Business Finance Review

UK Finance provides a regular analysis of how the finance needs of small and medium-sized enterprises (SMEs) are being supported through lending from mainstream lenders and specialised finance providers and also looks at their deposit holdings. This latest *Business Finance Review* provides a round-up of lending activity in Q2 2020 and shows how SME demand for finance developed through the unprecedented challenge and uncertainty resulting from the COVID-19 pandemic.

Stephen Pegge, Managing Director of Commercial Finance, comments:

"With lockdown support measures fully operational in the second quarter, our data shows that many companies still had a degree of financial headroom from a combination of existing facilities and deposits, but the demand for additional support was substantial.

"Gross lending for Q2 was up 50 per cent on the entire annual total in 2019, reflecting this significant demand with new overdraft facilities as well as the Government's business interruption finance schemes providing support.

"The finance industry continues to work closely with government and regulators to deliver the support schemes alongside its usual assistance measures to help viable businesses as they plan for recovery."

2020 Q2 HIGHLIGHTS

- **Gross lending of £34.5bn in the second quarter was, in a single quarter, 50 per cent more than the annual total in 2019.**
- **More than a million businesses had applications approved for finance under Government schemes by the end of June.**
- **Un-utilised overdraft facilities and invoice finance options provide businesses with a degree of financial flexibility during lockdown.**
- **Receipts from the Coronavirus Job Retention Scheme, along with business rates suspension and other temporary tax relief measures reduced operating expenses for businesses and resulted in a 20 per cent increase in deposit holdings since the beginning of the year.**
- **Available SME finance was widespread across regions and sectors but was particularly marked in hard-hit service industries.**

Economic context

Having seen a line drawn under Brexit-related political uncertainty in January, business concerns about the adverse impacts of the UK leaving the EU potentially without a trade deal at the end of this year were swiftly replaced by the coronavirus pandemic. Towards the end of the first quarter, economic growth started to slow, but the Government's imposed lockdown measures were felt dramatically across the economy in Q2. GDP growth contracted by an unprecedented 20.4 per cent in the second quarter, notwithstanding an improvement in June as certain aspects of lockdown eased, the retail landscape reopened, factories increased production and housebuilding re-started. By way of comparison, the economic contraction in GDP throughout the 2008/2009 Global Financial Crisis was no more than 2.1 per cent in any quarter and NIESR's expected impact of Brexit was a reduction in GDP of around 3-4 per cent. So, at the mid-point of the year, the UK economy was firmly in recession, while the overall level of output was some 17.2 per cent smaller than it was in February.

The Government and industry's response to the pandemic was multi-faceted. A Coronavirus Job Retention Scheme (CJRS), taken up by 78 per cent of businesses, provided 80 per cent of salary finance to allow employers to furlough staff, local authority grants were made available for small businesses, business rates and VAT payments were deferred and, through nearly one hundred lenders, Government guaranteed business interruption scheme finance was offered to support viable businesses unable to trade normally. Around a quarter of a million businesses ceased trading altogether and 20 per cent of businesses sought grants.

Despite the prospect of easing lockdown measures further in Q3 and the hope for a V-shaped recovery, there are significant drags on the service sector and consumer-dependent sectors in hospitality, transport, tourism and retail, with many businesses unlikely to return to full trading volumes for some time. The introduction of local lockdowns, encouragement to continue working from home for many and hospitality curfews in September will tend to flatten out the recovery path and business uncertainty is also re-surfacing as prospects of an EU trade deal at the year-end seem some way off. The consequence is that business investment and growth plans are being postponed.

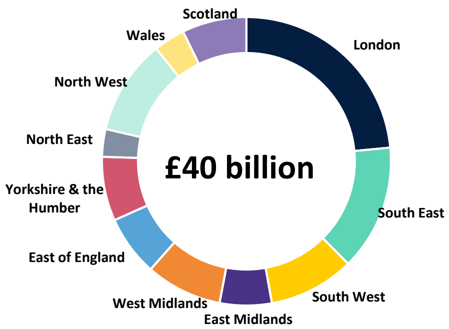
Business sentiment is understandably fragile. As the furlough scheme tapers off, the costs of retaining staff without the offset of trading revenue will challenge business models and profitability, even with the subsequent Job Support Scheme announced recently by the Chancellor. The SME Finance Monitor reflects the main concerns of small and medium-sized enterprises being the state of the economy, political uncertainty, cashflow and late payment, while access to finance has slipped well down the list of barriers seen to prevent growth.

Businesses have been able to access a wider range of finance opportunities since the start of the pandemic; the Government guaranteed Coronavirus Business Interruption Loan Scheme (CBILS) for SMEs, its variant for larger businesses (CLBILS) and the Bounce Back Loan Scheme (BBLS) have sat alongside lenders' existing commercial lending and options such as invoice finance and asset based lending. By the mid-year, lenders had facilitated the provision of nearly £35 billion under the schemes to businesses across the country and in most sectors.

SME Finance

The unprecedented circumstances seen in the second quarter mean that comparisons of lending with previous quarters or the same period last year are spurious at best. Driven by Government guaranteed schemes, which accounted for some three-quarters of all gross lending in the first half of the year, £40 billion was provided right across all regions of Great Britain (**chart 1**).

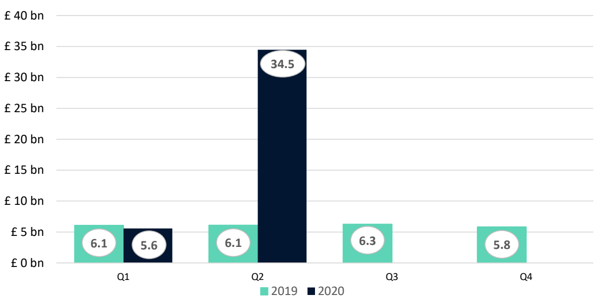
Chart 1: Gross lending to SMEs during H1 2020



Source: UK Finance

As **chart 2** shows, the amount of lending approved in the second quarter was more than five times the amount in Q2 last year and some 50 per cent higher than a full year total in normal times.

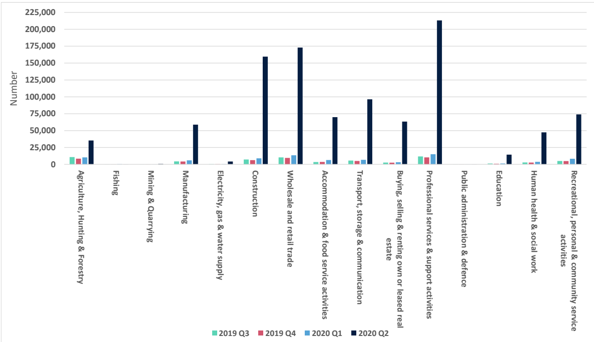
Chart 2: Gross lending to SMEs through loans and overdrafts in 2020 compared to 2019



Source: UK Finance

As **chart 3** shows, the numbers of loans and overdrafts approved in Q2 dwarfed previous quarterly volumes across most sectors of industry. Clearly, those sectors across retail, hospitality, travel and tourism activities have been most affected by the pandemic or lockdown measures and consequently they have shown most demand for additional finance. With approvals in previous quarters for any sector averaging fewer than 20,000, Q2 volumes exceeding 150,000 for construction or retail sectors and more than 200,000 for professional & support services were clearly exceptional as lenders met the unprecedented demand for additional support.

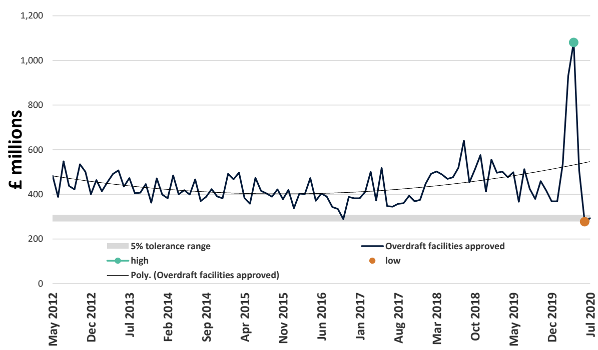
Chart 3: Number of SME loans and overdrafts approved



Source: UK Finance

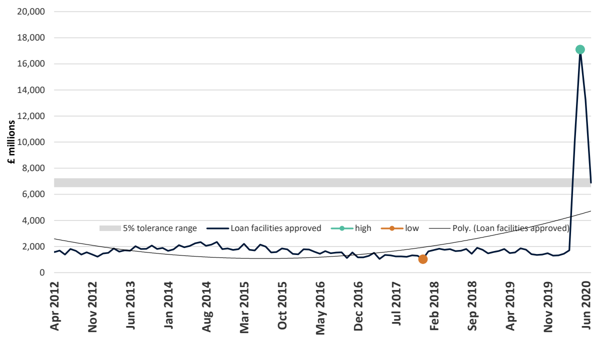
Towards the end of the first quarter, demand for overdraft facilities rose significantly as businesses sought to cover their cashflow (**chart 4**) but focus in the second quarter moved towards loan facilities, particularly under the government schemes (**chart 5**). More than simply business interruption support, CBILS and BBLS were effective life--support measures for businesses in survival mode.

Chart 4: Value of overdraft facilities approved



Source: UK Finance

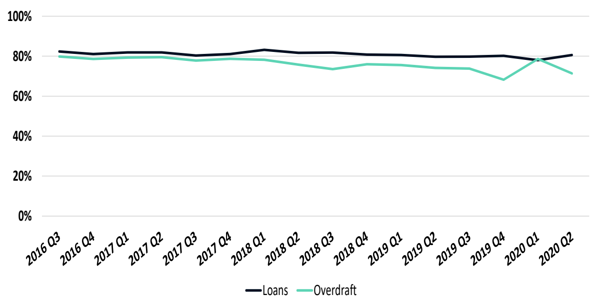
Chart 5: Value of loan facilities approved



Source: UK Finance

With no formal credit assessment involved in the provision of BBLS, the overall approval rate of eight in every ten loan applications was easily maintained in Q2 (**chart 6**).

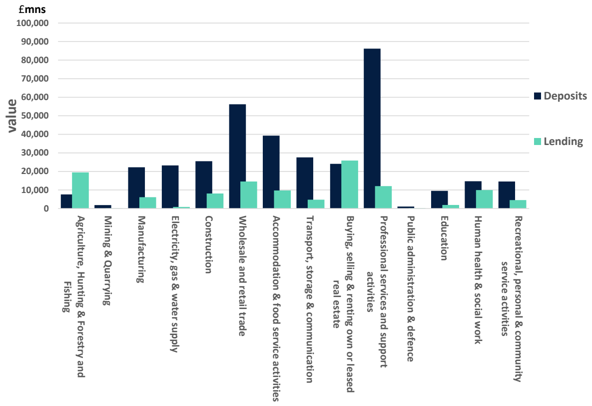
Chart 6: Borrowing approval rates for loan and overdraft applications



Source: UK Finance

The consequence of receiving Coronavirus Job Retention Scheme payments and government-scheme finance together with reduced operating expenses and tax deferrals resulted in a substantial rise in cash deposit holdings for businesses. At the mid-year, total deposits were some 20 per cent higher than at the beginning of the year. **Chart 7** shows the general excess of deposit levels over loan balances across most sectors. The BICS survey suggests that 45 per cent of businesses have less than six months' cash reserves, so those deposits will provide a temporary operational buffer for businesses unable to trade normally.

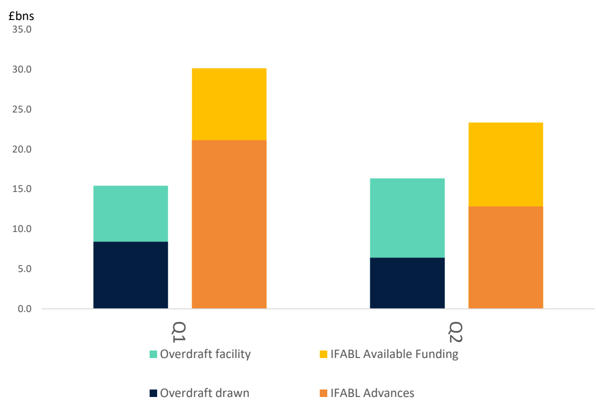
Chart 7: Deposits and Lending stock balances as at June 2020



Source: UK Finance

With the focus of businesses firmly fixed on short-term replacement or preservation of cashflow, a drop in the utilisation of overdraft facilities from 54 per cent in Q1 to 39 per cent in Q2 resulting from cash inflows, leaves substantial headroom to draw down available existing facilities if needed. The previously stable level of advances through invoice finance facilities has been adversely impacted by reduced trading volumes for many businesses as supply chains were disrupted by lockdown measures and has also been impacted by the ready availability of relatively cheaper finance through the government lending schemes and CJRS payments, tax deferrals etc, as per above (**chart 8**).

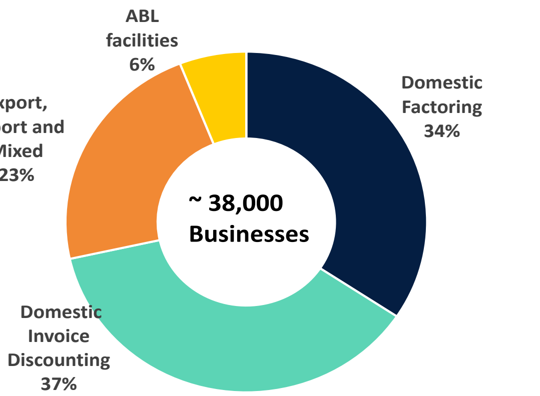
Chart 8: Overdraft and IFABL utilisation



Source: UK Finance

While the number of businesses using invoice finance reduced marginally, to 38,000, the product mix and sector spread remained stable (**chart 9**).

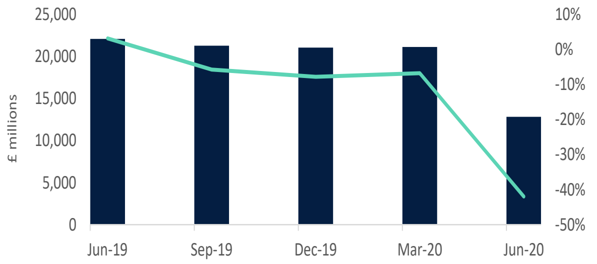
Chart 9: Invoice finance/asset based lending product distribution



Source: UK Finance

However, as **chart 10** shows, the level of advances fell by 40 per cent in Q2 from a fairly steady level over the previous year.

Chart 10: Advances through invoice finance facilities at quarter-end

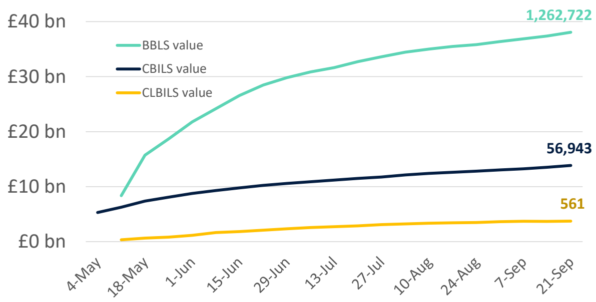


Source: UK Finance

Government Schemes

The government-guaranteed lending schemes warrant specific commentary, given the unique circumstances that led to the support made available for the economy. In just two months, 48,700 CBILS had been provided by a wide range of lenders, but that rate of take-up was completely overshadowed by demand for BBLS, which reached one million facilities by the first week of July. Latest data show that more than £50 billion has been provided to businesses by early September (**chart 11**).

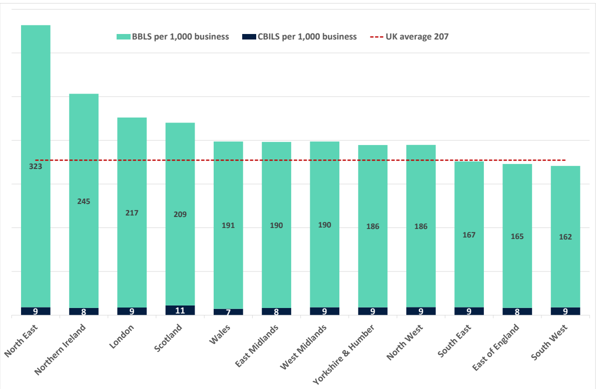
Chart 11: Lending to business under Government Schemes & number of facilities approved



Source: UK Finance

Nationally, approval rates of facilities have averaged 209 BBLS and 9 CBILS for every thousand businesses. The North East and Northern Ireland had substantially higher regional uptakes, despite having lower than average business populations, reflecting an increased appetite and need for financial support in those areas.

Chart 12: Government scheme lending volumes as a proportion of regional business populations



The Business Impact of Coronavirus Survey (BICS) conducted by the Office for National Statistics showed that at the end of July, 94 per cent of businesses were trading, but 29 per cent of those said that operating expenses were greater than or equal to their turnover.

Apart from the disruption to trading, changes in workforce practices has impacted on business. Nearly 14 per cent of the business workforce was on furlough in July and 38 per cent was working remotely. Around 44 per cent of the workforce was operating from their normal working locations, so that proportion was expected to rise but the imposition of tighter lockdown restrictions in September is likely to suppress the expansion in business activity in the second half of the year.