumption: In this study, the following definition of hybrid financing is used:

Hybrid financing is a mix of forms of financing that may include equity, debt in the form of both bank financing, and alternative forms of financing.

TOPIC 1. KNOWLEDGE AND SKILLS (products, company and process)

Products	Process	Client
A1) **Which financing products do you know about in the field of hybrid financing?**	**B1)** **What skills do you think a financial advisor needs in order to arrange hybrid financing?** • Analytical skills • Business-economics skills • Networking Skills • Communication skills • Credit management	**C1)** **Which customer data do you think are necessary in order to arrive at a financial recommendation?**
A2) **What knowledge do you lack in the area of hybrid financing?** 9. Zooming in on products that have been identified 10. Zooming in on products that have not been identified	**B2)** **What knowledge do you lack in the area of hybrid financing?** • Analytical skills • Business-economics skills • Networking Skills • Communication skills • Credit management	**C2** **How do you collect the client's data?** • Entrepreneur • Accountant • Other
A3) How do you ensure that you acquire new knowledge and keep abreast of new developments?	**B3)** **In what ways do clients or prospects come to you for financial advice?** • One-off recommendation • Subscription/annual/structural	**C3)** **What information is required for an actual application or applications for financing?** • The difference between a recommendation and an application
		C4) **What information about the entrepreneur/company is also relevant in the case of hybrid financing?**

		C5) question depending on the answer to question 1 (on general characteristics) **Do you also provide annual guidance regarding the annual figures of your clients?**
		C7) **Does the life stage play a role in the make-up of the financing? If so, what forms of financing do you consider appropriate for** **a. A start-up** **b. A growing company** **c. A mature company**

TOPIC 2. ATTITUDE

Adviser	Market	SME entrepreneur
D1) **What do you think about hybrid financing?** **Do you see it as** **a. a necessity** **b. an opportunity** **c. a complex application** **d. something else?**	**E1)** **What is the position in the market of the independent adviser with regard to hybrid financing, and how is this determined?** **Is the attitude** **a. active** **b. cautious** **c. something else?** **Does the attitude differ by adviser? If so, how?**	**F1)** **What is the position in the market of the SME entrepreneur with regard to hybrid financing, and how is this determined?** **What is the attitude among** **a. micro (<10 employees, <2 million);** **b. small (<10-50 employees, <10 million);** **c. mid-sized (<50-250 employees, <10-50 million);** **Does the attitude differ by sector? If so, how?**
D2) **Do you have preferred products and/or combinations?** **As for the financing requirement:** **a. 50K;** **b. 150K;** **c. 500K?** **As for the financing objective:** **a. Working capital;** **b. Refinancing;** **c. Growth financing?**	**E2)** **Are there certain products and/or combinations that are preferred in the market for advice on financing?**	**F2)** **Do SMEs specifically ask for certain financing products?** **Make a distinction here according to the size, sector and purpose of the financing.**
D3) **To what extent are you influenced by other people when putting together a recommendation?** **a. Colleagues;** **b. Competitors;** **c. Clients;** **d. Others?**	**E3)** **Are these products and/or combinations (E2) in the interest of the client, or do other motives play a role?**	

TOPIC 3. ACTIVITIES

Adviser	Market	Financiers
G1) What steps do you take when offering financial advice?	H1) What steps are generally taken when financial advice is offered? Do these differ from the approach you take?	I1) To what extent are you familiar with the different conditions offered by financiers? • Think of collateral • SBR • Financial ratios • Client characteristics
G2) What are the three main differences between a single-source and a hybrid financing recommendation?	H2) What does the average SME think is a reasonable rate for financial advice (financing of no more than 150K)?	I2) Do the requirements once hybrid financing becomes an option differ from those for single-source financial advice?
G3) What will you charge for a financial recommendation (for financing of no more than 150K)? • < E500,- • E500 - 1,000 • E1,000 - 1,500 • E1,500 - 2,000 • > 2,000	H3) What does the average SME think is a reasonable rate for financial advice (for financing of no more than 150K)?	I3) Why do you ultimately choose a particular financier? • Conditions • Relationship with the bank • Commission • Processing speed • Approval
G4) What will you charge for a recommendation on hybrid financing (for financing of no more than 150K)? • < E500,- • E500 - 1,000 • E1,000 - 1,500 • E1,500 - 2,000 • > 2,000		
G5) How many hours do you have to spend on a financial recommendation? • 5 hours • 5 - 10 hours • 10 - 15 hours		

15 - 20 hours **> 20 hours**		
G6) **How many hours do you have to spend on a recommendation for hybrid financing?** **5 hours** **5 - 10 hours** **10 - 15 hours** **15 - 20 hours** **> 20 hours**		

TOPIC 4. TOOLING

Adviser	**Market**	**Financiers**
J1) **Which ICT systems do you use for financial advice in the area of reporting and analysis?**	**K1)** **To what extent are these systems that are used for financial advice compatible with each other?** **The CRM, reporting, analysis, and application systems can communicate with each other**	**L1)** **Do you use a digital application system run by the providers?** **By means of a portal/platform (fintech)** **Why or why not?**
J2) **Which CRM systems do you use?**		**L2)** **Are these application portals also suitable for applying for hybrid funding?**
J3) **Which ICT systems do you use for financial analysis (*e.g.,* Finan)?**		
J4) **Which ICT systems do you use when applying for funding?**		

J5) **Which other ICT systems do you use in your work?**		