

## Business Finance Review

5.9 million businesses operate across the UK, manufacturing goods, constructing offices, factories, homes or infrastructure and providing services and facilitating trade nationally and internationally. They employ over 27 million people and generate annual output of £1.9 trillion. The provision of lending to support businesses is important for the sector's effective contribution to growth, investment and employment. In this review, we look at finance activity in the first three quarters of 2019, particularly for the UK's small and medium-sized enterprises (SMEs).

### Stephen Pegge, Managing Director of Commercial Finance, comments:

*"In Q3 2019, SME lending saw modest growth led by the transport and communications sector with the proportion of firms reporting that their use of finance has increased. Deposit balances continue to grow and are in aggregate twice the level of borrowing balances. This reflects subdued investment activity and the retention of reserves by businesses in the face of continued uncertainty. However, credit availability is strong with eight out of ten loans being approved and 50 per cent of term lending being committed for a term of ten years or more. Invoice finance and asset based lending has increased by ten per cent over three years as businesses seek a more diverse range of finance to support their cashflow needs."*

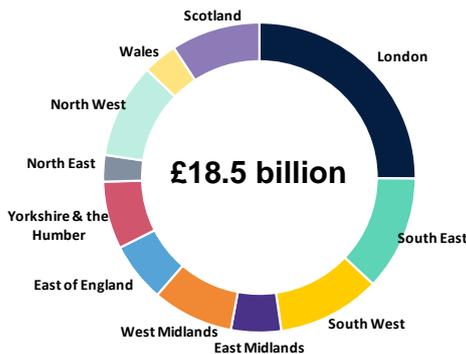
### 2019 Q3 HIGHLIGHTS

- While eight out of ten loan applications by small and medium-sized enterprises (SMEs) are approved, there were four per cent fewer loan applications in Q3 2019 than in the same quarter of last year.
- Some 40,000 businesses have been using invoice finance products over the past three years, during which time advances have grown by some ten per cent.
- SME deposits are growing by five per cent per annum.
- Overdraft utilisation remains around 60 per cent, leaving SMEs with borrowing headroom.

## SME Finance

The number of providers of finance to small and medium-sized enterprises continues to expand, but the mainstay of SME finance remains the loans and overdrafts provided by both large and small mainstream lenders with local branches where SMEs typically hold their business current accounts. The first three quarters of 2019 saw a wide geographic spread of loans approved across the UK with two thirds of loans being made to businesses outside of London and the South East (**chart 1**). In addition, over 60 per cent of SME lending amounts outstanding sits outside London and the South East where a similar proportion of national output is generated.

**Chart 1: Gross lending to SMEs as at Q3 2019**



Source: UK Finance

New lending in the first three quarters of 2019 ran slightly below the corresponding period a year earlier, however, Q3 was slightly above the recent quarterly average and higher than in Q3 2018 (**chart 2**).

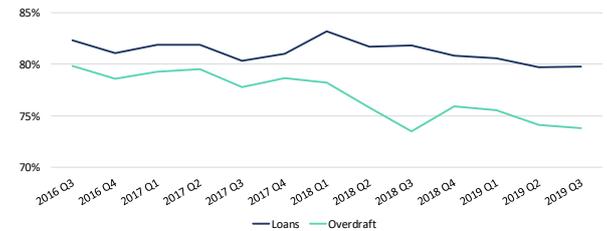
**Chart 2: Term lending to SMEs**



Source: UK Finance

Approval rates for applications remain generally stable and while around three quarters of all overdraft applications for new or increased facilities are approved, the success rate rises to over eight in ten for loan applications (**chart 3**).

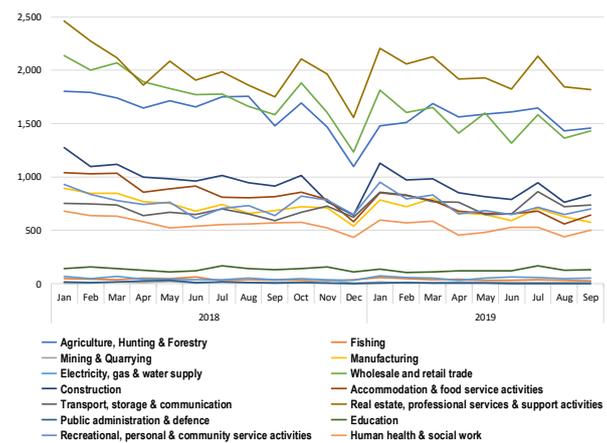
**Chart 3: Borrowing approval rates**



Source: UK Finance

Whilst approval rates have been steady, there has been a general declining trend in the number of applications received since 2016, reflected overall in fewer approvals over that period. The first three quarters of 2019 have seen reduced demand in major sectors such as wholesale, retail, accommodation & food, and construction, while transport & communications show a small increase compared to the same period in 2018. (**chart 4**).

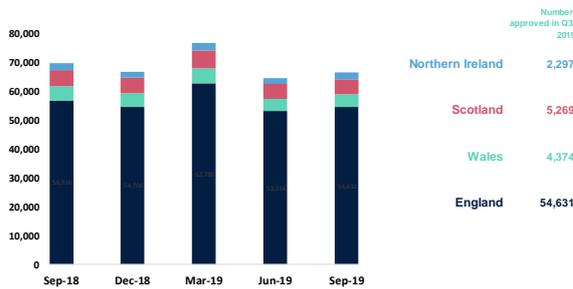
**Chart 4: Numbers of SME loans approved**



Source: UK Finance

The picture of fewer applications and approvals compared to Q3 2018 is replicated across UK geographies (**chart 5**).

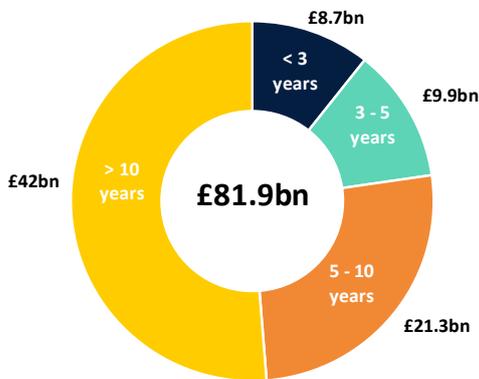
**Chart 5: Numbers of loans and overdrafts approved and year-on-year change across the UK regions**



Source: UK Finance

Loans are approved for SMEs with a range of maturities to reflect the purpose and assets acquired. More than three quarters of all loans outstanding at the end of September 2019 had an original term of three years or more and over half either 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**

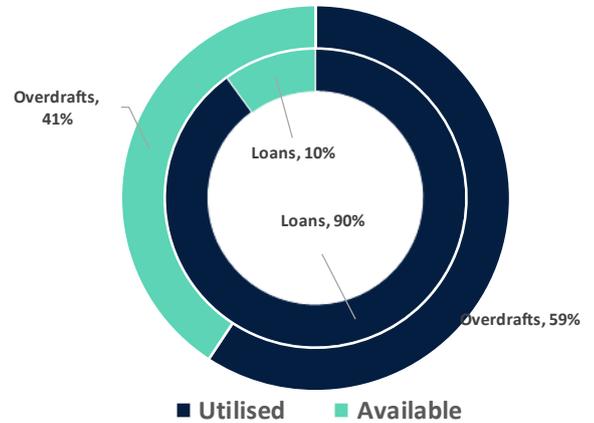


Source: UK Finance

SMEs usually draw down the full amount of loans approved 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 the third quarter of 2019, only 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**).

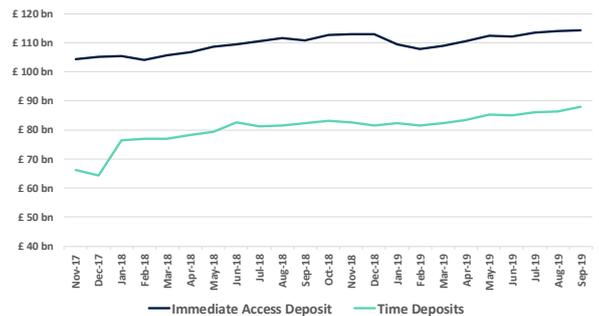
**Chart 7: Utilisation and borrowing headroom**



Source: UK Finance

A rising trend in business deposits has 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, while retaining the option to use those reserves quickly if needed.

**Chart 8: SME deposits**

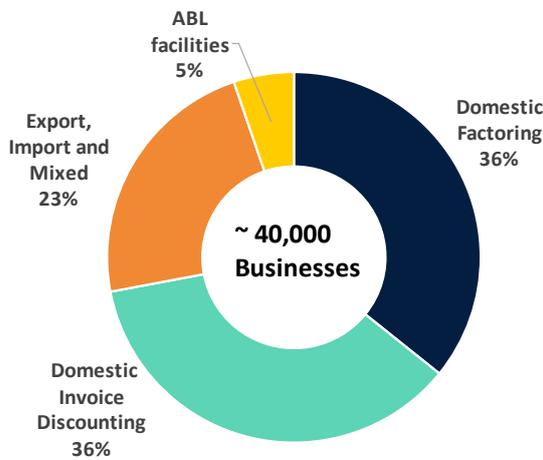


Source: UK Finance

**Invoice finance & asset based lending**

Complementary forms of finance such as factoring and invoice discounting are used by nearly 40,000 businesses (**chart 9**). The current spread of invoice finance and asset based lending (IFABL) products was little changed over the past year.

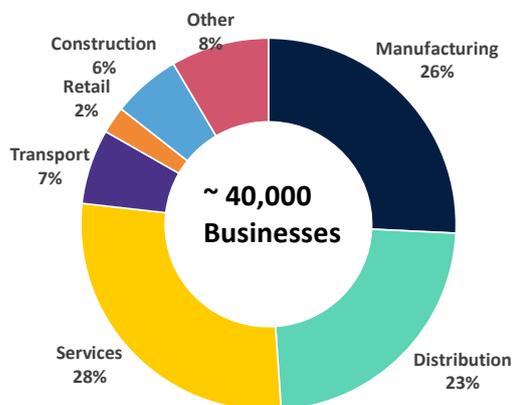
**Chart 9: Breakdown of invoice finance and asset based lending products**



Source: UK Finance

Overall advances through invoice finance and asset based lending (IFABL) have risen consistently over recent years to stand at £21.2 billion at the end of Q3 2019, of which £9.1 billion was advanced to around 38,000 SMEs. Provided by both banks and non-bank specialist financiers, these alternatives to 'conventional' bank borrowing provide ready cashflow against client sales (averaging around £70 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'. It should be noted, however, that the strongest growth in recent years has been seen in ABL facilities based on stock as an asset (**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 running costs for business.

The total trade deficit widened in the three months to October 2019. International trade in goods saw a 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 grew by 0.3 per cent in Q3 2019, following a fall in Q2. The growth in Q3 is mainly driven by the services sector and construction, while manufacturing failed to grow – in part reflecting a slowdown in the economy

Business investment remained flat and saw no growth between Q2 and Q3 2019, as increased uncertainty surrounding the UK's proposed departure from the EU continued to foster a reluctance by firms to take long-term decisions.

## SME attitudes towards external finance

The latest data from the independent SME Finance Monitor shows that the proportion of SMEs using any form of external finance rose to 46 per cent in Q3 2019 compared to 36 per cent in the same quarter in 2018. At the same time, the proportion not using external finance and with no apparent appetite to borrow has fallen to 39 per cent, the lowest proportion since 2012. 12 per cent of SMEs were reporting plans to apply for or renew finance.

## Credit Conditions

Lenders reporting to the Bank of England suggest that credit availability for corporates remained unchanged in Q3 and a higher proportion of lenders expected it to fall in Q4. Lenders felt that small business demand for

loans had fallen in Q3 and would be lower in Q4. While loan pricing remained stable in Q3, the balance of lenders reporting expectations of higher default rates edged up. Nevertheless, lenders were not expecting higher losses through default to emerge in the near term.

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