UK Finance

Business Finance Review 2024 Q3

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

December | 2024

2024 Q3 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 third quarter of 2024.

Executive Summary

- There was a weaker growth backdrop to our Q3 Business Finance Review and surveys are pointing to a rise in business uncertainty – in part a result of some of the measures impacting employers in the autumn budget. Continuing geopolitical tensions and challenging demand conditions in overseas markets are also weighing on sentiment.
- Overall lending to SMEs by the main banks has been stable, at around £4 billion per quarter this year. This is up on lending levels in 2023.
- New finance approvals also continue to be stronger than the same period a year ago. However, demand for new loan finance looks to be levelling off.
- In contrast, we observe strong growth in approvals for new and increased overdraft facilities, particularly for the smallest businesses. This could be a precautionary measure, given the rise in uncertainty and potential concerns about cost increases coming down the track.
- Invoice finance and asset-based lending (IF/ABL) advances also increased in the year to September overall. The data suggest there is strong demand from larger businesses, with average advances to SMEs relatively static.
- SMEs continue to retain significant buffers in their existing overdraft and IF/ABL facilities, with headroom still above levels seen pre-Covid.
- Cash deposits have continued to decline, but at a slower pace than seen through 2022 and 2023. Available cash reserves together with unutilised overdraft and IF/ABL facilities are likely to provide some support to many SMEs in managing near-term challenges.

Economic context

Following a solid rebound in GDP growth from the shallow recession at the end of 2023, activity slowed in the third quarter. GDP expanded by a softer than expected 0.1 per cent in the three months to September, as consumer and business confidence wobbled following the election and speculation about the priorities of the new government.

ONS data pointed to a marked slowdown in growth across the services sector, which expanded by just 0.1 per cent in Q3, following growth of 0.9 per cent and 0.6 per cent in Q1 and Q2, respectively. Decent growth in professional and technical activities, and retail, was offset by subdued or declining output elsewhere in services.

Production output declined sharply, mainly due to a large contraction in utilities output, however there was a modest 0.2 per cent increase in manufacturing output. But even within manufacturing growth was uneven, with transport equipment posting a further quarter of decline. Foundation sectors, such as metals, rubber and plastics, and chemicals helped push overall output in positive territory.

Finally, construction output saw something of a revival following three consecutive quarters of decline. Output was boosted by new infrastructure work, while repair and maintenance, particularly relating to private housing fell again.

Forecasters, including the Bank of England, had been anticipating some loss of momentum in economic activity in the second half of 2024, but the outturn was a more sluggish picture across all broad sectors. Business surveys, such as the purchasing managers' indices (PMI) over the summer provide some other clues on other factors in play.

The manufacturing PMI, for example, started to slide over the summer and tipped into contractionary territory at the start of Q4 with respondents noting customers were taking a 'wait and see' approach to placing orders ahead of the budget. Ongoing geopolitical uncertainty, likely including the outcome of the US election, also dampened business optimism. There was a similar weakening in sentiment in the services PMI, again the loss of momentum was attributed to client caution around the autumn budget.

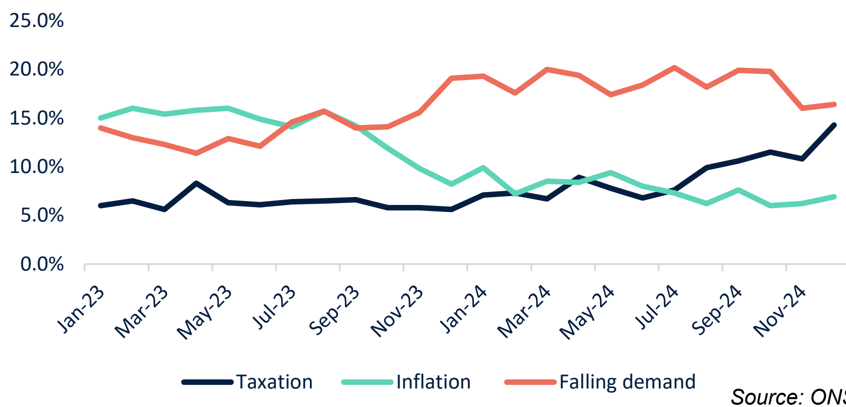
We finally saw the detail on the government's first fiscal package in October. While business (and consumer) confidence wobbled in anticipation of what might be announced, the statement has caused some concern for firms and representative groups.

A key goal of the Chancellor was to put the public finances on a 'stable footing'; to do so she brought forward tax increases amounting to just over £40 billion per year by the end of the forecast period (2029/30). The bulk of the revenue raising was from an

increase in employer national insurance contributions (NICs), including a cut to the level at which employers start paying NICs. There was an offsetting increase to the employment allowance aimed at minimising the impact on the smallest employers.

This also supported additional spending, reaching over £70 billion by the end of the forecast period – split roughly two-thirds departmental spending and one-third capital spending. This will provide departments with budgets for this financial year and next and set the broad spending envelope for the 2025 spending review.

The response from some business groups has been quite strident, saying that the decision to raise employer NICs will be 'tough for business to swallow' (British Chambers of Commerce) and will 'increase the employer cost base' (CBI). Recent findings from the ONS BICs survey (**chart 1**) suggest businesses agree, with concerns about taxation accelerating in recent months.



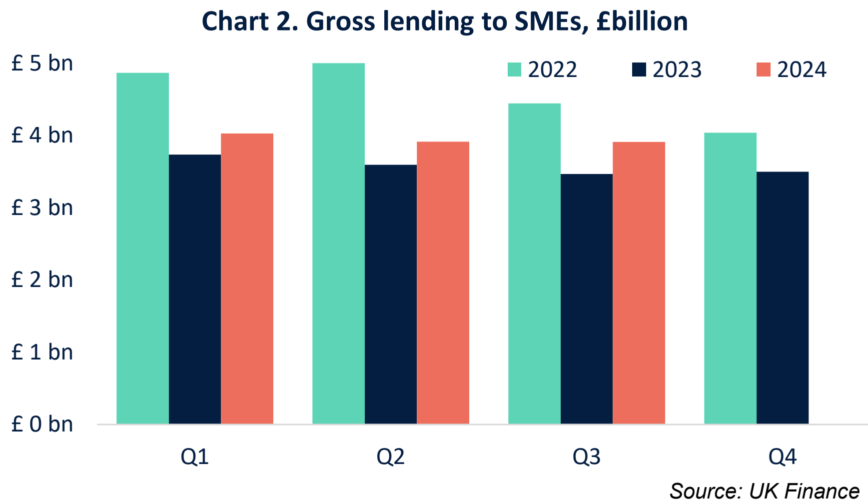
Source: ONS

The OBR's assessment of the package was that it will support slightly stronger growth in the near-term. However, CPI will be higher, notably next year as the OBR expects some pass through from higher NICs into consumer prices and the additional demand generated by fiscal loosening. NICs rises also feed into weaker real income growth – consequently, household spending growth will also be weaker. There were also downward revisions to business investment from squeezed profitability and a higher cost of capital.

The Bank of England's November Monetary Policy Report concurred with the OBR view that inflation is likely to be somewhat firmer next year. However, having made progress on taming inflationary pressures from last year's highs, the MPC voted to reduce interest rates by a further 25 basis points in November to 4.75 per cent. Further policy easing is expected, with the MPC stressing this will be a gradual process.

Lending to SMEs

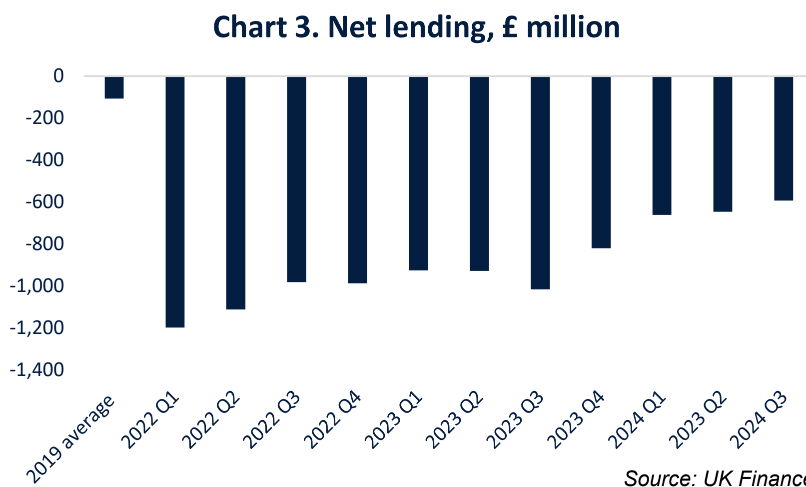
In the three months to September 2024 gross lending to SMEs by the main high street banks posted the third consecutive quarter of year-on-year growth. But at just over £3.9 billion (**chart 2**), lending has been stable but subdued relative to pre-Covid trends in the first three quarters of this year.



Modest growth in new lending is consistent with the muted recovery in business investment seen over the past year, as well as the backdrop of increased uncertainty around the change in government and fiscal policy, discussed in the previous section.

However, not all sectors have seen the same growth trajectory in new lending this year. Only a handful of sectors, including real estate and professional services, agriculture, and recreation and personal services, have recorded consistent year-on-year increases in gross lending over the course of the year to date. Nonetheless, levels of new lending in these sectors still remain around a third lower compared with the end of 2019, just prior to the pandemic. There has, in contrast, been a much weaker profile of lending growth to SMEs in manufacturing, and transport and storage.

While we have seen some return to growth in new lending, in aggregate, this continues to be outweighed by repayments, leaving net lending firmly negative compared with the marginally negative position seen before the pandemic (**chart 3**).

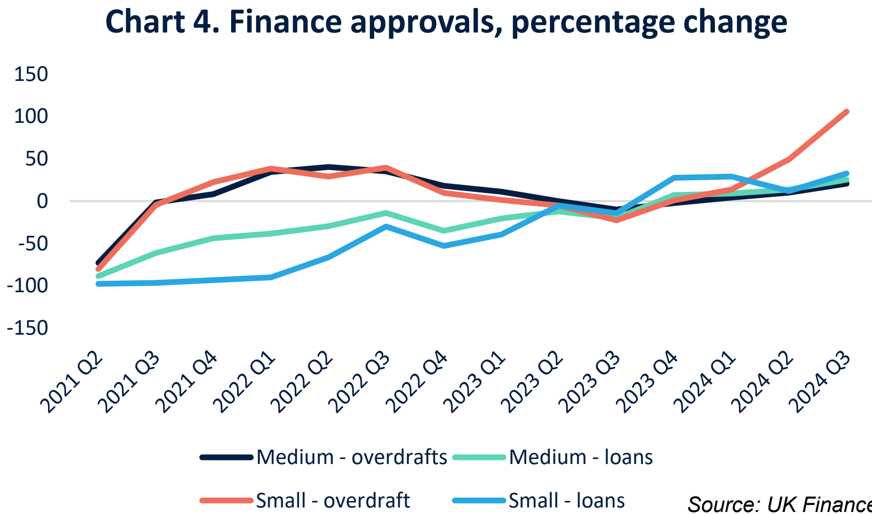


With potential headwinds to business borrowing from higher taxes and a still-sluggish demand outlook, as well as the ongoing Covid-loan repayment obligations, a

return to positive net lending, particularly for the smallest SMEs, does not appear to be in prospect, at least in the near term.

New finance approvals

The increase in gross lending this year has flowed from a fairly broad-based pick-up in the number and value of approvals for loans – albeit from the post-Covid lows of 2022. Growth in the number of new loans approved to both small and medium-sized businesses held up in the most recent quarter (**chart 4**). However, for the smallest businesses loan approval volumes were slightly down compared with the start of the year and for medium firms, new loans approved were slightly down on the previous quarter's post-pandemic high. This is likely a consequence of the more fragile confidence seen across many business surveys over the summer and paves the way for little change in the path of gross lending in the coming quarter.



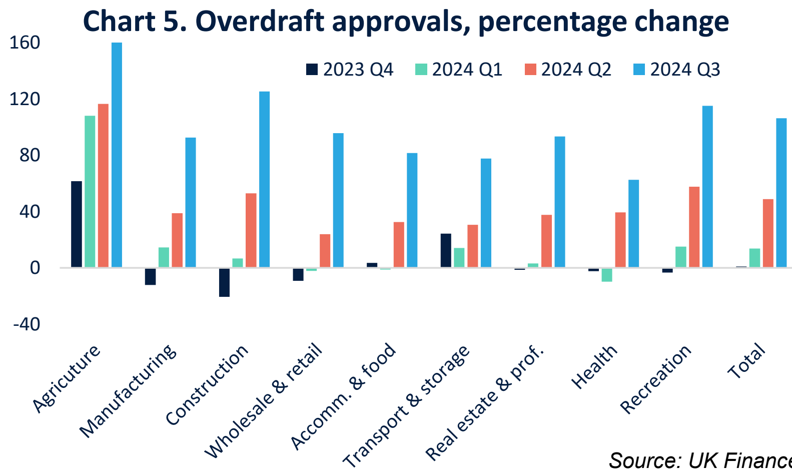
Source: UK Finance

However, what stands out in **chart 4** is the surge in overdraft approvals to small businesses, which were more than double compared with the same quarter a year ago, taking approval volumes to the highest level since 2020 Q2.

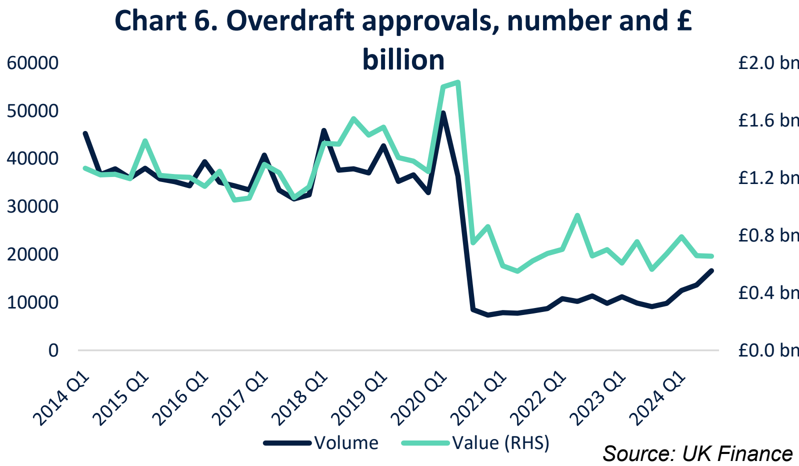
Moreover, while year-on-year growth in overdraft approvals to medium-sized businesses have shown signs of recovery this year, growth has been muted in comparison to their smaller counterparts.

The last time we saw a period of sustained growth in overdraft approvals, through 2022, it coincided with a significant increase in commodity and energy prices. The spike in post-pandemic inflationary pressure was exacerbated by the Russian invasion of Ukraine. However, as we noted in the first section of this review, these cost pressures are abating, suggesting that it is not the inflation outlook that is driving demand for overdraft facilities, but rather a precautionary measure given renewed policy and demand uncertainty.

Chart 5 shows that the sharp increase in overdraft approvals to smaller firms has followed a similar trend across all industry sectors this year. In the year to September the number of overdrafts approved to small businesses was over 50 per cent higher than the same period in 2023. All business sectors saw double-digit growth over the same period and across agriculture, approvals more than doubled.

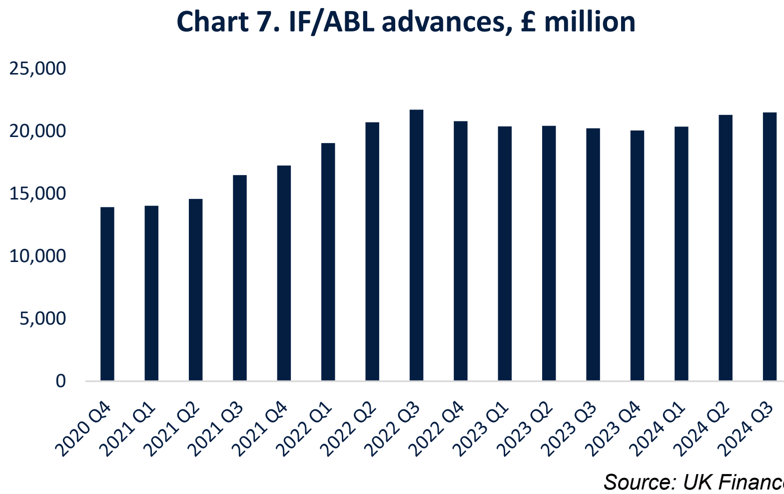


Even with the double-digit growth in overdraft approvals to small businesses, the total volume and value of overdrafts approved each quarter (for all SMEs) continues to significantly lag levels seen before the pandemic (**chart 6**). We saw overdraft demand displaced by government-backed loans at the beginning of 2020, with similar impacts being seen on other commercially provided working capital facilities. The accumulation of deposits during the pandemic similarly dampened demand for working capital finance. This renewed demand still leaves overdraft demand well down on that seen before 2020 and the robust growth rates of recent quarters represent only a slow normalisation of borrowing behaviour.



Invoice finance and asset-based lending

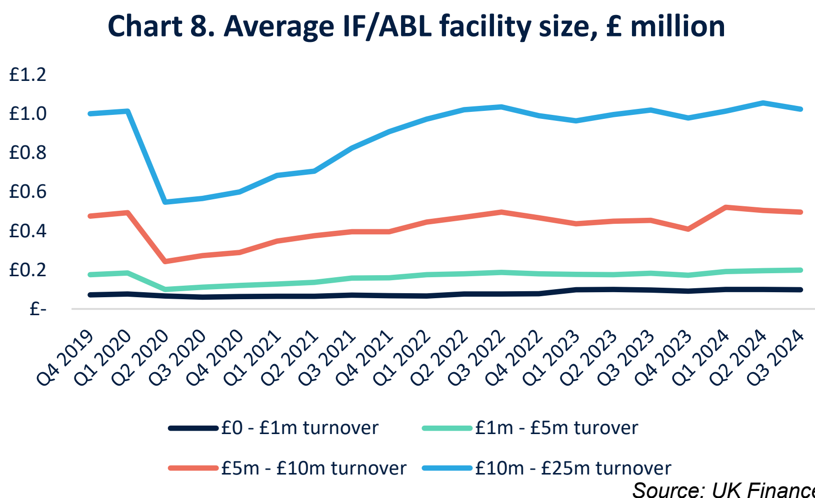
UK Finance's invoice finance and asset-based lending (IF/ABL) data covers business of all sizes, not just SMEs. As of the end of September 2024 £21.5bn of funding was provided to businesses through IF/ABL products. This represents a six per cent increase in the level of funding being provided in the last year, and two per cent higher than pre-Covid.



Source: UK Finance

Whilst there has been increased appetite for IF/ABL products from larger businesses over the last few years, the number of SMEs using IF/ABL products - and the total amount of finance provided to SMEs through IF/ABL products remains fairly static – likely reflecting a combination of suppressed demand, ample competition from technology-driven finance providers and the continuing roll-off of the government schemes, at the smaller end. Anecdotal reports suggest that new business enquiries are increasing, but as yet this is not being seen in the number of new facilities for SMEs.

Taking the average SME business using IF/ABL, the data shows that advances per client are steadily increasing. At September 2024, SMEs were utilising an average of £454,000 through their IF/ABL facilities. This is a 3.6 per cent increase in the last year, and 5.3 per cent higher than pre-Covid.

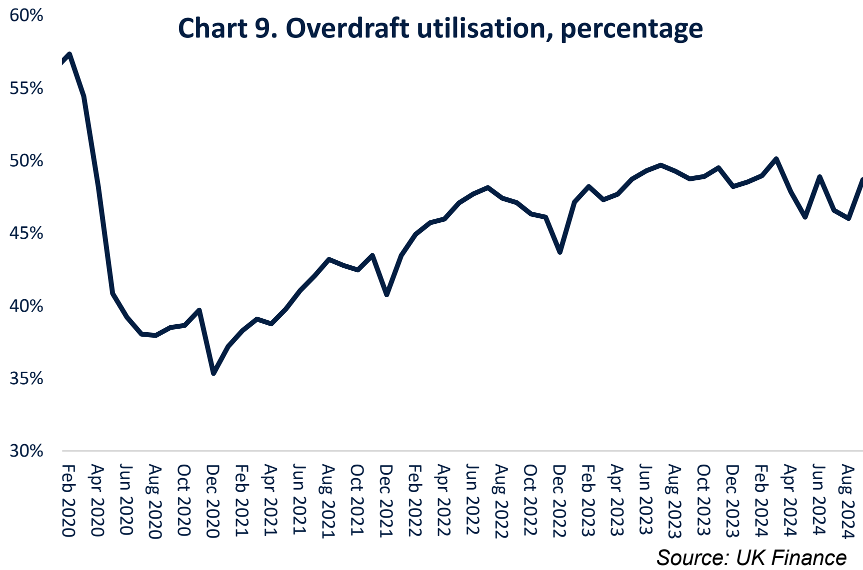


Source: UK Finance

However, this is a much lower increase than compared to the average advance across all businesses, where there has been a 7.9 per cent increase in the last year, and 20 per cent increase since pre-Covid. This suggests a different trend between SMEs and larger businesses.

Utilisation of existing facilities

While we have already discussed the increased demand for new overdraft facilities, our data does not point to a material change in utilisation rates (**chart 9**). Following a gradual increase in the use of overdrafts through 2021 and 2022, utilisation rates have been broadly stable, on average, over the past 18 months, barring some seasonality at year end, and month-to-month volatility.



Looking at utilisation by company size, we also observe little difference between small and medium sized firms. And continuing the trend we have reported in recent years, there is little to differentiate between sectors. Our data shows the usual uptick in overdraft utilisation for accommodation and food services businesses following a summer dip, and there has also been a notable increase in usage for real estate SMEs, though this tends to be slightly more erratic than other sectors. Overall, the story of overdraft availability continues to be one where SMEs, on aggregate, retain a good degree of headroom within those facilities.

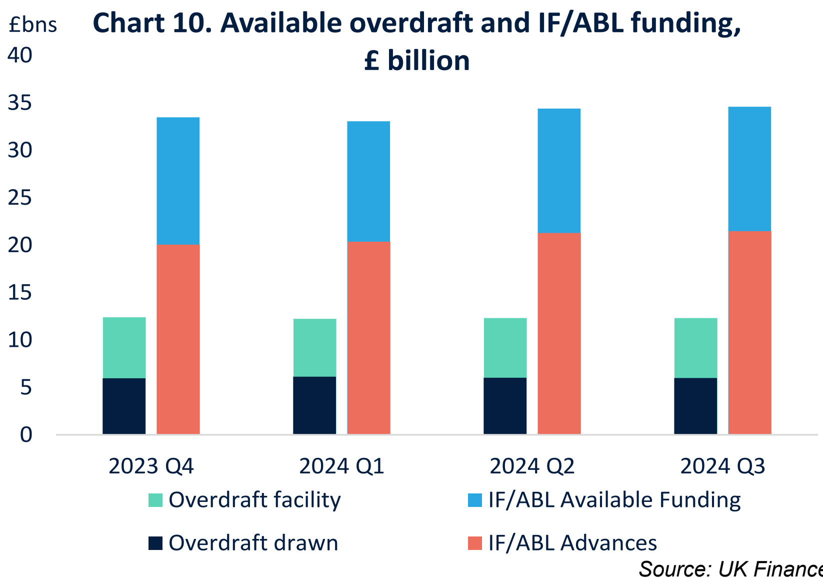


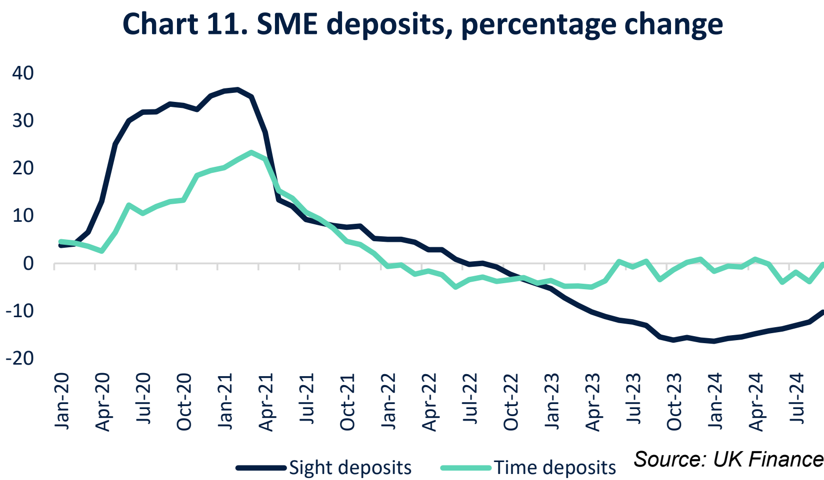
Chart 10 tells a similar story on utilisation of IF/ABL facilities across the whole business population. 2024 Q3 data show a steady increase in the level of utilisation,

going from 60.5 per cent utilisation in September 2023 to 62.1 per cent in September 2024.

It is unclear if this is due to more stabilised interest rates or a sign of increased pressure on businesses more generally. Despite the reduction in headroom in IF/ABL facilities in the last year, the figures indicate that businesses retain significant buffers in their existing facilities, with headroom remaining higher than pre-Covid.

SME deposits

The pace of decline in overall deposits, driven by those in current accounts, continued to ease in Q3. The total value of SME deposits was six per cent lower at the end of the quarter compared with a year ago, comprised of a ten per cent fall in current account credit balances and no change for deposits in notice accounts.



We have seen consistent year-on-year declines in deposits since mid-2022, but the rate of decline in the most recent quarter was the slowest since the start of 2023. By sector, total deposit levels in construction and real estate were unchanged compared with a year ago, but more rapid decumulation continues in recreation and personal services, and transport and storage.

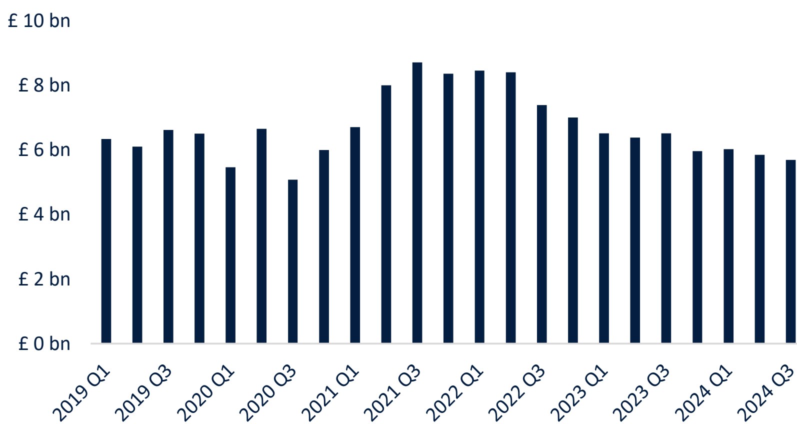
In last quarter's review, we noted that transport and storage were the only sectors to have fully depleted the savings buffers accumulated during the pandemic. While a further fall in deposits does not appear to have led to a greater appetite or usage of other forms to finance, we will monitor whether we begin to see any correlation emerges in the coming quarters.

Finance Repayments

Our latest data also sees little change in the profile of debt repayments (**chart 11**). Given the ongoing legacy of the government-backed loans during the pandemic, no material developments on the path of repayment activity is a positive sign. The latest government data on the performance of Bounce Back loans (BBLS) to the end of 2024 Q2, shows that nearly 14 per cent of the value of BBLS has been fully repaid, with a further 58 per cent on track with repayments.

Moreover, ongoing survey data from the ONS continues to indicate medium to high levels of confidence amongst those with outstanding debt that they can manage these obligations.

Chart 12. Repayments, £ billion



Source: UK Finance

While businesses may be keeping up to date with finance repayments, for some this may nevertheless be challenging.

We know, for example, from the SME Finance Monitor that around a fifth of businesses consider themselves to be struggling, and many of these are the smallest businesses. Keeping up with repayments may be more difficult if firms are also worried about other pressures on cashflow coming down the track. We continue to advise those concerned about managing debt obligations to have early discussions with their finance providers.

SME finance outlook

Gross lending to SMEs by the main high street banks does appear to have turned a corner, but the flow of finance continues to be some way from normal. This feels consistent with the positive, yet fairly subdued profile of business investment over the past year. And while the volume of new loan approvals coming through is still up on a year ago, the quarterly profile over 2024 to date would point to a static trend in new lending in the near term.

Given the recent fiscal announcements in the budget and the concerns raised by a number of business groups about the impact of the increase in employer National

Insurance Contributions, another hiatus in business investment, and borrowing applications to support it, seems a likely outcome in the coming quarters.

Undoubtedly, at the time of writing, many SMEs will not yet have fully processed what the tax changes mean in practice, the extent to which this may be offset by government investment in other areas, and the impact on wider demand for products and services. There are also likely to be some sectoral differences in impact and business responses when it comes to future finance requirements.

The surge in finance approvals for cashflow management, and the ongoing buffer many (but not all) SMEs still have in the form of cash reserves and unutilised facilities leaves SMEs well supported to manage through some short-lived uncertainty, at least at the aggregate level. However, we are not yet seeing the macroeconomic conditions that would underpin business confidence to investment in new capacity or business development opportunities.

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