UK Finance

Business Finance Review 2024 Q1

Quarterly commentary on business finance for small and medium-sized enterprises.

June | 2024

2024 Q1 Highlights

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 looks at their deposit holdings. This latest *Business Finance Review* provides a round-up of lending activity to SMEs in the first quarter of 2024.

Headlines

- Gross lending increases again in Q1 to the highest level since 2022 Q4.
- Most regions see growth in gross lending.
- Number of finance approvals rises by over a quarter in 2024 Q1, value up by ten per cent.
- Overdraft utilisation rises to post-pandemic high.
- SMEs continue to run down deposits and at a faster pace than the previous quarter.
- Repayments remain stable.

David Raw, Managing Director of Commercial Finance, comments:

"It is encouraging to see further signs that SME demand for finance is returning. As the economic outlook for SMEs improves, the financial services sector is helping businesses across the UK. Lenders remain ready to ready to support SMEs who need and can afford finance.

"Those concerned about their financial position or those planning for the future are always encouraged to have early conversations with their lender."

Economic context

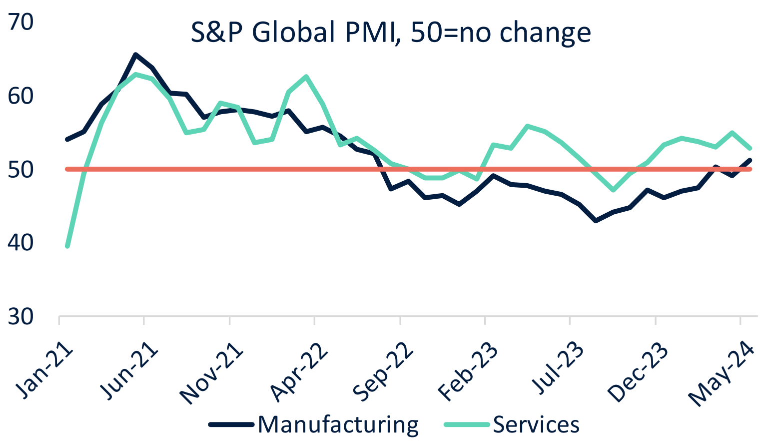
Following a short, shallow recession in the second half of 2023, the UK economy bounced back more strongly than expected in the first three months of 2024. GDP rose by 0.6 per cent in 2024 Q1 compared with the previous quarter, with manufacturing and services recording solid rates of expansion.

Services output posted growth for the first time in a year. Within the services sector, growth was fairly broad-based, including consumer-facing industries, which had contracted in the previous quarter, with the ONS calling out the strong performance of retail. Manufacturing output growth was spurred by buoyant activity in transport equipment production, food, and metals manufacturing.

In contrast, ONS data continued to point to challenges in the construction sector, with output shrinking for the second quarter running. Most components of the industry, with the exception of repair and maintenance, showed decline at the start of the year. While a soggy start to the year explains some of the construction weakness, higher borrowing costs, price pressures and constrained public investment on infrastructure are also contributing to the challenges for the industry.

There are other signs that private sector activity may be gradually emerging from the stagnation of the past 18 months. Business surveys, such as the Federation of Small Businesses Small Business index, pointed to improving business optimism at the start of this year and stronger revenue expectations for the year ahead.

Sector-specific surveys, such as the manufacturing and services PMIs also suggest that expanding activity continued at the start of Q2. Internationally focussed businesses may also be cheered by an improvement in sentiment in overseas markets. Additionally, official data also show that businesses have increased investment over the past six months – a potential sign of gradually improving confidence.



Source: Trading Economics

However, there remains a degree of uncertainty about how strong and sustained recovery will be in the coming quarters. Businesses continue to grapple with recent surges in input costs. Even if the rate of price growth is slowing, for some firms it will still feel like a struggle to manage costs and rebuild margins. We can see some evidence of this in the continuing rise in business insolvencies, for example. The lates data from the Insolvency service for April showed an 18 per cent year-on-year rise in company insolvencies in England and Wales, with number higher than both during and before the pandemic. Construction and wholesale and retail accounted for a third of insolvencies in the year to March. Hospitality has also seen a significant rise over this period.

Cost of living pressures are also still a key concern for households. Overall inflation and, particularly important for lower income households, the rate of price increases across energy and food, is now heading lower. While wage growth remains firm, consumers are still cautious about the outlook for their finances in the near term and the GfK consumer sentiment indicator continues to indicate some reticence to commit to major purchases. Until consumers become more confident that they have emerged from the inflationary challenges of the past couple of years, the demand outlook for businesses is likely to remain muted.

It is this backdrop that is leading forecasters to continue to expect modest GDP growth this year. The average new forecast across independent economists, pushed by HM Treasury, in May is for GDP growth of 0.6 per cent in 2024 and 1.2 per cent in 2025. While a July general election has come earlier than many were expecting and will likely be a short-term source of political uncertainty for businesses, any significant policy changes from the incoming government are unlikely to significantly shift the UK’s growth profile in the remainder of this year.

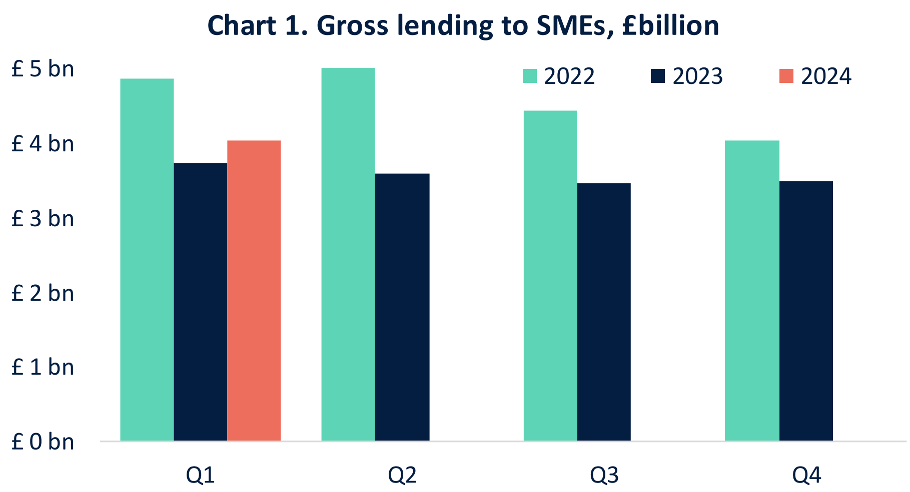
Easing inflation is also good news for policy makers. CPI inflation fell to 2.3 per cent in April, with the lower energy price cap the main driver of the fall. While this is the closest inflation has been to the Bank of England’s target since the end of 2021, April’s reading was, nevertheless, a bit higher than had been expected. Moreover, core and services inflation, at 3.9 per cent and 5.9 per cent respectively, confirm that inflationary pressures have not fully subsided.

May’s Monetary Policy Committee meeting did see some members vote for a quarter point reduction in Bank Rate, with others requiring more evidence of inflation returning sustainably to target. Market expectations are now that the first cut will come later in the summer.

Lending to SMEs

Last quarter our Business Finance Review reported the first quarterly rise in gross lending by the main high street banks since 2022 Q2. While the increase in lending in the final three months of 2023 was a modest one per cent compared with the previous quarter, there was also an increase in the volume of loans approved and the approved value was the highest since 2022 Q3. This suggested that further recovery in gross lending levels in the coming quarters were likely.

The latest data confirms that further growth in lending did indeed take place at the start of 2024. Q1 brought a more material increase in gross lending of 15 per cent compared with the previous quarter. At just over £4 billion, this was eight per cent higher than the same period a year ago and the joint highest lending figure since the final quarter in 2022.



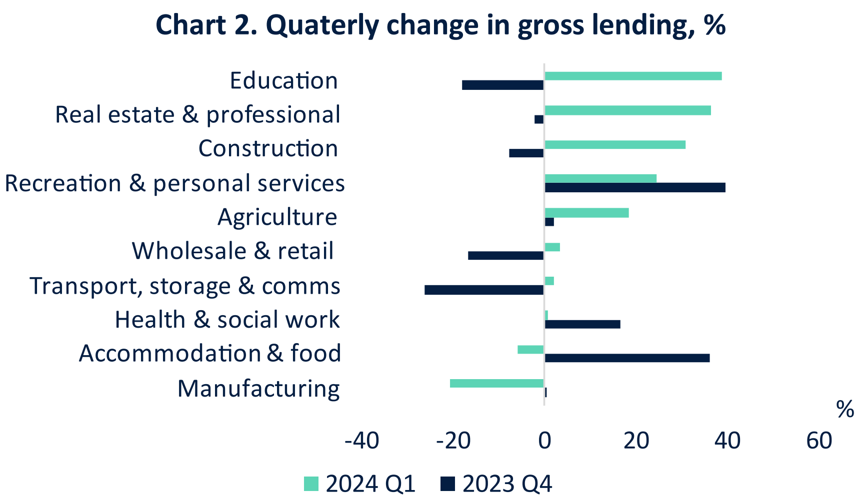
Source: UK Finance

As the official data outlined in the previous section show business activity is beginning to recover following a challenging two years, characterised by sluggish demand and elevated cost pressures. With more evidence that these are easing, confidence is improving and with it an appetite to take on finance as firms think about future growth and investment plans. However, the higher interest rate environment and current uncertainty about when Bank Rate might fall and by how much, may be leading some businesses to take a wait and see approach.

Lending growth is not yet evenly distributed across Great Britain. There were solid increases in new lending to SMEs in the East Midlands, London and the North East. In Scotland, lending was broadly unchanged from the previous quarter and in only Wales and the West Midland was lending modestly lower than in 2023 Q4.

Similar to the uneven regional picture we continue to see some sector variation in new lending. While the increase in finance approvals seen at the end of 2023 was broad-based across sectors, this did not translate into a uniform increase in gross lending across all industries. Lending rose in eight of the ten main sectors covered by our data in Q1, with the largest increases to SMEs in education, real estate and professional services and construction.

At the other end of the spectrum, accommodation and food services saw a decline in lending in Q2, although this followed a strong quarter of growth at the end of 2023. Manufacturing appears to have been the key outlier, with lending down a fifth compared with 2023 Q4.

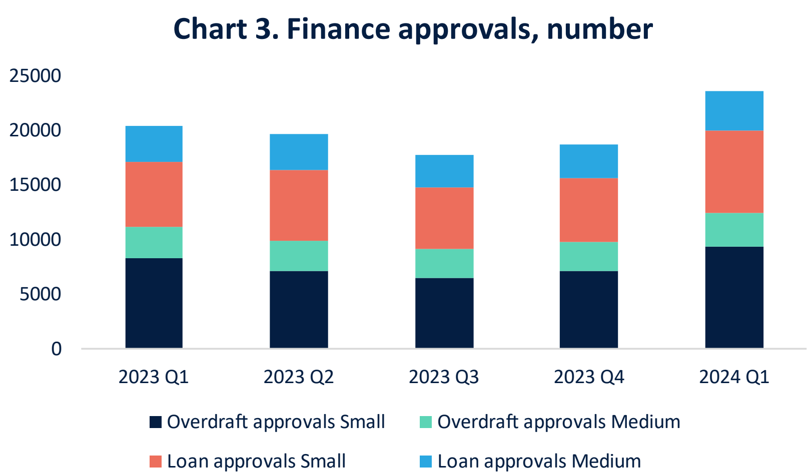


Source: UK Finance

New finance approvals

Following on from last quarter's increase in financial approvals, there was another material quarter of growth at the start of 2024. Overall finance approvals were 27 per cent higher in 2024 Q1 compared with the previous quarter, this equated to a ten per cent increase in the value of approved finance. This followed a five per cent rise in volumes at the end of 2023 and was the highest number of approvals for new or increased loans and overdrafts since 2022 Q1.

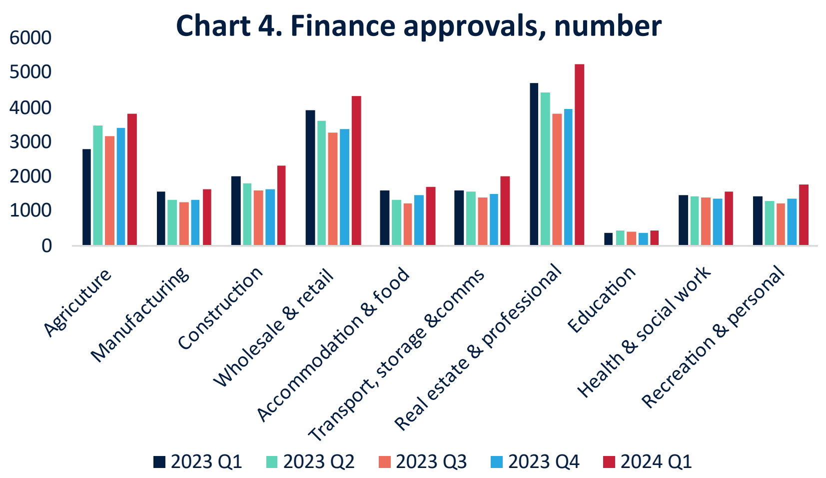
Looking in more detail at the breakdown of loan and overdraft approvals trends at the start of the year were positive across the board. The number of approved overdrafts rose by 27 per cent and new loan approvals were 26 per cent higher than the previous quarter. In terms of value, our data shows growth of 18 per cent and eight per cent respectively. Additionally, both small and medium-sized companies saw strong growth in the value and volume of new finance facilities secured. Small companies saw the number of finance approvals increase by over 30 per cent on the quarter.



Source: UK Finance

And approvals to medium-sized companies rising by a, still significant, 17 per cent on the quarter. There was little variation in growth rates when comparing loans and overdrafts. While the recent increases over the past six months represent just a couple of consecutive quarters of improvement, and from a low base, it does suggest that businesses are returning to their lenders for a range of finance options – for cashflow management and business development.

Moreover, we also note consistent growth in approval volumes and values across different industry sectors. All of the main sectors covered by our data saw double-digit increases in approval numbers, with the largest increases to SMEs in construction, and transport, storage and communications. These sectors also saw similarly large rises in the value of approvals with a fairly even split between loans and overdrafts.



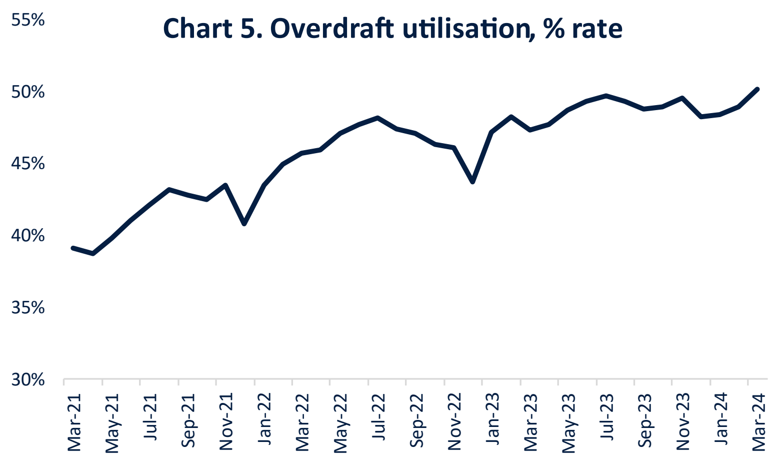
Source: UK Finance

The broadly consistent picture on new finance approvals – by size, sector and type of finance is a first tentative sign of a return to normal for financing conditions after the slew of government-backed pandemic lending and a short-lived post-Covid demand recovery.

These are positive first steps, particularly in signalling that the main high street lenders remain an important part of a diverse finance landscape for SMEs. However, given continued caution in the near-term economic outlook and the short-term political uncertainty that the election will generate, we'll need to see growth in finance demands being met sustained in the coming year before recovery is assured.

Utilisation of existing facilities

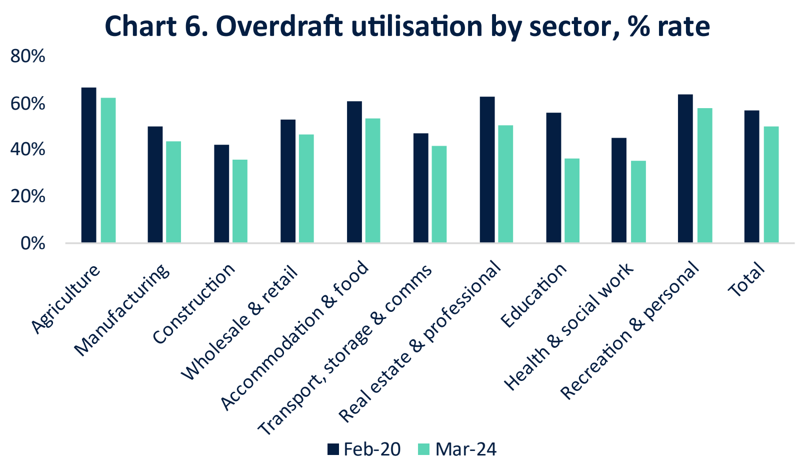
In addition to the rising applications numbers for new or increased overdraft facilities in the past two quarters, we also see a gradual increase in the utilisation of existing ones. At the end of 2024 Q1, overdraft utilisation rose to just over 50 per cent. This was the highest rate since the pandemic.



Source: UK Finance

We see a similar increase in utilisation rates across most industry sectors, with accommodation and food, and recreational and personal services recording the largest rises in utilisation rates over the past six months. As we've noted in previous reviews, and we continue to see across a range of business surveys, these sectors have seen sustained cost pressures, not just from rising raw materials prices but also from increasing wage costs, which have proved more difficult to pass on to customers. This may be contributing to the need to make greater use of existing overdraft facilities, relative to other industries.

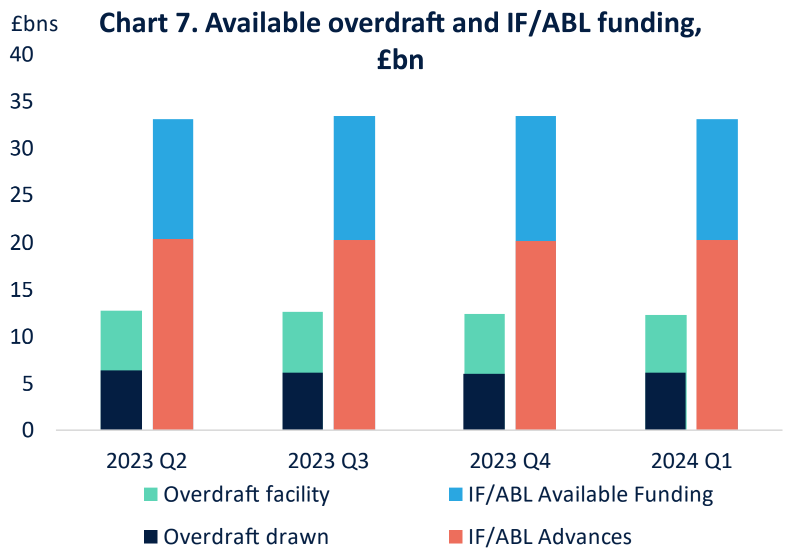
Despite the recent rises, overdraft utilisation rates remain lower than immediately prior to the pandemic. Overall, utilisation rates are around seven percentage points lower compared with February 2020, though some sectors, such as manufacturing, and transport and storage are closer to closing the gap on pre-pandemic usage.



Source: UK Finance

However, as we've noted, cost pressures are now easing, which may mean that overdraft utilisation rates stabilise at a lower level than that seen before the pandemic and SME focus less on finance to manage day-to-day cashflow and more on finance for business development.

Our invoice finance and asset-based lending (IF/ABL) data also indicate a good degree of flexibility in existing facilities. As we noted in last's quarter's Review, 2023 was a bumper year for client sales driving record availability within IF/ABL facilities. While provisional data for 2024 Q1 suggest that client sales have come down at the turn of the year compared with that seen in the previous 12 months, advances drawn down were broadly unchanged in the quarter.



Source: UK Finance

This leaves utilisation of IF/ABL facilities at 61 per cent – exactly in line with the average through 2023. In line with the headroom within overdraft facilities, IF/ABL clients have consistently had access to a good degree of flexibility within existing arrangements.

SME deposits

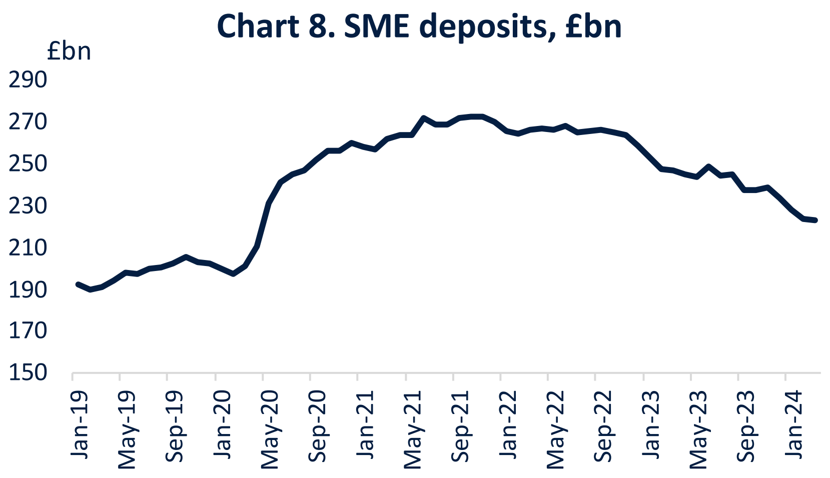
In addition to increasing their use of overdrafts at the start of 2024, SMEs have continued to reduce the stock of cash deposits. Overall deposits were 4.5 per cent lower at the end of Q1 compared with the end of the previous quarter. This was the fastest pace of decline recorded since the end of the pandemic. Deposits have fallen from their peak of just over £270 billion in 2021 Q4 to £223 billion. Over the quarter our data notes falls in both sight and time deposits (down six per cent and three per cent respectively).

The cushion of deposits accumulated during 2020 and 2021 will undoubtedly have been vital for many firms having to managing recent cost spikes and fragile demand. Though we recognise that this headroom will not have been evenly distributed across all SMEs.

Nevertheless, even with a somewhat better demand outlook SMEs still retain a significant buffer within existing deposits, which remains over ten per cent higher than was the case before the pandemic.

The reduction in deposits was widespread across industry sectors, though accommodation and food services saw the largest decline relative to the previous quarter (just over ten per cent), followed by agriculture (down eight per cent). All sectors, however, mirror the aggregate picture with deposit levels remaining above pre-pandemic levels.

Despite SMEs in the accommodation and food sector running down their cash deposits more rapidly than other sectors in recent quarters, deposits held by firms in that sector are a third higher than pre-pandemic. SMEs in wholesale and retail, and construction are in a similar position. This points to many SMEs continuing to have internal resources to navigate further unforeseen challenges.

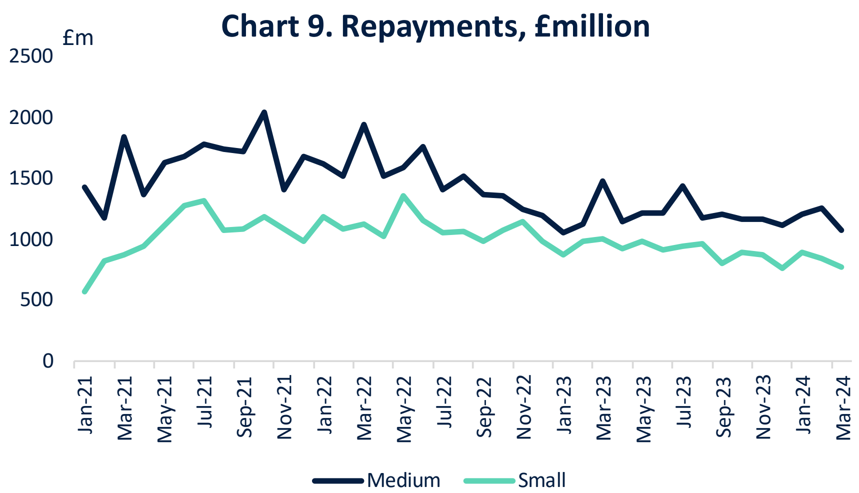


Source: UK Finance

Finance Repayments

The SME finance repayment trend has been largely stable over the past year. The monthly average has edged down very slightly in the past couple of quarters, with the little difference in the path of repayments by small- and medium-sized businesses.

Further modest declines in repayments are to be expected. The latest government data on the performance of government-backed loans to the end of 2023 shows continued progress on repayments, with 12.5 per cent of BBLS (by value now fully repaid) and three-fifths on schedule for repayment.



Source: UK Finance

As such, the stock of fixed-rate borrowing was the lowest since May 2020 (when bounce back loans were introduced). Given the relatively low levels of new borrowing in recent years, there has been little offsetting increase in the stock of variable rate borrowing.

There are, however, some sector differences in the path of repayments in recent quarters. Repayments by manufacturers and SMEs in transport, storage & communications have fallen away more quickly than average in recent quarters, while repayments in accommodation and food services have increased – more notably in the first three months of this year.

SME finance outlook

Our latest data for the start of 2024 is one of the more positive readouts of SME finance than we have seen for some time. Demand uncertainty, cost pressures and rising interest rates have all contributed to suppressing demand for finance, aside from some modest increases in overdraft approvals to manage cashflow.

The turnaround in gross lending, with higher approvals signalling that a further quarter of growth is likely, may indicate that some SMEs are now emerging from survival mode and looking to the future. The broad-based nature of the increase in the flow of finance is also encouraging.

In addition, and in line with the data in our *Business Finance Reviews* over the past two years, SMEs, in aggregate, continue to have a good degree of financial headroom within existing finance facilities and deposits. These are being eroded, but perhaps more gradually than might have been expected given the challenges outlined above. But even on current trends it will take some time before deposit levels or overdraft utilisation return to pre-pandemic norms.

Looking to later in the year, and beyond the forthcoming election, a gradually improving economy, the prospect of interest rates starting to come down and the likelihood of more policy clarity at the start of a new parliament will hopefully help to cement a recovery in SME confidence and plans to invest for future growth opportunities.