



# Small Business Lending

## Myth vs. Reality

### Abstract

Described as the “engine room of the economy” by Prime Minister Theresa May, Small Medium sized Enterprises account for over 99% of UK firms. However, since the financial crisis, SMEs ability to access traditional bank finance has become harder due to a decline in bank lending. At the same time, new sources – often called alternative finance or FinTech – have been emerging.

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Louise Beaumont has over twenty years' experience in growing companies - from initial spark, to operationalisation, results delivered, and value created. Having previously worked for organisations such as Siemens, Hewlett Packard, Microsoft, and Capgemini, Louise has focused on the UK's fast growing alternative finance sector since 2010, including co-founding one of GLI's investment companies. Louise has advised key UK government departments and units on FinTech and AltFin including; HM Treasury, British Business Bank, Government Office for Science, Cabinet Office, UK Trade & Industry, Department for Business, Innovation & Skills, and Number 10 Downing Street's Policy Unit.

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Adam Owadally graduated in Economics from University College London (UCL). Adam's experience covers interning at firms such as HSBC, Tejara Capital, and Bank Muscat. Academically, Adam's experience includes being elected Financial Director for a Young Enterprise company, captaining his school's team in Bank of England's Target Two Point Zero competition, and leading a team of 4 analysts in UCL's student-led investment fund, Bloomsbury Capital. In Adam's final year of undergraduate studies, he developed an avid interest for Entrepreneurship and for the alternative finance sector. In September 2016, Adam begins studying for a Masters in Financial Analysis at London Business School.

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## Introduction

### Small Business - the engine room of the UK economy

SMEs account for over 99% of UK firms

Responsible for over half overall UK turnover

Represent 60% of all private sector employment

Described as the “engine room of the economy” by Prime Minister Theresa May, Small Medium sized Enterprises (SMEs) account for over 99% of UK firms. However, since the financial crisis, SMEs ability to access traditional bank finance has become harder due to a decline in bank lending. At the same time, new sources – often called alternative finance or FinTech – have been emerging.<sup>i</sup>

### Bank Lending – obfuscation and fact

The rate of this decline, and the reasons for it, have been fiercely contested.

In this report we examine data from three sources to go beyond the obfuscation and get to the bottom of what has really been going on. We’ve ignored the press releases and interrogated the base data on SME lending from the Bank of England; the British Bankers Association, and the SME Finance Monitor.

The purpose of this report is to shine a light on the reality facing SMEs and provide a snapshot of actions that could be taken to help address the issue of access to finance.

## The Data

### SME Finance Monitor – a clear demand

The SME Finance Monitor is produced on a quarterly basis by research firm BDRG Continental, and focuses on a sample of SMEs to assess sentiment.<sup>ii</sup> The survey was setup in 2010 by the Business Finance Taskforce, representing the six largest banks in the UK, as part of a wider review into how the banks could help the UK return to sustainable growth.

Excluding SMEs which describe themselves as ‘permanent non borrowers’, in 2015 SMEs displayed an appetite for external finance:

- 70% of SMEs used external finance
- 25% of SMEs planned to apply for external finance
- 45% of SMEs wanted to use external finance to grow

It is clear that there is demand from SMEs for external finance – both to survive and to thrive.

### Bank of England Data – SME lending in decline

Yet Bank of England data indicates SMEs are struggling disproportionately compared to large businesses when it comes to accessing finance.<sup>iii</sup> Data lowlights include:

- Traditional banks dedicate more resources in lending to large businesses than to SMEs. In the last five years, gross lending (excluding overdrafts) to large businesses has consistently been twice the value of gross lending to SMEs
- And the gap is widening - in January 2012, gross lending to large businesses was almost three times greater than gross lending to SMEs. By January 2016, this figure had increased to three and a half times
- The amount held in loans (excluding overdrafts) by SMEs has fallen by 15.7% in the last five years (from £176bn in April 2011 to £149bn in April 2016)
- The overdraft picture is even bleaker: in the last five years, large businesses have increased the amounts drawn from their overdrafts by 14.3%. Whereas SMEs have decreased the amounts drawn from their overdraft facilities by -42.2%

## British Bankers Association Data – a long-term problem

British Bankers Association data<sup>iv</sup> reveals a long-term issue:

- The number of loan facilities approved for SMEs fell by 54% from July 2011 to December 2015, and the value of loan facilities available to SMEs fell by 9% over same period
- The number of overdraft facilities approved by banks for SMEs fell by 53% from July 2011 to December 2015, and the overdraft capacity – drawn and undrawn (i.e. the total 'headroom' available) - for SMEs has fallen by 24% from July 2011 (£37bn) to December 2015 (£28bn)

And the data also reveals some sizeable gaps – raw data is not made available for loan and overdraft applications, borrowing facilities applied for, or overdrafts enquiries made.

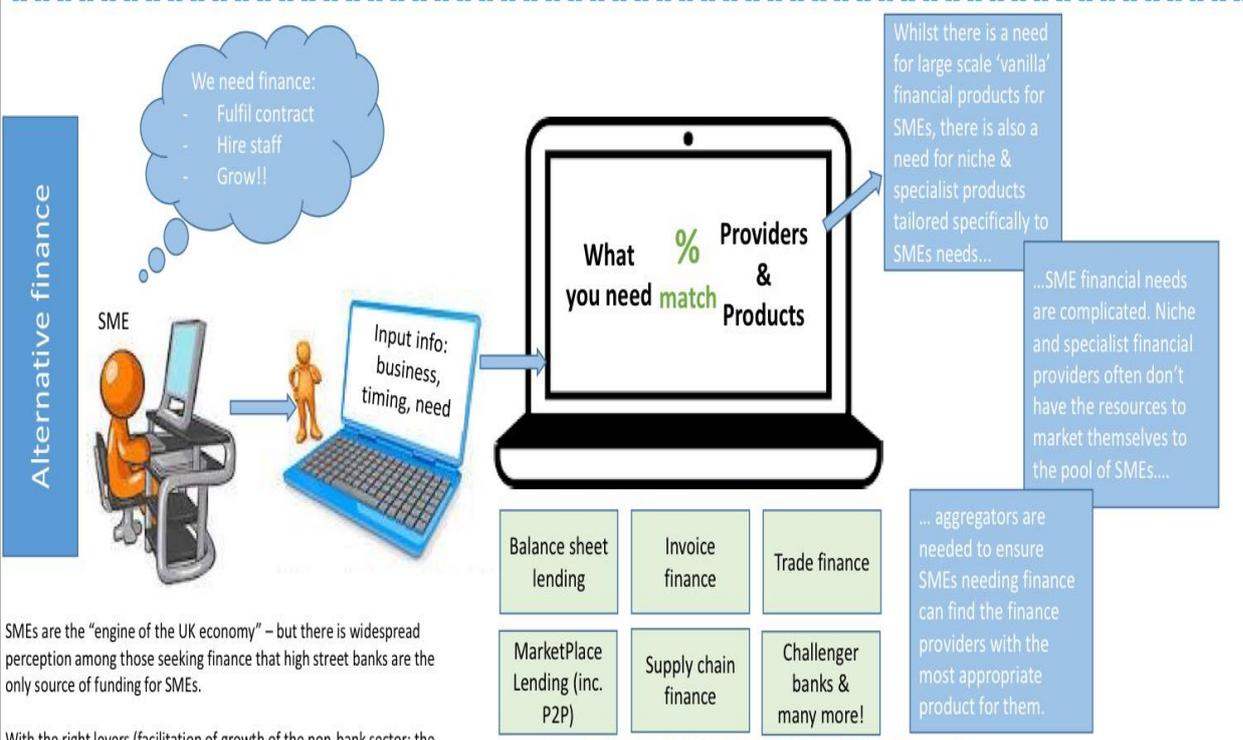
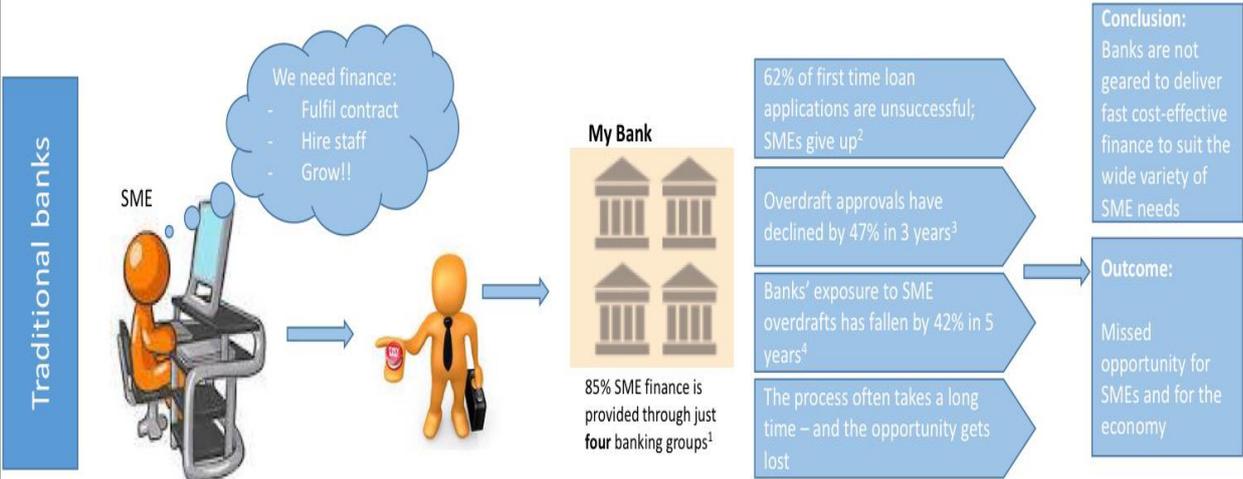
## The Verdict: SMEs are being held back due to access to finance

Our analysis of publically available data has illustrated UK SMEs are facing an enormous challenge to access the finance they need to both stay in business and to grow. This issue is systemic, and long-term trends suggest that a lack of willingness from traditional lenders to provide finance for SMEs is no longer an exception, but unfortunately the new normal.

Something needs to change in order to reverse this trend. Such change is not only imperative for individual businesses but for the UK economy as a whole.

# How do SMEs find finance?

## Finance – how does it work for SMEs?



SMEs are the "engine of the UK economy" – but there is widespread perception among those seeking finance that high street banks are the only source of funding for SMEs.

With the right levers (facilitation of growth of the non-bank sector; the swift and effective implementation of the referral scheme by HMT, the BBB, banks and neutral finance platforms; and increased competition in banking) those SMEs seeking finance can choose the best provider and product for their needs, in an appropriate timescale.

1: FT March, 2015 <http://www.ft.com/cms/s/0/d73e2204-c8d3-11e4-b43b-00144feab7de.html#axzz3Vogwd5S>  
 2: In the 18 months to Q2 2014, 62% first time loan applicants were unsuccessful in securing a facility. BDRIC <http://bdric-continental.com/wp-content/uploads/2014/11/Q2-2014-SME-Finance-Monitor.pdf>  
 3: Bank support for SMEs – 2<sup>nd</sup> quarter 2015: BBA [https://www.bba.org.uk/news/statistics/sme-statistics/bank-support-for-smes-2nd-quarter-2015/#.Yym4e\\_krLgG](https://www.bba.org.uk/news/statistics/sme-statistics/bank-support-for-smes-2nd-quarter-2015/#.Yym4e_krLgG)  
 4: Bank of England, Monthly amounts outstanding of monetary financial institutions' sterling and all foreign currency balance of overdrafts drawn by small and medium sized enterprises (in sterling millions) not seasonally adjusted: <http://www.bankofengland.co.uk/boeapps/sadb/FromShowColumns.asp?Travel=NixSx&SearchText=RPMZ8YE&POINT.x=13&POINT.y=5>

# A Solution to the Problem

## Legislation and Regulation - fuelling the engine

Both legislation and regulation have been required to open up the SME lending market to alternative finance, and ensure that the engine room of the economy can be fuelled.

Government has a role and duty to enable SMEs to access a wide range of finance options to suit their needs. And alternative finance is part of this solution – not least because tech-enabled finance platforms can more easily gear their products to suit the specific requirements of SMEs.

To support SME access to alternative finance the government has acted in three ways:

**Legislation:** HM Treasury led the charge in mandating the four big banking groups to refer SMEs that they decline for finance to designated finance platforms which will help the SME work out the best form of finance for their needs, and which lenders provide it. This legislation, within the Small Business, Enterprise and Employment Act (SBEE Act), comes into effect in Autumn 2016 – which means that any SME declined for finance by a bank will be swiftly referred to Funding Options, Funding Xchange, and BizFiTech

**Regulation:** The Competition and Markets Authority (CMA) stated in Summer 2016, in their review of the retail banks, that the four big banking groups must also prominently display hyperlinks on their websites to designated finance platforms – again to help SMEs find the most appropriate and cost-effective finance for their needs. The CMA's stated aim is to increase the numbers of SMEs using designated finance platforms, which will then incentivise other providers to use these sites as a means of customer acquisition – thus increasing competition

**British Business Bank:** the Government has financially supported the British Business Bank which has provided capital for a number of alternative finance platforms serving the SME market

## Call to Action

We have called for a number of simple – cost minimal – actions by government to ensure the success of the alternative finance industry in its support for SMEs:

1. Ensuring the British Business Bank is empowered and well-funded to ensure the success of the Small Business, Enterprise and Employment Act
2. National marketing campaigns to raise awareness and understanding of alternative finance amongst SMEs
3. Alternative finance education programmes for bank relationship managers and professional financial advisers
4. The expedited introduction of a separate class of Peer-to-Peer ISA
5. Maintaining the current trajectory of tax reliefs on investments in the FinTech sector

Both Coalition and Conservative Governments have strongly supported this rationale, and in so doing built the foundations for the UK to become a world-leading hub for FinTech. As we head towards Brexit, this remains more important than ever. The industry has been delighted with the expedited introduction of the P2P ISA and more recently the Innovative ISA, as well as maintaining the trajectory of tax reliefs on investments in the FinTech sector.

Yet, there remains more to do.

As recognised by the Competition and Markets Authority, Business Innovation and Skills Committee members, and representatives from the British Business Bank and industry, the missing piece in access to finance is that of awareness.

The industry – from banks to alternative finance providers – states it is supporting a growing number of SMEs, and products do exist to serve niche and specialist requirements, but far too often SMEs do not know they exist. Recent CMA data also highlighted that 70% of UK SMEs that had been in business for over ten years have been with the same bank for over ten years. <sup>v</sup>

Steps to close this gap so far only comprise the Business Finance Guide published annually by the British Business Bank in conjunction with a wide range of business groups.<sup>vi</sup> However, a solitary tactic simply cannot be relied upon to single-handedly bridge the SME awareness and understanding gap – the economic risk is simply too great.

## A Way Forward – changing behaviour

We believe that a government-led campaign, closely supported by industry groups, and the industry itself, would raise awareness and understanding of alternative funding solutions for SMEs and is based on the successes we have witnessed from similar initiatives across a range of government policies.

There are many issues that the government has resolved by awareness raising campaigns – from road tax to pensions - so the basis of our proposed solution is well founded. Work in this field has been led by the Government's Behavioural Insights Team (commonly referred to as the Nudge Unit), which utilises human behaviour insights to raise awareness and change behaviour.

## Case Studies

SMEs who have found finance via Funding Options<sup>vii</sup>, which is one of three government-designated neutral finance platforms.

### **Taiwo Sonekan**

Mariam Sonekan is a womenswear and textiles designer, specialising in uniquely designed and high-quality handmade pieces.

After studying Fashion Textiles at London College of Fashion, Mariam was working freelance, making bespoke pieces to order for individual clients. But a trip to New York for an internship inspired this creative young designer to start her own company, and she founded Taiwo Sonekan in 2015.

Scaling up: soon after deciding to set up on her own, Mariam was approached by an online designer marketplace that wanted to sell her clothes. For the first time, she was planning to produce multiple orders rather than one-off commissioned pieces, and worried about how she could pay suppliers for the stock weeks or months before being paid herself for the completed order.

Mariam visited the Funding Options site one evening, and got a call from a Business Finance Specialist the next morning (her birthday!) to discuss her business plans. Her situation was potentially tricky, because the brand-new business didn't have a long enough trading history for many lenders. Luckily, we were able to quickly negotiate with a lender to get Mariam a loan based on her strong personal credit history.

Five days after the night she contacted us, the money was in Mariam's account — so she can move her exciting fashion business forward with a new relationship.

### **fd**

fd are industry leaders in executive search and recruitment dedicated to Finance professionals. With both stock exchange-listed big names and innovative SMEs in their client book, the motto 'committed to growth' sums up their way of doing business.

fd approached Funding Options to explore what flexible invoice discounting products were on the market to support their continued growth. They had secured terms with standard bank products, but these were much too rigid and particularly unsuited to the structure of the company — which specialises in providing both permanent and temporary placements.

We worked with the owners to understand what product would match the business's service, and introduced fd to an alternative invoice finance provider that offered a simple and transparent facility in a very short period of time. This allowed the business owners to move forward with their growth plans and concentrate on what matters the most — the running of the business!

Two bespoke alternatives: Eight months later, David and business partner Adam were looking to take their growth to the next level, and got back in touch with Funding Options. David had read about pension-led funding, and thought it could be the right fit for the long-term plans of the company. Pension-led funding allows you to use the money in your pension to lend to your business — so the business gets the funding it needs, and repays the pension with interest. That means David could see both his business and his personal pension grow.

fd have gone from strength to strength since unlocking the funding from David's pension — showing that alternative finance was the right fit for their dynamic business not once, but twice.

## **Simmons Bar**

Nick Campbell wanted to expand his chain of cocktail bars in London and launch the newest Simmons Bar in Soho. To do it, he and his business partner Jason needed £50,000 for refurbishments and the down payment on the lease, as well as a flexible line of credit for the future needs of the bar.

The team's existing business bank was the obvious first choice, and they were offered a £25,000 unsecured loan. But Nick and Jason needed more than this to carry out their plans, and the bank was unwilling to negotiate because their offer was based on trading history — rather than the clear signs of a growing business doing well in the fast-moving London bar scene.

Nick had heard about crowdfunding in a TV ad and considered it for the business. He also approached a second high street bank, but decided that comparing all his options was the best course of action, so he got in touch with Funding Options.

After an assessment of the business and a chat about their options, Nick and Jason chose RateSetter, an innovative peer-to-peer lending platform.

RateSetter looked at Nick and Jason's considerable experience running profitable bars in London, their excellent track record, and the fact that they'd identified a clear market opportunity — they agreed a £50,000 loan for the new Simmons Bar.

We packaged the deal quickly and it was turned around fast by RateSetter, so Nick and Jason could stick to their tight deadlines and keep the project on track. They also appreciated some of the benefits of RateSetter, like having no early repayment fees and the option to draw down again in the future — both big advantages for a business in a period of fast growth.

## **Minerva Crafts**

Minerva Crafts is a family-run business in Lancashire, established in 1998 with the aim of becoming Europe's number one online sewing, knitting, and crafts retailer. They were looking for funding to improve their offering and expand.

Minerva Crafts customers expect the newest and best craft items on the market — but the business was being held back by a lack of warehouse space. This lack of storage was leaving stock levels lower and the range smaller than they would have liked:

“Due to the great relationship we have with our suppliers everything we need is available to us. The issue that has been holding us back is warehouse space”  
— Phil Ormerod, co-owner, Minerva Crafts

The family behind Minerva wanted to capitalise on their good existing relationships with suppliers, by expanding their warehouse to stock a wider range of items in bigger volume.

To do it, they needed business finance for the new racking equipment — which would have to be paid for before the uplift in revenue they predicted.

Funding Options was put in touch with Minerva Crafts, and things started well:

“Excellent first conversation, it made me feel like they might be able to do something for our business which was very positive. The person I spoke to was very helpful and explained the process in great detail.”

After such a positive start, the team at Minerva Crafts provided bank data and proof of identity and within only 7 days they had the money in their account.

With a bigger warehouse space, Minerva Crafts are stocking more sewing, knitting and craft items than ever — and keeping relationships strong with their suppliers and customers alike.

## Footnotes

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<sup>i</sup> Competition & Markets Authority 'Retail Banking Market Investigation' - <https://assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf>

<sup>ii</sup> SME Finance Monitor - <http://bdrc-continental.com/products/sme-finance-monitor/>

Data range from January 2011 to December 2015

SMEs defined as having turnover of less than £25m

<sup>iii</sup> Bank Of England data - <http://www.bankofengland.co.uk/boeapps/iadb/NewInterMed.asp>

Data range from April 2011 to April 2016

SMEs defined as those businesses with annual turnover on main business account of less than £25m

Large businesses defined as those with annual turnover on main business account of more than £25m

<sup>iv</sup> British Bankers Association data - <https://www.bba.org.uk/news/statistics/sme-statistics/bank-support-for-smes-4th-quarter-2015/#.V9fk7PArLs1>

Data range from January 2011 to December 2015

Small businesses defined as having less than £2m annual turnover

Medium businesses defined as having less than £25m annual turnover

<sup>v</sup> Competition & Markets Authority 'Retail Banking Market Investigation' - <https://assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf>

<sup>vi</sup> British Business Bank 'Business Finance Guide' - <http://british-business-bank.co.uk/advice/>

<sup>vii</sup> GLI Finance is an investor in Funding Options