

## Business Finance Review

UK Finance provides a regular analysis of how SME finance needs are being supported through lending from mainstream lenders and specialised finance providers, and also further information about the provision of deposit accounts. This latest *Business Finance Review* provides a round-up of lending activity in 2019. This will provide an important baseline we can use to understand how SME demand for finance and use of deposits will develop through the current period of unprecedented challenge and uncertainty resulting from the Covid-19 pandemic.

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

*“The subdued economic environment and elevated uncertainty of 2019 translated into moderation in some of the key indicators tracked in our Finance Review.*

*“Last year saw applications for lending and, therefore, approvals for new finance trend down. This was consistent across all UK regions and most sectors of the economy.*

*“SMEs also continued to increase cash deposits over the past year, adding to the headroom within existing unused overdrafts, invoice and asset finance lines.*

*“This will mean that many will enter this period of crisis with more flexibility than was the case in 2008/09. However, the pace and extent of the unfolding crisis, which is inevitably putting huge strains on businesses, means the government’s support packages are crucial and banks are working hard to channel funds to viable businesses that need them.”*

### 2019 HIGHLIGHTS

- Gross lending totalled £24.3 billion in 2019, fractionally down on the previous year.
- New lending was evenly spread across UK regions and sectors.
- Loan approval rates continued to be stable with around 80 per cent of applications agreed.
- SMEs continued to have some borrowing headroom with nearly half of overdraft facilities unutilised.
- SMEs also continued to build a safely net with further increases in deposits in 2019; this was evident across almost all industry sectors.
- Finance through invoice finance and asset based lending (IFABL) facilities also remained stable, with 40,000 businesses benefitting from this form of finance.

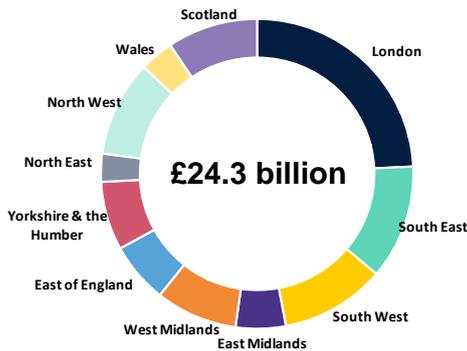
## SME Finance

The backdrop to SME lending in 2019 was characterised by tepid growth in the UK economy, global trade tensions and continuing uncertainty around the timing of the UK’s exit from the European Union. Political uncertainty ramped up towards the end of last year with another general election, but the decisive outcome was beginning to prompt strengthening business confidence as we entered 2020.

That was short-lived as SMEs are now faced with the unprecedented challenges of the spread of Covid-19. This latest *Business Finance Review* does not yet capture the impact of this crisis on economic activity or borrowing behaviour, nor does it consider the impact of the financial interventions government has put in place. It does, however, provide a baseline of data on lending activity in 2019 against which we will be tracking developments in the coming quarters.

Consistent with previous releases the mainstay of SME finance remains the loans and overdrafts provided by both large and small mainstream lenders where SMEs typically hold their business current accounts.

**Chart 1: Gross lending to SMEs as at Q4 2019**

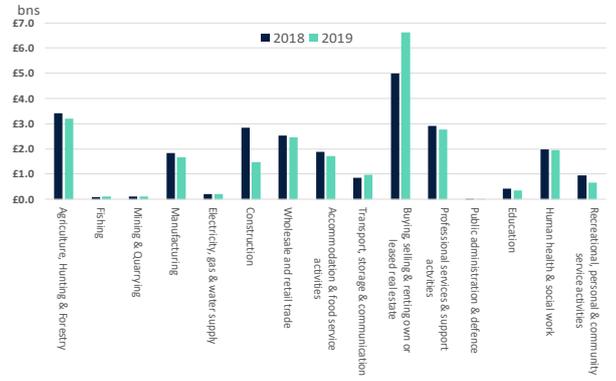


Source: UK Finance

Total new lending on loans and overdrafts across the GB economy amounted to £24.3bn, fractionally down on £24.9bn in 2018. The geographic spread of this lending (**chart 1**) is largely consistent with the location of business

activity across the regions and devolved nations of the UK. While London and the South East look to be dominant, around 60 per cent of lending is to SMEs in the rest of the country.

**Chart 2: Gross lending to SMEs by Sector**



Source: UK Finance

To provide a baseline of lending at the end of 2019 **chart 2** illustrates gross lending split by broad economic sector. Real estate accounts for a disproportionately large share of gross lending in the economy. Excluding this, other sectors of the economy, with the exception of agriculture, lending across other industries in 2019 was broadly in line with their share of gross value added (GVA).

Looking at the dispersion of new lending approved throughout 2019 **chart 3** shows a fairly stable quarterly pattern of lending over the past two years. Although a slightly weaker outturn in the final months of 2019 was likely a reflection of elevated political uncertainty and was further explained by the decline in business investment noted in official figures in Q4 2019.

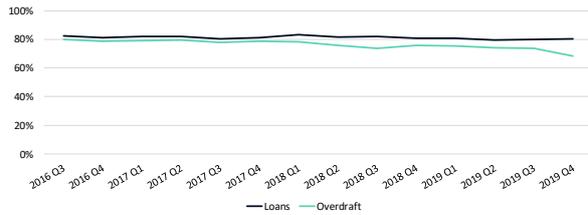
**Chart 3: Term lending to SMEs**



Source: UK Finance

While there were some modest fluctuations in the amount of lending agreed over the past couple of quarters, approval rates for applications remain generally stable. The success rate for loan applications have been consistently around eight in ten in the past year (**chart 4**).

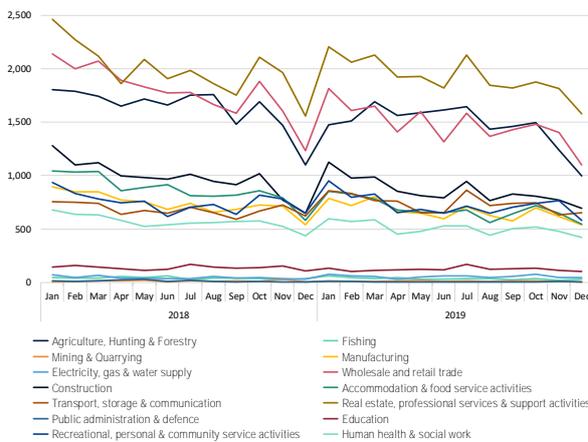
**Chart 4: Borrowing approval rates**



Source: UK Finance

Whilst approval rates have been steady, previous *Business Finance Reviews* have discussed the general reduction in the number of applications received since 2016, which inevitably translates into a lower number of approvals. This trend accelerated in the final months of 2019 with most sectors seeing a reduction in the number of facilities approved. This widespread trend is likely indicative of the economic climate and uncertainty previously mentioned, rather than any specific underlying sector challenges (**chart 5**).

**Chart 5: Numbers of SME loans approved**

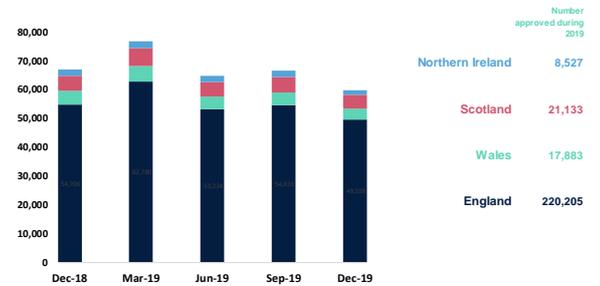


Source: UK Finance

Adding further weight to this picture is the regional split of approvals across the UK,

where we again see a consistent picture of moderation in the number of approved facilities (**chart 6**).

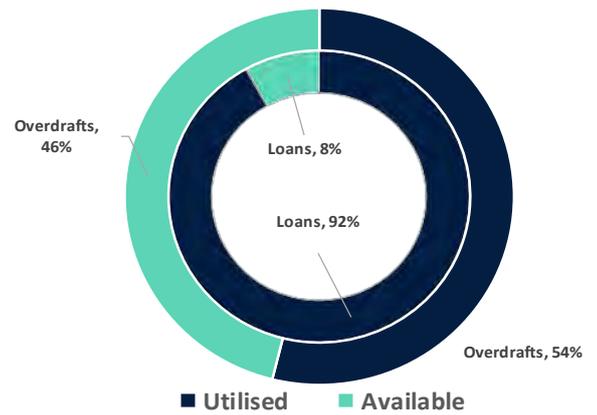
**Chart 6: Numbers of loans and overdrafts approved across the UK regions**



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. Looking in more detail at overdrafts, which are a flexible source of finance generally related to cashflow changes in the business, will provide some insight in the coming quarters as to how SMEs are managing their finances during the ongoing Covid-19 crisis.

**Chart 7: Utilisation and borrowing headroom**

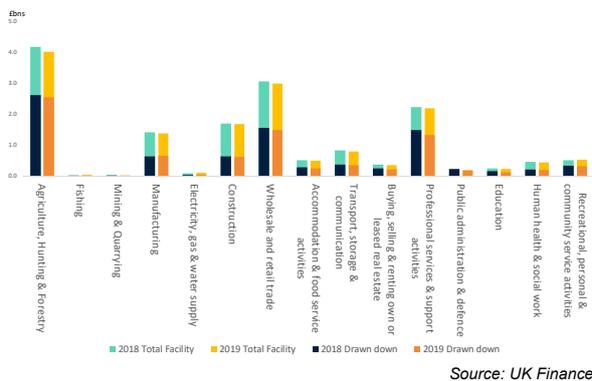


Source: UK Finance

The starting point suggests that SMEs have some degree of headroom within existing facilities with just over half agreed overdraft limits being utilised at the end of last year (**chart 7**).

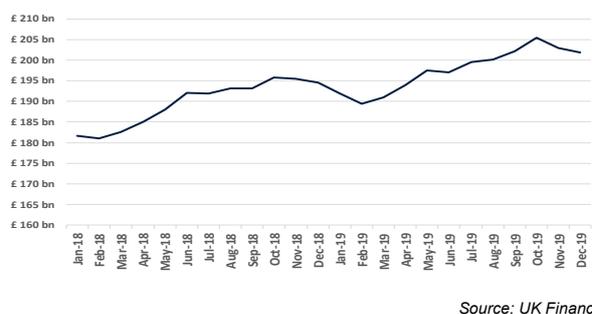
While recognising that different sectors may be more adversely affected than others in the coming quarters, we have provided some sectoral analysis on unutilised overdrafts (**chart 8**). This indicates that there is current flexibility within existing facilities across all sectors, ranging from over three-fifths of overdraft values yet to be drawn down in construction and utilities to around 40 per cent unutilised in professional services.

**Chart 8: Overdrafts Utilisation and borrowing**



A further indicator to watch will be shifts in SME deposits. We have seen a rising trend in business deposits in recent years with SMEs building up a cash safety net for some time in immediate access accounts (**chart 9**) as a hedge against uncertain trading conditions, while retaining the option to use those reserves quickly if needed. Aside from some seasonal variation towards the end of the year, this continued to be the case throughout 2019. Moreover, our analysis indicates that this trend is evident across almost all industry sectors.

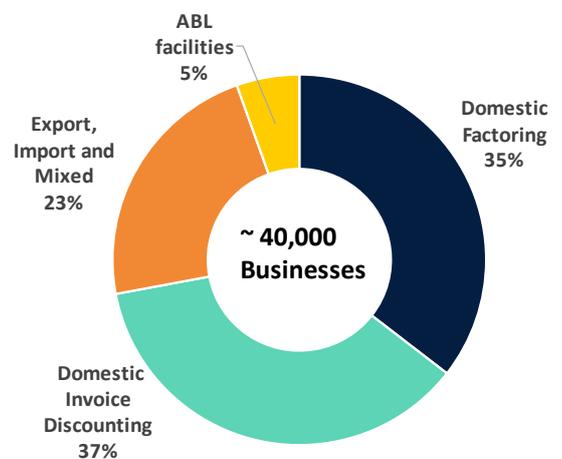
**Chart 9: Total SME deposits**



**Invoice finance & asset based lending**

Complementary forms of finance such as factoring and invoice discounting (together termed invoice finance) and asset based lending (IFABL) were used by nearly 40,000 businesses in 2019 (**chart 10**). The current spread of these facilities across the constituent product types was stable over the past year.

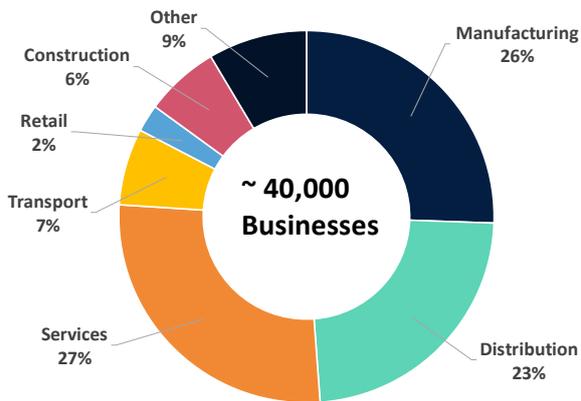
**Chart 10: Breakdown of invoice finance and asset based lending products**



Overall advances through these facilities had shown steady growth in recent years, but in line with other forms of finance the latest data points to some moderation in the final quarters of 2019. At the end of last year £21 billion of funding through IFABL facilities was being advanced to clients, of which £8.7 billion was supplied to around 37,000 SMEs (businesses with up to £25 million turnover).

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. Manufacturing firms are disproportionately represented in IFABL finance, accounting for just over a quarter of client businesses supported (**chart 11**).

**Chart 11: IFABL client distribution**



Source: UK Finance

### SME attitudes towards external finance

The latest data from the independent SME Finance Monitor is consistent with the trends shown in the *Business Finance Review*. The monitor results for 2019 shows that the proportion of SMEs using any form of external finance rose to 45 per cent in 2019 from 36 per cent in the previous year. However, the quarterly profile indicates that this trend peaked in the first half of 2019, tailing off in the latter quarters. For those SMEs applying for finance, three-quarters of applications resulted in a facility.

Ahead of the current crisis, most SMEs were not expecting to apply for finance in the near term, with the proportion expecting to apply (11 per cent) broadly unchanged from the previous two years. The Monitor will be tracking how attitudes and plans will evolve in response to the business impact of Covid-19.

### General business environment

As noted in the earlier sections, growth across the UK economy was subdued in 2019. For the year as a whole, GDP expanded by a rather sub-par 1.4 per cent, though this was a shade better than the 1.3 per cent outturn in the previous year. There was little momentum coming into 2020 as economic growth stalled in the final quarter of last year, with notable

weakness in both household spending and business investment.

There had been some initial tentative signs that activity could turn a corner this year as we saw a resolution to step one of the UK's exit from the EU and political uncertainty was ebbing following the general election result.

However, business activity and confidence indicators have swung sharply into reverse as the impact of the Covid-19 pandemic is starting to become clear. Early indications from monthly purchasing managers' indices point to sharp contractions in manufacturing and services activity in the UK and across most of the Eurozone. Confidence indicators have also dropped sharply, with further falls expected.

The complete cessation of business activity in many sectors has been synchronised around the world and will take a significant toll on global growth, at least in the first half of this year. Some preliminary estimates suggest that global GDP growth could be four per cent lower than previously expected this year, with most of that contraction experienced in the first half of 2020.

Coordinated government and central bank support has been significant – in the UK and elsewhere. The speed of the health policy and the economic response, will to a very large degree, determine how sustained and enduring the effects of the crisis are on business activity.

### Disclaimer

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