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## ABSTRACT

We investigate the relationship between community belongingness and small business banking in Scotland, focusing on Scottish Islands, specifically, Shetland, Orkney and the Outer Hebrides. These islands provide a unique case study as they form the majority of British Isles, not counting Crown Dependencies and British Overseas Territories. Within Scotland, these are also the localities with the strongest sense of community. Our analysis is based on quantitative methods and uses detailed survey data for small businesses across Scotland, for the period 2016–2019. Our findings show that Scottish islands are positioned at the top, or near it, in the share of small businesses describing a strong working relationship with their main bank. The positive relationship between community belongingness and businesses' attitude towards their banks also holds more broadly, across Scotland. These findings seem to indicate the continuing relevance of soft information, or else tacit knowledge, in small business banking.

## KEYWORDS

Community belongingness; small business banking; soft information; Shetland; Orkney; Outer Hebrides

**JEL** G20; R11; G21; G41; O10; R51

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## 1. INTRODUCTION

We investigate the relationship between community belongingness and small business banking in Scotland, focusing on small Scottish Islands. We ask, specifically, whether community belongingness impacts small businesses' attitude towards the banks that serve them. Our guiding theoretical consideration is that community belongingness is likely to enable the production and use of soft information, or else tacit knowledge, in day-to-day interactions of small businesses with their banks.

The focus on small islands is a novel contribution of the paper. Focusing on small islands goes beyond the conventional urban–periphery divide, by explicitly treating the periphery as a heterogeneous area, considering small islands as areas with distinctive socio-economic characteristics. Notably, although previous literature on small islands has discussed belongingness and economic relations in these areas (e.g., Armstrong et al., 2014; Gibbons, 2010; McCall, 1994) we are aware of no study to combine islandness with banking. For Scottish Islands, the 'nearest' result in Web

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of Science, when running a combined literature search with names of Scottish Islands and the keywords 'bank' or 'banking', is a geology paper on Blackstones Bank, a submarine complex near the Isle of Mull (Dickin & Durant, 2002).

We focus on three groups of Scottish Islands, Shetland, Orkney and the Outer Hebrides. These islands provide a unique case study, considering their remoteness, not just from the British mainland, but also from Europe, in combination with the fact that they form the vast majority of British Islands, not counting Crown Dependencies and British Overseas Territories. In addition, small and micro businesses are at the very heart of their economies. Indicatively, more than 90% of businesses in Orkney Islands are reported to employ less than ten people (Orkney.com, 2024). These are also the localities that record the highest degree of community belongingness across Scotland.

Our contribution is interdisciplinary in nature, informed by geography and economics, as well as the multi-disciplinary research on belongingness. For our empirical analysis we employ a quantitative approach, combining descriptive statistics with econometric analysis. While existing datasets are generally deficient when it comes to small islands (Armstrong et al., 2012), there are two resources that enable a meaningful empirical analysis on the topic. One is Scotland's official statistics, out of which we retrieve data on various indicators of community belongingness and information on the economic background of Scottish Islands. The other is the UK Small to Medium Enterprise (SME) Finance Monitor (UKSMEF), a large cross-sectional survey with comprehensive data on small businesses' balance sheets and financial history (BDRC, 2023). Our analysis covers the period 2016–2019.

Outlined briefly, our analysis shows that Orkney and the Outer Hebrides are not only at the top of Scotland in community belongingness, but also in the share of small businesses describing a strong working relationship with their main bank. Shetland is also near the top when considering only micro-businesses, that is, businesses with no more than ten employees. Our econometric evidence confirms the positive relationship between community belongingness and small businesses' attitude towards their banks more broadly across Scotland. All being equal, small businesses located in areas with a high degree of belongingness are more likely to report a strong working relationship with their main bank.

The rest of the paper is organised as follows. In the next section we discuss existing literature on soft information, community belongingness and small islands. We then elaborate in detail our data sources and variables. Following that, we delve into our empirical analysis, first by providing information on the economic background of Scottish Islands, and second, by examining the relationship between community belongingness and small business banking. In the last section we conclude and reflect on policy.

## 2. DISCUSSION

### 2.1. Soft information

Common ground in financial geography and regional studies is to highlight the significance of soft information, or else tacit knowledge, in financial relationships.<sup>1</sup> Stein (2002) defines soft information as 'information that cannot be directly verified by anyone other than the agent who produces it' (2002, p. 1892). He mentions the example of a loan officer who has worked with a small company president and may come to believe that this person is honest and hard-working. Hardly can such information turn into a numerical score to pass to higher levels of the banking hierarchy.

Soft information is particularly important in small businesses lending. Given that small businesses are the most unlikely to access bond and equity markets, the ability of lenders to exploit soft information largely depends on the spatial structure of a country's banking system (e.g., Ioannou & Wójcik, 2021; Klagge & Martin, 2005; Papi et al., 2017). From this point

of view, decentralised banking systems are better equipped for enabling the development of long-term relationships and trust between banks and small business borrowers.

Empirical studies provide ample evidence on the significance of soft information in small business lending. This is either done explicitly, or implicitly, by concentrating on the significance of geographical distance between lender and borrower. Cosci et al. (2016) find that soft information exercises a positive effect in firms' ability to innovate. Lee and Brown (2017) find that due to the 'liability of distance', as they call it, small innovative businesses in UK peripheral regions are more likely to have their loan applications rejected. D'Aurizio et al. (2015) and Barboni and Rossi (2019) show that thanks to the weight attached to soft information, local banks in Italy were the least inclined to ration credit and terminate existing relationships with borrowers during the crisis of 2008. Porzio et al. (2020) suggest that soft information is more likely to get lost when the duration of the relationship between the borrower and the bank is shorter and when the borrower conducts business with a greater number of banks.

On the 'darker' side, Canales and Nanda (2012) suggest despite the merits of decentralised banking, attribution of greater autonomy to local branch managers can also allow them to restrict credit and charge higher interest rates to small businesses when they hold significant market power in the localities where they operate. Gropp and Guettler (2018) suggest that, all being equal, small and medium enterprises (SMEs) with positive soft information are more likely to approach small banks when applying for a loan rather than large banks. This creates an adverse selection problem in which large banks are left with borrowers associated with negative soft information on average.

Only a handful of studies have explored the production and use of soft information in SME lending using qualitative methods. Flögel and Zademach (2017) show how the physical arrangement of the interior of a local bank branch influences the quality of communication between the bank and the customer, by shaping the sense of accessibility and confidentiality, aspects themselves related to trust and knowledge creation. Flögel (2018) shows that large banks are also able to exploit soft information by providing enhanced autonomy to their local staff for loans up to a certain size, to SMEs with good credit scores. For local banks, soft information appears to matter mostly when hard data is inconclusive, typically due to low credit scores.

## 2.2. Belongingness

Despite often feeling like a straight-forward concept, belongingness can turn out to be a convoluted concept. Generally speaking, different people can feel that they belong in many different ways to many different things. The feeling of belonging can vary from a single person to the whole of humanity, in a concrete or abstract way (Yuval-Davis, 2006). A football or music fan, for example, can hold a sense of belonging to their favourite team or music band. A teenager can feel they belong to the group of 'cool guys' in school. A religiously devoted person might acquire a sense of belongingness by going to church on Sundays. Belonging can be a personal choice due to taste and preferences, borne out of the need to feel special or borne out of the fear of exclusion.

To analytically elaborate the concept of belongingness, Yuval-Davis (2006) and Antonsich (2010) differentiate between two major dimensions, the personal and the social. At the personal level, belongingness refers to the feeling of being 'at home'. Taken in abstraction, home here does not necessarily stand for a material space but for a symbolic space of familiarity, security, and emotional attachment. Belongingness at the personal level is shaped by numerous factors, including social factors (long-lasting friend and family relationships); cultural factors (e.g., language and religion); and economic factors, such as the feeling of economic security. It is also a critical factor in the formation of self-identity. Moreover, the emotional strength attached to one's sense of belongingness can fluctuate, typically increasing when threatened from the outside

(Yuval-Davis, 2006; Yuval-Davis et al., 2005). Consider, for example, one's sense of national belongingness when one's country is attacked by another.

Belongingness is not just a matter of how one feels, but also entails a social aspect – what Yuval-Davis (2006) describes as the 'politics of belonging'. Politics of belonging involves two opposite sides, the one that claims belonging and the one that has the power of granting it. Belongingness is in that respect a process of negotiation rather than status (Mackenzie, 2004). Negotiation can either occur at the individual scale (e.g., effort of a non-native person to become part of a small community) or at the collective scale (e.g., social integration of ethnic minorities). At its essence, politics of belonging is about the distinction between 'us' and 'them', or about what Crowley (1999, p. 30) describes as the 'dirty work' of boundary maintenance. It is also about determining what is involved in belonging (Yuval-Davis, 2006). Typically, the claim to belonging is either based on the grounds of economic belonging, i.e., the contribution to the economy of a place; social belonging, i.e., the participation in everyday social relations; universal belonging, meaning claim to belonging on the basis of human rights; or a combination of the previous three (Antonsich, 2010).

The granting of belongingness is not just about issuing a residence or working permit. Belongingness is a deeper concept than citizenship, and in that respect the role of political institutions is necessary but insufficient for granting it (Antonsich, 2010). To feel at home, one also needs to feel welcome, enjoy the space to express his or her identity, and feel valued and listened to (Buonfino & Thomson, 2007). It is also crucial to distinguish between the granting of belonging and the acceptance with the expectation of assimilation, in other words the acceptance with the expectation of adopting local cultural, social or religious norms (Garlard & Chakraborti, 2006).

Geography is vital in shaping one's sense of belongingness. Feeling at home can be intertwined with the sense of place-identity, though home here can as well mean one's own flat, neighbourhood, region or country (Antonsich, 2010; Cuba & Hummon, 1993). Notably, there are different factors determining one's sense of belongingness at each spatial scale. Neighbourhood belongingness, for example, is likely to be shaped by social participation in the local community and can even be fostered just by walking around the neighbourhood (Fenster, 2005). On the other side, national belongingness is likely to be driven by a collective narrative and imagination of a glorious past (Cuba & Hummon, 1993; Yuval-Davis, 2006; Yuval-Davis et al., 2005). Moreover, the various spatial levels are not necessarily concentric and consistent in the belongingness they inspire. Consider, for example, the symbiosis of regional belongingness in the psyche of pro-independence Catalans with their lack of a sense of belonging at the country level. In the case of immigrants, home belongingness can refer to their homeland rather than the neighbourhood in which they live (Fenster, 2005).

### 2.3. The unique characteristics of communities in small islands

Naturally, one could expect soft information and belongingness to matter the most in small communities, where residents exhibit strong cultural bonds and tend to know each other well. In such localities, belonging to the same community does not just mean that a bank officer knows about the environment in which a small business operates and is aware of the honesty of its owner. It also makes it likely for the owner of that small business to be the bank officer's neighbour or distant relative; for the owner's sister to teach at the school where their kids go; or for the owner to run the bar where the bank officer goes out on Fridays. In the context of rural England, Pugh (2007) notices that dual relationships and 'out of hours' interactions make it particularly challenging to establish and maintain confidentiality compared to large urban areas: 'simply to be seen visiting someone's home, or for a service user to be seen entering a local office, provides opportunities for gossip and speculation' (2007, p. 1406).

While not the only areas hosting small communities, small islands have a number of distinct characteristics that makes their study particularly interesting. According to McCall (1994), who coins the concept of ‘nissology’ (after *νησί*, the Greek word for island), the unique physical characteristics of islands provide a clearer sense of community belongingness; of ‘us’ and ‘them’ (Antonsich, 2010; Yuval-Davis, 2006). Small islands are also likely to be places in which belongingness is simultaneously shaped both by active involvement in the community and a collective narrative of the island’s history. Important in this context is not just the physical separation of islands from the mainland, but also the topographical isolation that often characterises islands (Armstrong et al., 2012; Cottrell, 2017; Gibbons, 2010; McCall, 1994; Spilanis et al., 2012).

McCall (1994) writes that especially in small islands, social relationships tend to be highly ‘particularistic’:

Rather than the Weberian bureaucratic rational-legal ideal under which people in complex continental societies live, islanders tend to know and, thus, treat differently the individuals with whom they come into contact. [...] People in small island places may not be personally known to one another, but they will have some ascribed characteristics by which to guide their social commerce, such as regional, ethnic, even kin characteristics. Bureaucratic procedures, developed for populous continental places may simply fail to operate in small island places and officials who ought to be following universalist precepts, instead favour persons known to them, or who are from their areas. (McCall, 1994, p. 4)

Azzopardi (2015) corroborates these remarks, based on fieldwork research in the Maltese island of Gozo. He finds that local small business managers and entrepreneurs tend to feel fear and suspicion towards formal structures. When needing to take some action, they are more likely to keep silent vis-à-vis formal business and civic institutions, and instead rely on their own resourcefulness and their networks of friends and relatives. Azzopardi observes that doing business in this way – or else the ‘island way’ – provides a sense of empowerment to local managers and entrepreneurs, and strengthens the collegiality and trust among them.

Hayfield and Schug (2019) highlight the closeness of small island communities, based on fieldwork in the Faroe Islands. According to these authors, although it is impossible to remain anonymous, it is also impossible for a non-native not to be identified as a stranger, even if a familiar one. Such observations echo the view that belongingness entails a social dimension, subject to continuous negotiation (Antonsich, 2010; Yuval-Davis, 2006).

There are various examples of what it means to be accepted as a local in an island place. Writing in the context of Madeline Island in Wisconsin, US, Gibbons (2010) observes that it can impact how people talk to one, as well as what they talk about. From a material perspective, it can give access to better deals on food and drinks – with ‘island pricing’ – better quality services and better housing. Hayfield and Schug (2019) also indicate that being accepted as a local, influences the ability to participate in conversations as well as the support one might receive in the work environment.

Demographically and economically, small islands exhibit their own distinct characteristics. First, small islands face strict limits in local labour supply, which can get further exacerbated, inasmuch as the younger and better educated persons seek to move away for better employment opportunities or lifestyle (Armstrong et al., 2014). Second, it is common for small islands to rely on niche market specialisations, such as agriculture, fishing or tourism (Armstrong et al., 2012; 2014; Ratter, 2007). Armstrong et al. (2014) point out that niche specialisation is due to the interaction of a small domestic market, limited factor supplies and high transportation costs. While it can also be driven by geographical uniqueness and endowment in natural resources, such as oil or gas, niche specialisation remains a double-edged sword. Although, on one side,

it can foster prosperity, it can also make small islands particularly vulnerable to sudden shifts in external economic circumstances (Armstrong et al., 2012).

## 2.4. Research hypotheses

Putting the previous parts together makes it possible to frame the two theoretical hypotheses to test in this paper. Presented analytically, these are as follows:

H1: Small islands are the areas where the share of firms describing a strong working relationship with their bank is likely to be the highest.

H2: More broadly, firms located in areas with a high degree of community belongingness are more likely to report a strong working relationship with their bank.

While previous literature has studied belongingness in small islandic communities, this paper is the first – to the best of our knowledge – to ground the topic of belongingness in the context of banking, as well as the first to study bank relationships in the Scottish islands.

There are two implicit assumptions in hypothesis H2. First, we assume that owners and managers of small businesses in small islands live in the same islands where their businesses operate. Although a heroic assumption at the level of corporate conglomerates, we take it as a relatively more realistic assumption in the case of small businesses. Secondly, in our interpretation of results, we assume a positive association between the strength of the working relationship between small businesses and their banks, and the presence of soft information. As with empirical studies using geographical distance and location of banks as an indirect proxies for soft information (e.g., Barboni & Rossi, 2019; Lee & Brown, 2017), on the assumption that close distance between lender and borrower enables frequent interaction and, consequently, the production of soft information, our approach takes the working relationship between small businesses and their banks as an indirect proxy of soft information, assuming that firms reporting a strong working relationship with their banks are more likely to frequently interact with them, thus enabling the production of soft information. While available data allows for a quantified measurement of this working relationship (see below for details), soft information is by nature non-quantifiable, hence such an assumption is necessary to allow a reasonable approximation, even if imperfect.

## 3. DATA AND METHODOLOGY

### 3.1. Data

Our analysis is based on two data resources. One is Scotland's official statistics (Statistics.Gov.Scot, 2024), which provides annual social, demographic and economic data by region (council area). From this dataset we extract data on community belongingness, as well as regional data on earnings, unemployment, output and business demographics.<sup>2</sup>

To measure community belongingness, we use the Community Belonging section of the Scottish Household Survey, part of Scotland's official statistics. The survey asks adults in Scotland to describe how strongly they feel they belong to their immediate neighbourhood, with five possible responses ranging from 'very strongly' to 'not at all strongly'. As our key belongingness indicator, we use the share of households that respond 'very strongly' in each council area. Data is available until 2019, a constraint that sets the upper bound in the temporal dimension of our sample. For our analysis, we consider the full-time average value of the indicator.

The Scottish Household Survey also provides other indicators that can measure community belongingness indirectly. One is a set of questions aiming at measuring neighbourhood involvement (e.g., one question asks whether respondents feel they can rely on their neighbours to help

them). Another is a question asking respondents to describe how safe they feel when alone at home. In Appendix B of the online supplemental data we show how Scottish regions rank when belongingness is measured by these variables, to complement our main findings.

To provide an overview of the broader economic environment of the three groups of Scottish Islands, we also use data on output, unemployment, earnings and firm demographics, specifically, the entry-to-exit ratio of firms (if greater than one, this ratio would indicate that there are more firms being established than going out of business in a given year and location).

The second dataset we use is the UK SME Finance Monitor (UKSMEF), a large cross-sectional survey with comprehensive data on SMEs' balance sheets and financial history, designed by the BVA/BDRC institute and made available through the UK Data Service (BVA/BDRC for Brulé-Ville Associés/Business Development Research Consultants). The survey covers for-profit UK firms that employ between 1 and 250 employees, have an annual turnover of no more than 25 million pounds, and do not have more than 50% foreign ownership. The geographical location of each surveyed firm is identified by postcode area (the UK divides into 121 postcode areas in total).<sup>3</sup>

The UKSMEF survey has been conducted every three months since 2011. While some firms might be interviewed more than once, the selection is otherwise random, in other words there is no set pattern in which surveyed firms reappear in the dataset. This means that while the dataset of this paper contains both a spatial and a temporal dimension it is not a panel. A limitation of the survey is that although basic questions concerning the characteristics of surveyed firms (e.g., age, size, etc.) remain the same over time, the list of all other questions is frequently updated. This makes it particularly challenging to establish a consistent long-term time series.

As per the definition of small businesses (UK Government, 2024), we only consider firms with no more than 50 employees (these businesses correspond to 92% of the firms surveyed in the Scottish islands).<sup>4</sup> For matching with data from Scottish Statistics we aggregate the UKSMEF data by council area. Under the current structure of local governance, Scotland divides into 32 council areas. Scotland's largest cities, such as Glasgow and Edinburgh, each correspond to one council area. Other council areas, such as the Highlands, cover wider geographies. Shetland and the Outer Hebrides are each classified as a separate council area. One limitation is that postcode areas do not always precisely match council areas. Whenever this is the case, we match postcode areas with the council area in which the largest city resides, on the assumption that this is where interviewed firms are most likely to be located (the IV postcode, for example, matches with Highland, the council area that hosts Inverness, despite some IV postcodes expanding to the council area of Moray). On this assumption, we also match the Orkney postcode with the Orkney Islands council area, although here it is hard to establish a clear distinction between the Orkney islands and Orkney mainland (Kirkwall in the Orkney Islands is Orkney's largest city in population size, with 7500 inhabitants; the next two biggest cities from Orkney mainland, Thurso and Wick, also have a population of similar size, respectively 7390 and 6870; source: NRS, 2023). Merging the two datasets in this way gives data for 16 council areas in total.

To investigate the working relationship between small businesses and the banks that serve them, we use the survey question that asks firms to describe their relationship with their main bank (Q24a in UKSMEF, 2019). This question is part of UKSMEF's questionnaire since 2016 and is framed as follows:

'Thinking about your main bank, which of these best describes your relationship with them?

- (a) We have a strong working relationship with our bank and feel we can approach them whenever we need to.
- (b) The relationship with our bank is fine, but we really just use the bank for transactions, so rarely need to approach them.
- (c) We don't have an active working relationship with our bank and wish that we had one.'



Based on these responses, we construct a binary variable, set equal to 1 for firms responding (a), otherwise set equal to zero.

Given the temporal constraints of the two datasets, we set 2016–2019 as the period covered in our sample. Filtering the UKSMEF dataset for Scotland gives 4954 firms, corresponding to 16 survey rounds. Out of these, 196 observations correspond to surveys conducted with firms in Shetland (56), Orkney (101) and the Outer Hebrides (39).<sup>5</sup>

### 3.2. Econometric methodology

To examine the broader relationship between community belongingness and small businesses' attitude towards their banks (hypothesis H2) we conduct an econometric exercise, based on a probit model. On the left-hand side we use the above mentioned binary variable counting the share of firms reporting a strong working relationship with their main bank. On the right-hand side, we include our main variable for belongingness (share of households describing a very strong sense of belongingness towards their local area), together with a list of control variables sourced from UKSMEF. These include: (a) a descriptor of the gender of the owner or leader of the firm; (b) a variable to indicate whether the firm has a formal written business plan; (c) a measurement of innovation; (d) a variable to indicate whether the person in charge of the firm's financial management has a financial qualification or has undertaken financial training; (e) a variable to indicate whether the interviewed firm has made a profit in the twelve months prior to the time of the interview and (f) a variable to suggest whether the firm has an aspiration to grow over the year following the interview (details for all variables in Appendix A of the online supplemental data).<sup>6</sup> We also control for firms' risk level, industrial classification, legal status, age and time. Presented analytically, our model is as follows:

$$\Pr(y_{ij} = 1 | B_j, X_{ij}, u_{ij}) = \Phi(\beta B_j + \gamma X_{ij} + u_{ij}) \quad (1)$$

Where  $i$  and  $j$  are, respectively, the subscripts for firms and council areas,  $\Phi \in [0, 1]$  is the cumulative density function of the normal distribution,  $y_{ij}$  is the response of firm  $i$ , located in council area  $j$ , to the question whether it has a strong working relationship with its bank (1 for a positive response, 0 otherwise),  $B_j$  is the variable measuring community belongingness,  $X_{ij}$  is the vector of control variables,  $\beta$  and  $\gamma$  are the model's parameter values and  $u_{ij}$  is the unobserved firm-specific effect. The model is estimated using maximum likelihood. For all regressions, we use heteroskedasticity-robust standard errors, clustered by council area so as to tackle intra-cluster correlation. All UKSMEF data are weighted according to the business population weights provided by the data authors.

To test for robustness, we report four varieties of the model with different combinations of control variables (Table 2, column number in brackets): the most basic model includes community belongingness on the right-hand side, together with quarterly time-dummies and a constant (1). To this we then insert controls for industrial classification, legal status and age (2). Following this, we add all other control variables (3). To minimise multicollinearity noise, we also present a variety of the model with only statistically significant controls (4). For completeness, we also report an estimation of the basic model using the logic instead of the probit estimator (5). Additionally, we report a variety of the model of column 4 with two more variables, an island dummy set equal to 1 for Shetland, Orkney and the Outer Hebrides, and its interactive term with community belongingness (6). Further, in column 7, we present a model with neighbourhood involvement used as an alternative proxy for community belongingness (see Section 3.1 and Appendix B).

We also include various re-iterations of our baseline model for alternative sub-samples. We first run a regression for the part of the sample corresponding to micro-businesses, that is, firms with less than 10 employees (8). We then present the model only for the part of the sample that includes islandic localities (9). To make sure our results are not entirely driven by islands we also

**Table 1.** Summary statistics.

Variable	Details	Obs.	Mean	Std. Dev.	Min	Max
Output (GBP Billion)		32	13,410.83	9577.10	505.08	28,558.35
Unemployment rate		32	4.28	1.02	2.10	5.90
Firms' entry-to-exit ratio	council area level data,	32	1.14	0.10	0.97	1.26
Mean weekly earnings	full time averages for	32	522.59	42.53	431.68	593.58
Community belongingness	2016–2019.	32	33.04	7.91	26.75	70.50
Neighbourhood ties		32	85.78	4.45	77.94	94.56
Strength of working relationship of small businesses with their main bank		4954	0.24	0.43	0	1
Female ownership	firm level data,	4954	0.54	0.50	0	1
Business plan	2016–2019.	4954	0.33	0.47	0	1
Profit		4954	0.74	0.44	0	1
Innovator		4954	0.15	0.36	0	1
Financial education		4954	0.25	0.43	0	1
Aim to grow		4954	0.45	0.50	0	1
High risk		4954	0.38	0.49	0	1

Sources: UKSMEF, Scotland's official statistics. Weights applied in firm-level (UKSMEF) variables. Council area data in full time averages for 2016–2019.

report a specification for the part of our sample outside Shetland, Orkney and the Outer Hebrides (10).

Table 1 presents the summary statistics of all the variables used in the paper.

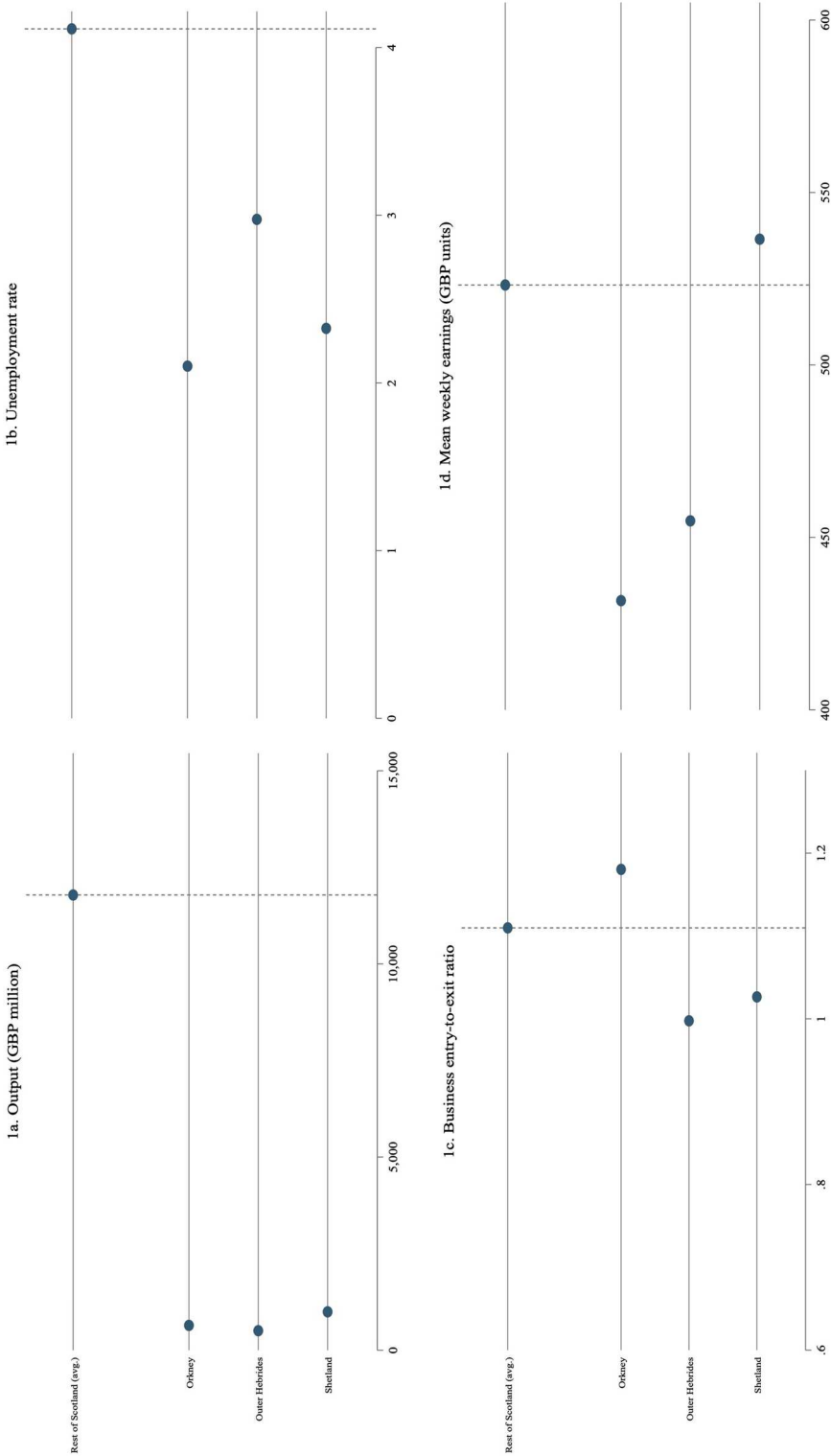
## 4. EMPIRICAL ANALYSIS

### 4.1. The broader economic background

Figure 1 demonstrates the differences across the three groups of islands and the rest of Scotland, for a number of economic indicators, for 2016–2019.<sup>7</sup> Figure 1a shows how small the three islandic economies are in comparison to the average of the rest of Scotland. Indeed, the Outer Hebrides is the smallest economy in Scotland with an average annual output of 595 million pounds, followed by Orkney and Shetland with 642 and 993 million pounds average output respectively. For comparison, Glasgow and Edinburgh record an average output of 22.4 and 19.8 billion pounds respectively, about 24% of the island total.<sup>8</sup>

Figure 1b shows that the rate of unemployment is significantly lower in the islands compared to the average of the rest of Scotland. Orkney and Shetland are the bottom two locations across the whole of Scotland, with unemployment rates of 2.1% and 2.3% respectively, followed by Perth and Kinross, Aberdeenshire and the Outer Hebrides. Glasgow and Dundee are at the other end, with unemployment rates of 5.6% and 5.9% respectively. Of course, in the interpretation of these figures, one also needs to bear in mind the tendency of the labour force from small islands, particularly young people, to migrate to the mainland (Armstrong et al., 2014).

Figure 1c displays the business entry-to-exit ratios registered in the three groups of islands and contrasts them with the rest of Scotland. The comparison is mixed, suggesting a lower



**Figure 1.** Economic background of Scottish Islands and comparison with the rest of Scotland. Full-time averages for 2016–2019. Source: Scotland’s official statistics and author’s elaboration.

ratio for the Outer Hebrides and Shetland and a higher ratio for Orkney. Figure 1(d) demonstrates that mean weekly earnings are significantly less than the rest of Scotland in Orkney and the Outer Hebrides and slightly higher in Shetland.

#### 4.2. Community belongingness, islandness and small business banking

Figure 2 elaborates the relationship between community belongingness and the share of small businesses describing a strong working relationship with their main bank, based on full time average values for 2016–2019. First, Figure 2a identifies Shetland, Orkney and the Outer Hebrides at the very top of the belongingness dimension (vertical axis). The two council areas ranking right after, Dumfries & Galloway and Highland, are also highly rural in the sense of neither of them being host to a large city (Inverness, located in Highland, could be pointed out as one exception, though Highland as a council area covers a wide geography). On the other hand, all large Scottish cities rank at the bottom, with Aberdeen recording the lowest level of belongingness. Appendix B in the online supplemental data provides further corroborative evidence, using ‘neighbourhood involvement’ and the ‘feeling of safety at home’ as alternative variables for measuring community belongingness. In all counts the positioning of the three groups of islands at the top remains unchanged.

Figure 2a also identifies a positive relationship between community belongingness and small businesses’ attitude towards the banks they work with. In line with hypothesis H1, Orkney and the Outer Hebrides are located at the upper-left, i.e., the part of the graph that indicates the highest share of small businesses describing a strong working relationship with their main bank. On the other hand, Shetland’s share of businesses describing a strong working relationship is located at the low end of the scale.

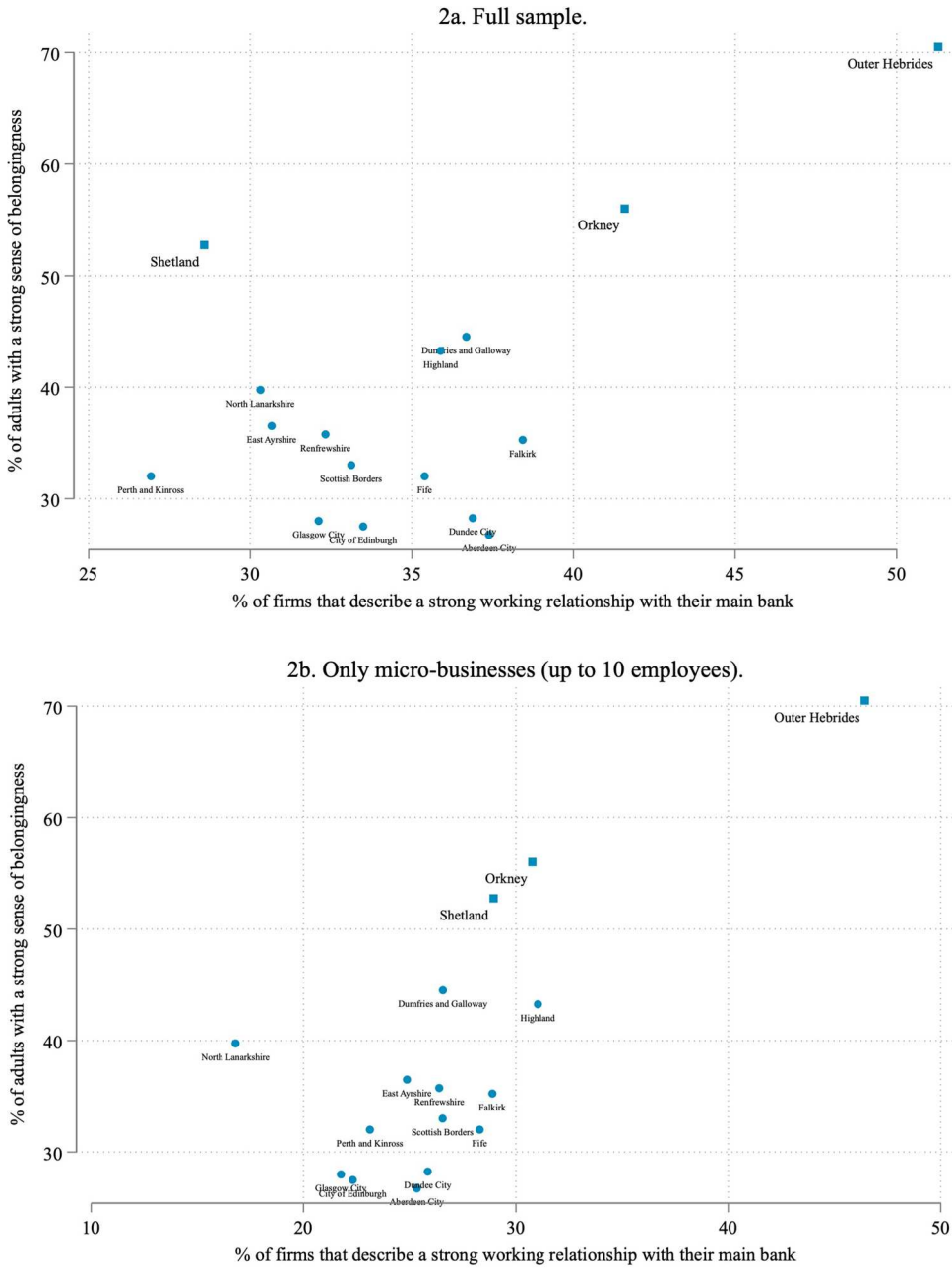
Figure 2b plots the same variables only for micro-businesses, i.e., businesses hiring no more than ten employees. This figure indicates an even stronger positive relationship between community belongingness and firms’ attitude towards their banks. It also provides clearer evidence on the positioning of islands at the high end in both dimensions, this time mapping Shetland nearer Orkney and the Outer Hebrides.

#### 4.3. Econometric analysis

To examine the broader relationship between community belongingness and small businesses’ attitude towards their banks, Table 2 presents a comprehensive package of econometric results.

The table confirms that community belongingness is highly statistically significant and positive. This holds regardless of the control variables included in the model and the estimator used. The variable’s statistical significance stands at 1%, in all cases except for the model with the interactive term (column 6) where it stands at 5% and the regression for the part of our sample outside Shetland, Orkney and the Outer Hebrides (column 10), where it borders with 5% (*t*-statistic is 1.95). Expectedly, results are the strongest for the regression for just islandic localities, though the small sample size of this regression ( $N = 194$ ) means that these results should be treated with caution. The variable’s parameter value is also fairly consistent across the various models, ranging between 0.010 and 0.013, save for the logit specification where it is slightly higher (0.019) and the regression for islands where it reaches 0.08. In column 6, the combination of positive and significant results for belongingness and its interaction with the island dummy, alongside the negative and significant results for the stand-alone island dummy, show that the positive influence of islandness on bank relationships passes through its impact on belongingness. Column 7 indicates that community belongingness is also statistically significant when approximated indirectly via neighbourhood involvement.

The table also presents interesting findings regarding other significant factors. Consistent to what one might expect, firms with owners and/or managers with financial training appear to be more likely to report a strong working relationship with their main bank. The same holds for



**Figure 2.** Community belongingness and share of firms reporting a strong working relationship with their main bank.  
 Source: UKSMEF, Scotland’s official statistics, and author’s elaboration. Full time average values (2016–2019).

firms with a clear business plan. On the other hand, innovative firms are less likely to report a strong relationship with their bank, a finding broadly consistent with previous evidence suggesting that innovative firms are more likely to have their applications for finance rejected, all being equal (Lee & Brown, 2017). Taken in absolute values, the parameters of these three

Table 2. Econometric analysis.

Dependent variable: binary variable equal to 1 for businesses that report a strong working relationship with their bank, otherwise equal to 0.	Full sample models					Sub-sample models				
	Simplest models (1)	(2)	Baseline models (3)	Logit regression (5)	Model with interactive term (6)	Alternative proxy for community belongingness (7)	Micro-businesses only (8)	Sub-samples for islands (9)	Sub-sample without islands (10)	
Community belongingness	0.010*** (2.789)	0.010*** (2.619)	0.011*** (2.611)	0.011*** (2.735)	0.013** (1.988)		0.012*** (2.632)	0.080*** (9.401)	0.013* (1.950)	
(Community belongingness)*island dummy					0.024** (2.085)					
Island dummy					-1.533** (-2.370)					
Neighbourhood involvement						0.014* (1.681)				
Female ownership			-0.094 (-0.945)	-0.164 (-0.951)		-0.089 (-0.884)	-0.086 (-0.779)	0.022 (0.103)	-0.098 (-0.938)	
Business plan			0.225*** (2.862)	0.388*** (2.916)	0.231*** (3.166)	0.226*** (2.877)	0.212** (2.419)	0.879*** (3.268)	0.227*** (2.721)	
Profit			0.005 (0.042)	0.003 (0.017)		0.006 (0.055)	-0.002 (-0.021)	0.689** (2.196)	-0.018 (-0.163)	
Innovator			-0.167** (-2.009)	-0.293** (-2.003)	-0.168** (-2.196)	-0.168** (-2.026)	-0.178* (-1.877)	-0.628 (-1.517)	-0.132* (-1.651)	

(Continued)

Table 2. Continued.

Dependent variable: binary variable equal to 1 for businesses that report a strong working relationship with their bank, otherwise equal to 0.	Full sample models					Sub-sample models				
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
	Simplest models	Baseline models	Logit regression	Model with interactive term	Alternative proxy for community belongingness	Micro-businesses only	Sub-samples for islands	Sub-sample without islands		
Financial education		0.221** (2.029)	0.216** (2.086)	0.372** (2.004)	0.218** (2.107)	0.210** (1.962)	0.201* (1.748)	-0.246 (-0.791)	0.239** (2.122)	
Aim to grow		0.017 (0.243)		0.040 (0.329)		0.019 (0.265)	-0.001 (-0.010)	0.155 (0.342)	0.014 (0.187)	
High risk		-0.035 (-0.415)		-0.062 (-0.433)		-0.038 (-0.461)	-0.009 (-0.105)	-0.844* (-1.925)	-0.018 (-0.206)	
Constant	-1.059*** (-4.041)	-0.781** (-2.279)	-0.913** (-2.472)	-0.946*** (-2.624)	-1.547** (-2.480)	-1.000*** (-2.589)	-0.913** (-2.312)	-5.408*** (-10.648)	-0.946** (-2.318)	
Time dummies	Y	Y	Y	Y	Y	Y	Y	Y	Y	
Industrial classification controls	N	Y	Y	Y	Y	Y	Y	Y	Y	
Legal status controls	N	Y	Y	Y	Y	Y	Y	Y	Y	
Age controls	N	Y	Y	Y	Y	Y	Y	Y	Y	
N	4954	4954	4954	4954	4954	4954	2991	194	4758	
Pseudo-R2	0.010	0.026	0.038	0.037	0.038	0.038	0.034	0.513	0.035	

Notes: \*, \*\* and \*\*\* denote significance at the 10%, 5% and 1% levels respectively. Probit estimator used unless stated otherwise. Standard errors in parentheses. Heteroskedasticity robust errors, clustered by council area (sample includes 16 council areas). Weights applied. Industrial classification controls include: manufacturing; construction; retail; hotels and restaurants; transport; storage and communication; real estate; renting and business activities; health and social work; other community, social and personal service activities. Legal status controls include: partnership; limited liability partnership; limited liability company. Age controls distinguish businesses into the following brackets (numbers denote years of age): 2-5; 6-9; 10-15; > 15. Island dummy refers to Shetland, Orkney and the Outer Hebrides.

variables range between 0.167 and 0.225, according to the baseline model 3, thus indicating a higher economic significance to community belongingness. This is to be expected as these variables are more directly related to business and finance. Gender, firms' plans to grow, profitability and level of risk are statistically insignificant in all specifications except for the model for islands where profitability and risk are significant, accompanied respectively by a positive and a negative sign.

## 5. CONCLUSION

We discuss the relationship between community belongingness and the attitude of small businesses towards the banks that serve them, contrasting small Scottish islands (Shetland, Orkney and the Outer Hebrides) with other Scottish regions. While previous literature has extensively discussed belongingness as a personal feeling and a socially negotiated status (Anton-sich, 2010; Yuval-Davis, 2006), our paper is the first to connect belongingness with banking. It is also the first to ground the topic in the context of the Scottish islands.

Our analysis covers the period 2016–2019. Our results confirm that Orkney and the Outer Hebrides stand at the top of Scotland not only in community belongingness, but also in the share of small businesses describing a strong working relationship with their main bank. Shetland is also near the top when considering only micro-businesses. Our econometric evidence also suggests a positive relationship between community belongingness and small businesses' attitude towards their banks more broadly, across Scotland.

A question still to be answered is whether there are any tentative policy implications based on these findings. Indeed, the aim of this paper is not to draw an idyllic picture of small islands, neither to present them as victims of global capital. Echoing the literature on the significance of soft information and geographical distance in small business banking (e.g., Flögel, 2018; Lee & Brown, 2017) the paper stands with previous calls for decentralised banking (Ioannou & Wójcik, 2021; Klagge & Martin, 2005). This is a particularly timely call, considering the current wave of closures of bank branches in the UK (in Scotland, the total number of bank branches has declined by 41% since 2012; source: House of Commons, 2023). Particularly in small and remote islands, the ability of small business clients to meet face-to-face with bank officers, with who they might already be familiar from outside the bank, seems to enable a sense of trust, which in turn can make them feel more confident to apply for funding.

By the same token, it is also important to point out potential disadvantages associated with community belongingness in small islands. First, as with other rural areas, the preservation of confidentiality might be particularly challenging (Pugh, 2007). Just the fear of sensitive information finding its way to the wrong people might lead some businesses to hesitate to disclose such information to their banks. Second, as with earlier remarks on the politics of belongingness (Mackenzie, 2004; Yuval-Davis, 2006) and observations on the privilege positioning of islanders (Gibbons, 2010; Hayfield & Schug, 2019), it is possible for staff working in local bank branches to discriminate in favour of small businesses owned by native professionals, e.g., by providing extra help in case of financial distress, or by showing more flexibility when asked to set up an appointment. Ultimately, these are aspects that might also affect borrowing costs.

There are two notable limitations in our study. First, our data on the strength of the working relationship between small businesses and their banks comes out of small businesses' own responses, hence involve a significant element of subjectivity. We do not have similar data from bank officers dealing with those businesses, and it is important to acknowledge that their responses might not necessarily be the same with the responses given by small businesses. Second, we do not know whether those working in the banks dealing with the businesses covered in our sample are natives or not. Given that available quantitative data doesn't go to that level of detail, further research on the topic is likely to benefit from fieldwork research in small islands.



## DATA AVAILABILITY STATEMENT

This study uses data from two different resources, Scotland's official statistics and UK SME Finance Monitor. Scotland's official statistics are openly available at <https://statistics.gov.scot/home>. Data from the UK SME Finance Monitor are available through the UK Data Service (<https://ukdataservice.ac.uk>).

## DISCLOSURE STATEMENT

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## NOTES

1. In this paper, we treat the terms 'soft information' and 'tacit knowledge' as synonyms.
2. One limitation in the unemployment series made available by the Scottish statistical agency for council areas is that unemployment figures are model estimates, calculated as ratio of the total population rather than active labour force, as per the typical definition of unemployment.
3. One limitation is that the Orkney postcode (KW) does not only include Orkney Islands but also the far-north part of the Scottish mainland. On the other hand, Shetland and the Outer Hebrides each have their own postcode, respectively ZE and HS.
4. UKSMEF surveys aim at replicating the business demography of each area, hence the shares of specific types of firms in each area should provide a good representation of the area's actual business composition.
5. We exclude firms less than a year old, on the premise that such firms are unlikely to be in a position to describe their working relationship with their bank yet. The number of observations for the rest of the council areas included in our sample are as follows (postcode areas in parentheses): Aberdeen City (AB, 666); Dundee City (DD, 263); Dumfries and Galloway (DG, 199); City of Edinburgh (EH, 821); Falkirk (FK, 216); Glasgow City (G, 794); Highland (IV, 326); East Ayrshire (KA, 287); Fife (KY, 339); North Lanarkshire (ML, 221); Renfrewshire (PA, 232); Perth and Kinross (PH, 234); Scottish Borders (TD, 160).
6. Although the gender variable is made available in a binary form by UKSMEF, separating between male and female, it is important to acknowledge that such identification of gender is problematic, as it fails to encompass queer/non-binary individuals.
7. Although data is available separately for each council area, we take the rest of Scotland in an average form so as to allow a better visual focus on the data reported for Shetland, Orkney and the Outer Hebrides.
8. As made available by the Scottish Annual Business Survey, regional output data does not include activities related to finance, insurance, education, health and public administration. Taking these into account is likely to further exacerbate the difference between the islands and the rest of Scotland.

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