

Business Finance Review

5.7 million businesses operate across the UK, manufacturing goods, constructing offices, factories, homes or infrastructure and providing services for the UK economy. They employ 27 million people and generate output of £1.8 trillion annually. In this review, we look at finance activity in the first quarter of 2019, particularly for the UK's 4.5 million small and medium-sized enterprises (SMEs).

Stephen Pegge, MD of Commercial Finance comments:

“With SME deposit and current account balances now standing at double outstanding borrowing, and overdraft utilisation at 60 per cent of limits, businesses have significant headroom to meet their cashflow requirements. Invoice finance and asset-based lending complement these sources of liquidity and while demand for longer term finance is currently subdued, eight out of ten loans continue to be approved and finance is well spread geographically across the UK.”

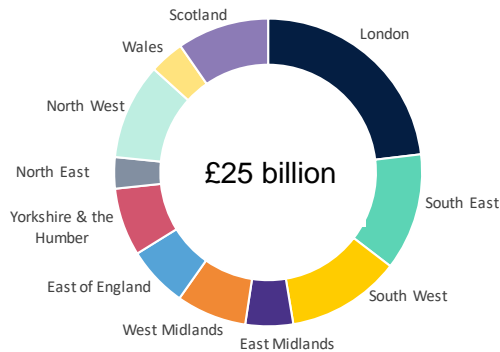
2019 Q1 HIGHLIGHTS

- **Eight out of ten applications for loans by small & medium-sized enterprises (SMEs) are approved.**
- **Loan applications were five per cent fewer in Q1 2019 than in the same quarter of last year.**
- **The number of businesses using invoice finance products has remained stable at 40,000 over the past three years, during which time advances have grown by some 20 per cent.**
- **SME deposits are growing at only three per cent per annum, the slowest growth rate for three years.**
- **Utilisation of overdraft limits remains around 60 per cent, leaving SMEs with borrowing headroom.**

SME Finance

The number of finance providers for small and medium-sized enterprises continues to expand, but the mainstay of SME finance is loans and overdrafts provided out of the regional branch network of the mainstream lenders where SMEs typically hold their business current accounts. Through 2018, £25 billion of loans were approved in the UK, with a wide geographic spread for SMEs outside London and the South (**chart 1**) where 46 per cent of national output is generated by business communities.

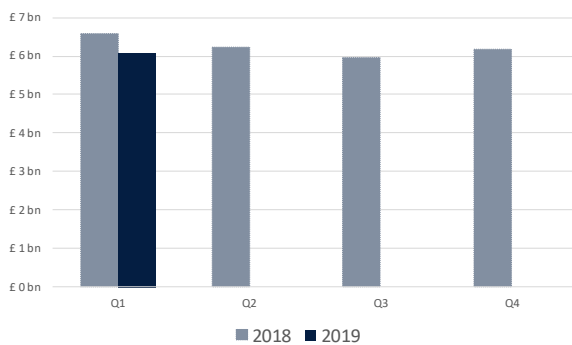
Chart 1: Gross lending to SMEs in 2018



Source: UK Finance

New loans in Q1 2019 totalled £6.1 billion, a slightly lower amount than in the same quarter a year earlier, but in line with the recent quarterly average.

Chart 2: Gross loans to SMEs

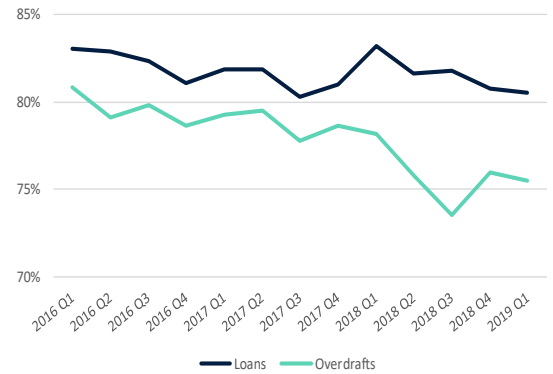


Source: UK Finance

Approval rates for applications are generally stable and, while more than three-quarters of

all overdraft applications are approved, the success rate rises to over eight in ten for loan applications (**chart 3**).

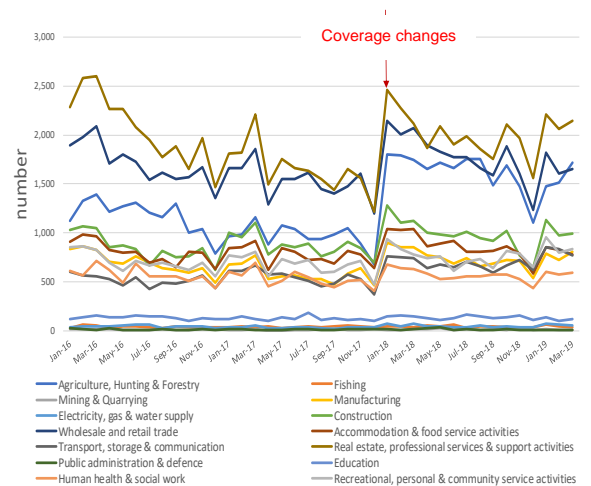
Chart 3: Borrowing approval rates



Source: UK Finance

Through 2016/17, the number of approvals month-on-month declined and, although data monitoring was disrupted by a re-calibration of business customer segments at the start of 2018, the underlying trend in demand continued to fall throughout last year, particularly towards the year-end. The first quarter of 2019 has seen some stability return in approvals numbers for most industry sectors (**chart 4**).

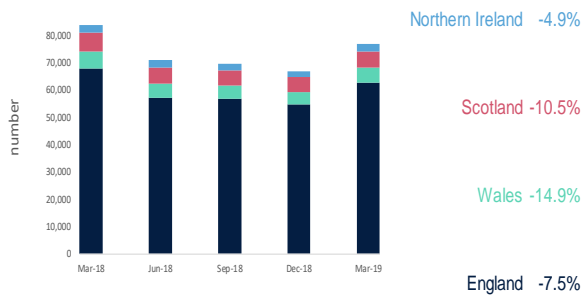
Chart 4: Numbers of loans approved



Source: UK Finance

In total, however, loan application volumes were five per cent fewer in Q1 2019 than in the same quarter last year and approvals were consequently lower in all regions (**chart 5**).

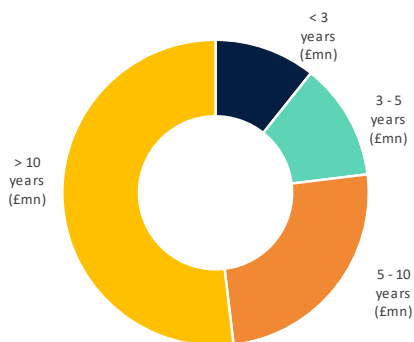
Chart 5: Numbers of loans approved and year-on-year change within the UK regions



Source: UK Finance

Loans are approved for SMEs with a range of maturities to match business needs. More than three-quarters of all loans outstanding at the end of Q1 had a term of three years or more and over half have a term greater than ten years or are undated. Some 20 per cent of lending is made at fixed interest rates, giving SMEs certainty over their borrowing costs. (**chart 6**).

Chart 6: Maturity breakdown of SME lending

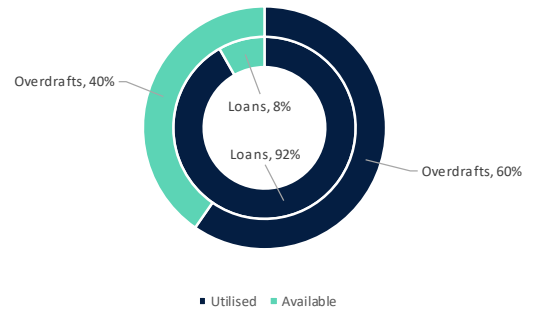


Source: UK Finance

SMEs usually draw down the full amount of loans approved, either in one or more tranches, so that most structured term finance is fully utilised. Overdrafts, on the other hand, are a flexible source of finance, adapting to cashflow changes in the business. At the end of Q1 2019, around 60 per cent of agreed overdraft limits were being utilised, leaving significant

borrowing headroom for SMEs to meet short-term finance requirements (**chart 7**).

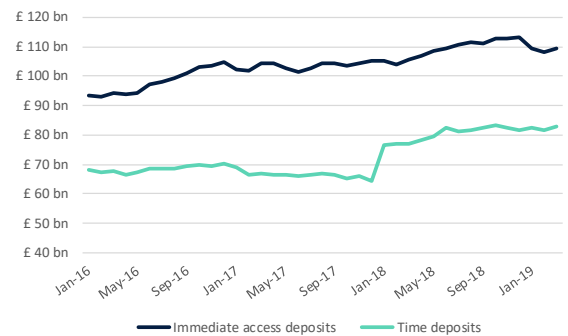
Chart 7: Utilisation and available borrowing headroom



Source: UK Finance

Rising business deposits have been very evident for SMEs, who have been building up cash for a long time in immediate access accounts (**chart 8**) as a hedge against uncertain trading conditions and retaining the option to use those reserves quickly if needed.

Chart 8: SME deposits

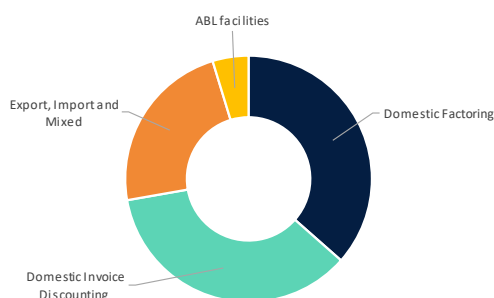


Source: UK Finance

Invoice finance & asset-based lending

Complementary types of finance such as factoring and invoice discounting (referred to as invoice finance) and are used by more than 40,000 businesses (**chart 9**). The current spread of products has remained little changed over the past year.

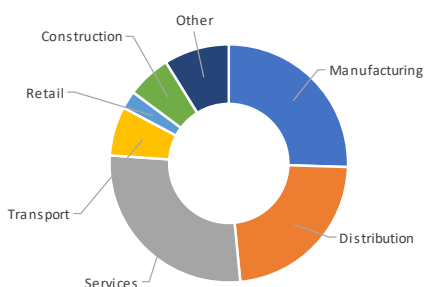
Chart 9: Breakdown of invoice finance products



Source: UK Finance

Advances based on these products and services have risen consistently over recent years to stand at £22.7 billion at the end of Q1 2019. Provided by both banks and non-bank specialist financiers, these alternatives to 'conventional' bank borrowing provide ready cashflow against client sales averaging more than £71 billion a quarter, as well as against other business assets. The services, manufacturing and distribution sectors dominate the client profile, reflecting the popularity of these products amongst businesses within the 'real economy' (**chart 10**).

Chart 10: IFABL client distribution



Source: UK Finance

General business environment

Since the Referendum vote, the value of sterling has depreciated, helping exporters, but hindering importers. Together with higher oil prices, more expensive imports are adding to business costs.

International trade in goods saw a Q1 deficit (imports exceeding exports), which was offset by a surplus in services. The net picture is of a worsening trade position for the UK with the rest of the world.

GDP growth in 2018 was 1.4 per cent, the lowest annual figure since 2012, reflecting a slowing down of the UK economy.

Business investment was subdued through 2018 as uncertainty surrounding the UK's proposed departure from the EU bred a reluctance to take long-term decisions.

SME attitudes towards external finance

The independent SME Finance Monitor finds that only 43 per cent of all SMEs are using any form of external finance and around half have no apparent appetite to borrow. Only 13 per cent of SMEs are reporting plans to apply for or renew finance.

Credit Conditions

Lenders reporting to the Bank of England suggest that credit availability for corporates had been unchanged in Q1 and was expected to remain so in Q2. Demand was not expected to change in Q2 for small businesses and loan pricing was stable. While there was some evidence of default rates edging up, losses given default are little changed.

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