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 annual output of £1.8 trillion. In this review, we look at finance activity in the first two quarters of 2019, particularly for the UK's small and medium-sized enterprises (SMEs).

Stephen Pegge, MD of Commercial Finance comments:

"With the SME sector's cash reserves held in deposit and current accounts now standing at twice the level of 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 complements these traditional sources of liquidity and, although demand for longer term finance is currently subdued, eight out of ten loans continue to be approved and finance is geographically well spread across the UK."

2019 Q2 HIGHLIGHTS

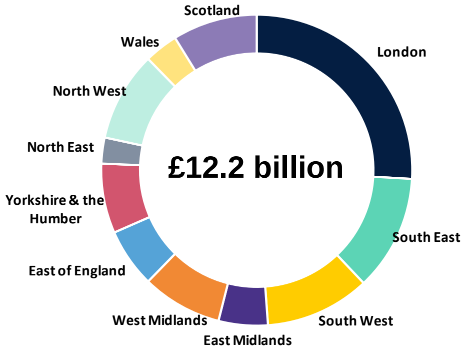
- **While eight out of ten loan applications by small and medium-sized enterprises (SMEs) are approved, there were nine per cent fewer loan applications in Q2 2019 than in the same quarter of last year.**
- **Some 40,000 businesses have been using invoice finance products over the past three years, during which time advances have grown by some 20 per cent.**
- **SME deposits are growing by three per cent per annum, the slowest rate for three years.**
- **Overdraft utilisation remains around 60 per cent, leaving SMEs with borrowing headroom.**

Company number: 10250295.
Registered address: UK Finance Limited, 1 Angel Court, London, EC2R 7HJ

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 out of the mainstream lenders' regional branch network, where SMEs typically hold their business current accounts. Businesses in London and the South East receive around 40 per cent of all SME lending and generate a similar proportion of national output, while the first half of 2019 saw a wide geographic spread of loans approved across the UK (***chart 1***).

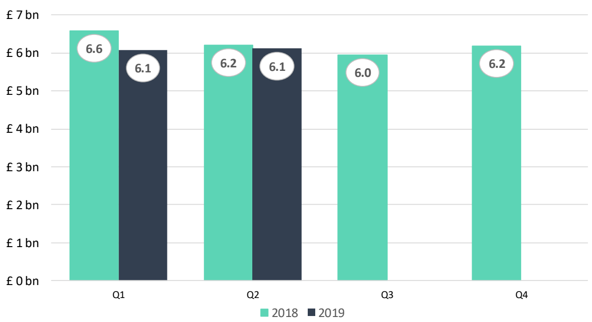
Chart 1: Gross lending to SMEs in 2019 H1



Source: UK Finance

New lending in the first half of 2019, however, ran slightly below amounts in the corresponding period a year earlier but Q2 was in line with the recent quarterly average.

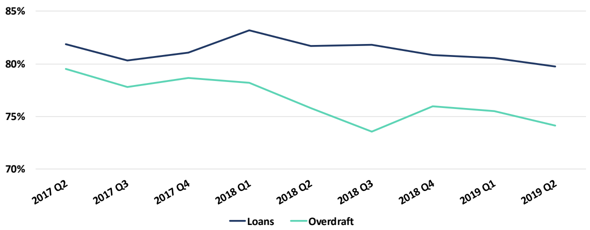
Chart 2: Gross loans to SMEs



Source: UK Finance

Approval rates for applications remain 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***).

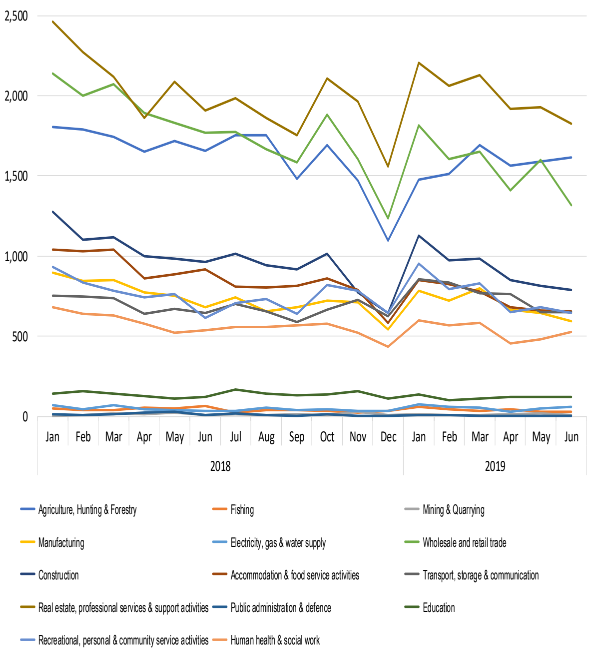
Chart 3: Borrowing approval rates



Source: UK Finance

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 approval numbers over that period. The first half of 2019 has seen some stability return to application numbers for some industries, however reduced demand in major sectors such as wholesale, retail, accommodation & food and construction have seen the overall volume of approvals dip in H1, notwithstanding approval rates holding steady (***chart 4***).

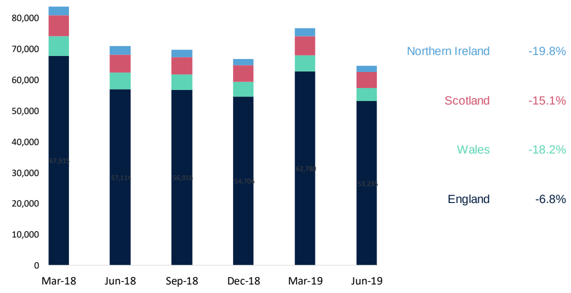
Chart 4: Numbers of SME loans approved



Source: UK Finance

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

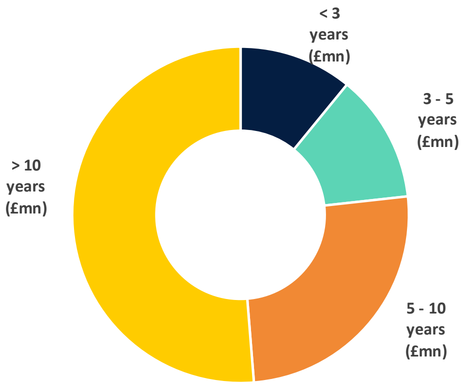
Chart 5: Numbers of loans and overdrafts approved and year-on-year change across the UK regions



Source: UK Finance

Loans are approved for SMEs with a range of maturities to suit the needs of businesses. More than three-quarters of all loans outstanding at the middle of 2019 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***).

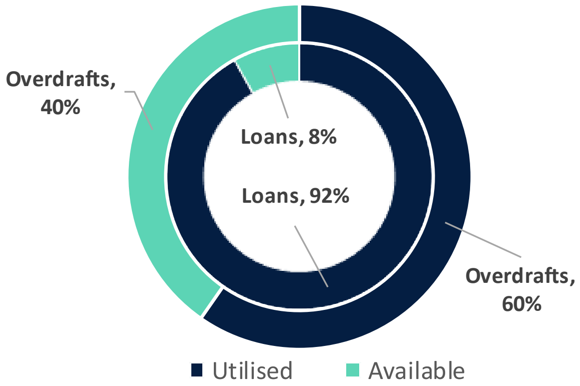
Chart 6: Maturity breakdown of SME lending



Source: UK Finance

SMEs usually draw down the full amount of loans approved 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 middle 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***).

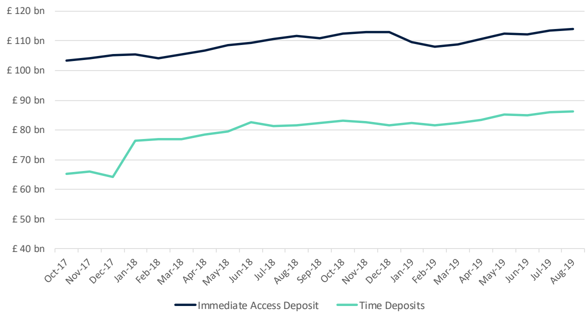
Chart 7: Utilisation and borrowing headroom



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 and retaining the option to use those reserves quickly if needed.

Chart 8: SME deposits

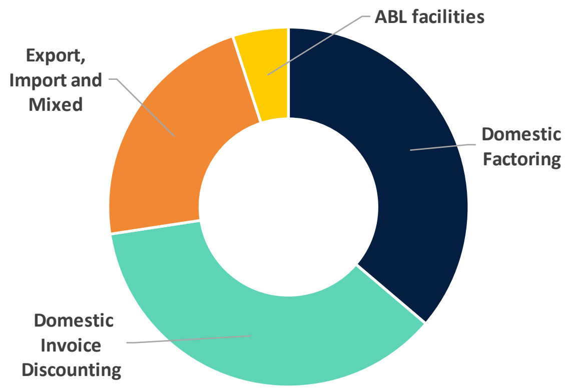


Source: UK Finance

Invoice finance & asset based lending

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

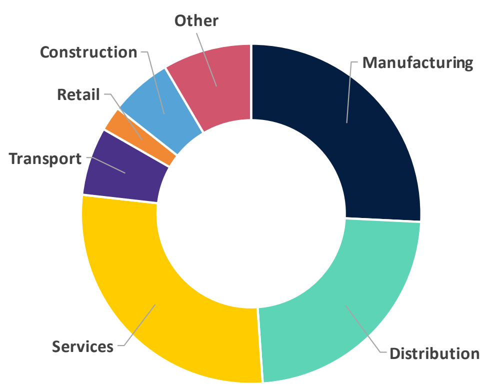
Chart 9: Breakdown of invoice finance products



Source: UK Finance

Overall advances through invoice finance and asset based lending have risen consistently over recent years to stand at £22.1 billion at the end of Q2 2019. 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 had been seen in ABL facilities based on stock as an asset and this has reversed over H1 (***chart 10***).

Chart 10: IFABL client distribution



Source: UK Finance

General business environment

Since the referendum vote to leave the EU in 2016, 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.

International trade in goods saw a Q2 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, with Q2 even seeing a small quarter-on-quarter contraction.

Business investment has remained subdued in the first half of the year, as uncertainty surrounding the UK's proposed departure from the EU continues 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 has risen sharply in H1, to 46 per cent, the highest proportion recorded. At the same time, the proportion not using external finance and with no apparent appetite to borrow has fallen to 41 per cent, the lowest proportion since 2012. Only 12 per cent of SMEs are reporting plans to apply for or to renew finance.

Credit Conditions

Lenders reporting to the Bank of England suggest that credit availability for corporates had fallen in Q2 and a higher proportion of lenders expected it to fall further in Q3, particularly for real estate. Lenders felt that small business demand for loans had fallen in Q2 and would be lower in Q3. While loan pricing remains stable, the balance of lenders reporting expectations of higher default rates edged up. However, lenders are not yet expecting higher losses given default to emerge in the near term.

Disclaimer