Business Finance Review

UK Finance produces a regular analysis of how the finance needs of small and medium-sized enterprises (SMEs) are being supported through lending from mainstream or specialised finance providers in addition to their deposit holdings. This latest *Business Finance Review* of lending activity in Q3 2020 shows how SME demand for finance and their deposits developed through the unprecedented challenges and uncertainty resulting from the Covid-19 pandemic.

Stephen Pegge, Managing Director of Commercial Finance, comments:

"2020 was a challenging year with the disruption of Covid-19 restrictions and uncertainty ahead of the end of EU transition. The UK's banking and finance industry continues to support businesses of all sizes across the country to help them trade and invest for recovery.

"Gross lending in the first three quarters of last year was more than double the annual total in 2019, boosted by over 1.5 million businesses borrowing with government-guaranteed facilities totalling over £68 billion. SME financing was particularly in demand in the service industries, which were amongst the hardest hit by the pandemic.

"Approvals of overdraft facilities rose significantly at the start of last year but demand in the second and third quarters moved towards loans. SMEs can now 'top-up' their Bounce Back Loan to the maximum of £50,000 or 25 per cent of their turnover if lower, with the application deadline for the schemes now running until the end of March 2021. This extension and the wider support of the industry will help businesses access the finance they need as the pandemic continues to affect the economy.

"While the business community in aggregate does not appear overindebted, with liquidity reserves and capacity to provide finance strong overall, many individual businesses and some specific sectors are facing significant and much more extended disruption and may find themselves in financial difficulty in 2021.

"In addition to the further grant support announced this week, widespread restructuring and recovery situations are expected. In response, the finance sector and related professional services are focused on the provision of capacity and expertise to help support the turnaround of companies where possible, while ensuring the sympathetic treatment of those businesses which are no longer viable."

2020 Q3 HIGHLIGHTS

- **Gross lending in the first three quarters of 2020 was more than double the annual total in 2019.**
- **Un-utilised overdraft facilities and invoice finance options have provided businesses with a degree of financial flexibility during restricted trading circumstances.**
- **Reduced operating expenses for businesses and receipts arising from government pandemic response funding resulted in a 20 per cent increase in deposit holdings since the start of the year.**
- **SME finance was available across all regions and sectors, particularly for service industries hit hardest by the pandemic.**

2020 was an unprecedented year for businesses, as the impacts of the coronavirus pandemic reverberated through society. The imposition of lockdown measures by government and devolved administrations, guidance on workforce safety and society's adherence to social distancing have provided fundamental challenges to all businesses across the UK. The response to the pandemic has had associated impacts on the labour market and public finances, which are shaping the economy and will do well into the future.

Output followed the classic downturn and V-shaped recovery in Q2/Q3, as second quarter GDP fell by 20.4 per cent and rose by 15.5 per cent in the three months to end-September. The level of GDP was however, at end-Q3, 9.7 per cent lower than in the final quarter of last year, so the economy only partially recovered.

Monetary policy reaction by the Bank of England saw Bank Rate quickly dropped to 0.1 per cent in March in response to the pandemic to stimulate credit supply and demand. Quantitative Easing (QE) was expanded by £100 billion in Q2 and a further £150 billion in November, to stand at £895 billion. Providing temporary liquidity to financial institutions through QE asset purchases has supported lenders' funding when their margins are squeezed in a very low interest rate environment. Inflation fell from a peak of 1.8 per cent in January to 0.8 per cent in September, while consumer prices are not expected to rise in the short-term. The government's fiscal response to support the economy through the pandemic has been much more notable. Considerable public sector funding has seen the Coronavirus Job Retention Scheme (CJRS) maintain the attachment of furloughed employees to companies. This support, in addition to the help for the self-employed, has prevented an exaggerated increase in redundancies and unemployment. At the same time, grants and lending guarantees have been made available for companies as well as business rate and VAT suspensions and a Stamp Duty 'holiday' on property purchases that will last until the end of March 2021. The National Institute of Economic and Social Research (NIESR) projects the fiscal deficit to rise from 0.6 per cent of GDP to over 14 per cent by the end of 2020, resulting in an increase of over £250 billion. This will push the public sector debt to GDP ratio above 100 per cent for the first time since 1960-61. Even with a successful development and roll-out of Covid-19 vaccines, NIESR thinks it will take until 2023 for the 2019 GDP level to be regained.

With Parliamentary assent on the final day of 2020 for the UK-EU Trade and Cooperation Agreement, the UK now has control of its trade policy, outside the EU customs union and single market. It remains to be seen whether there will be operational frictions in trade with other countries, but the 'Brexit deal' of zero tariffs and zero quotas was welcomed by businesses and provides the import-export trading clarity they were seeking. We would expect greater use of trade finance facilities in future as more documentation will potentially be involved for trade both with the EU and in expanding trade elsewhere, so the soon to be launched General Export Facility, guaranteed by UK Export Finance, may play an important role

The government's ambitions around infrastructure spending, green investment and the 'levelling up' regional agenda, all of which could support activity in the business sector, will be challenged by the cost to public finances caused by fighting the pandemic and the likely need for fiscal tightening over the medium term.

Clearly, the key 2020 determinant for business cashflow and profitability has been the restricted ability to trade with customers. The Business Impact of Coronavirus Survey from the Office for National Statistics (ONS) showed that around the end of Q3, only 86.3 per cent of businesses were trading normally, 9.9 per cent were not trading and not expecting to in the short-term, while 1.2 per cent (more than 50,000) had permanently ceased trading. Obviously, some sectors were more adversely affected by the trading restrictions, particularly for the Arts, Entertainment and Recreation, Information and Communications and Accommodation and Food Services sectors, which had paused or reduced trading at the end of September. Further national or regional restrictions will continue to suppress business activity, increasing pressures on business viability in hospitality, travel and entertainment, where seven in ten businesses are seeing significantly decreased footfall.

For those businesses trading in some form, 25 per cent were seeing their turnover 20 per cent lower than expected, 15 per cent were seeing turnover between 20 and 50 per cent lower and nine per cent were seeing turnover less than half expected levels.

Government support for workers continues through the furlough scheme, with 9.6 million employees in 1.2 million businesses on furlough leave, costing around £40 billion in the second and third quarters. For self-employed individuals, some £5.7 billion had been made available by the end of Q3 through grants to some 2.6 million eligible businesses.

In addition to traditional forms of commercial finance (eg loans, overdrafts, credit cards, commercial mortgages, invoice finance and asset-based lending), direct financial support for businesses has been available since March through the government-guaranteed lending schemes (Coronavirus Business Interruption Loan Scheme, Coronavirus Large Business Interruption Loan Scheme and the Bounce Back Loan Scheme) provided by accredited lenders. As we reached the year-end, total support provided by all lenders to all sizes of business under the schemes had risen to £68 billion for 1.5 million businesses.

Table 1

Facilities provided under government-guaranteed lending schemes

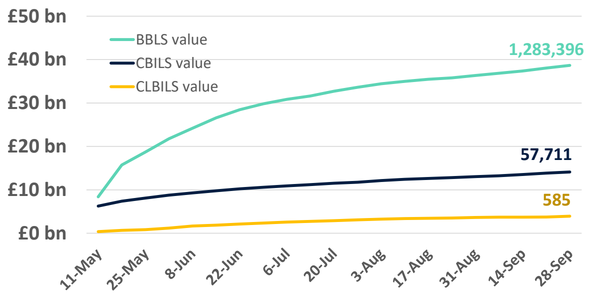
(as at 13th December)

	Number	Value
CBILS	82,618	£19.64bn
CLBILS	675	£4.97bn
BBLS	1,431,987	£43.54bn

Source: HM Treasury

UK Finance's tracking of government scheme lending by our members shows in **chart 1** the rapid growth in demand for scheme finance during the second and third quarters.

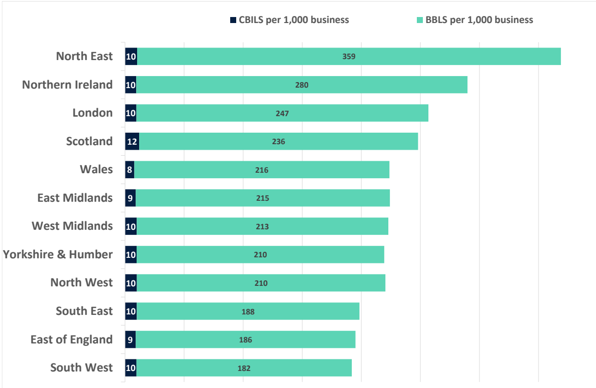
Chart 1: Lending to businesses under government schemes & number of facilities approved



Source: UK Finance

Nationally, lenders have issued, on average, 229 BBLS and 10 CBILS facilities for every thousand businesses. The North East and Northern Ireland had substantially higher regional uptakes, despite having lower than average numbers of business populations, reflecting an increased appetite and need for financial support in those areas.

Chart 2: Government scheme lending volumes as a proportion of regional business populations

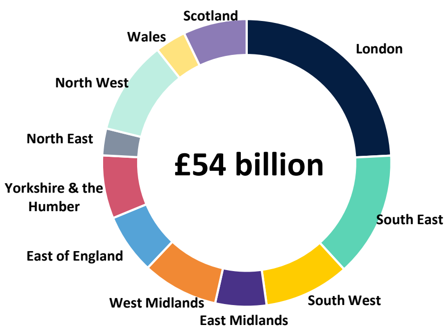


Source: UK Finance

SME Finance

The government lending schemes have expanded finance for SMEs across the UK during 2020. Gross lending in the first three quarters of 2020 totalled £54bn, more than twice the total amount of lending in 2019. The schemes do not differentiate lending to SMEs at a size threshold of £25m turnover, so within the **chart 3** totals, it is not possible to quantify the component attributable to extra government scheme lending, but it would have been a significant proportion.

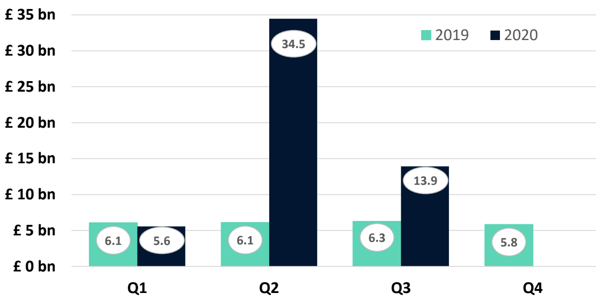
Chart 3: Gross lending to SMEs during 2020



Source: UK Finance

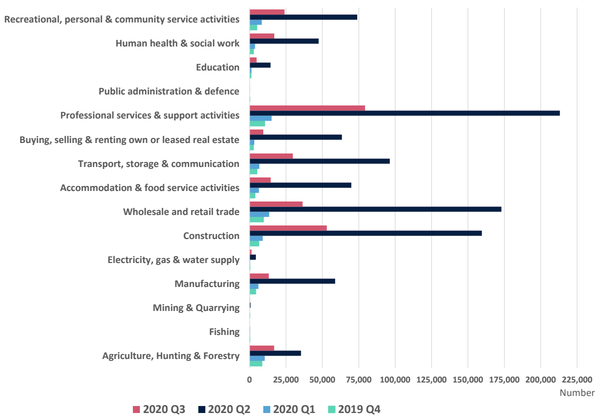
As **chart 4** shows, the amount of lending approved in the second and third quarters was some £36 billion higher than during the same period of 2019. A large proportion of that extra lending would have been reflected in the government schemes.

Chart 4: Gross lending to SMEs through all loans and overdrafts in 2020 compared to 2019



In **chart 5**, the numbers of loans and overdrafts approved in Q2 and Q3 dwarfed previous quarterly volumes across most sectors of industry. Clearly, those sectors across retail, hospitality, travel and tourism activities have been most affected by the pandemic or lockdown measures and consequently they have shown most demand for additional finance. With approvals in quarters prior to Q2 for any sector averaging fewer than 20,000, Q2 and Q3 volumes exceeding 150,000 for construction or retail sectors and more than 200,000 for professional and support services were clearly exceptional as lenders met the unprecedented demand for additional finance to support businesses.

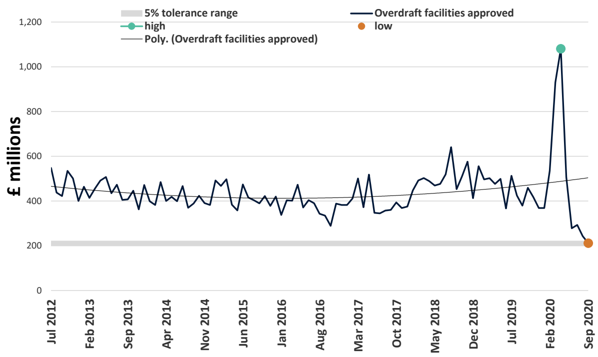
Chart 5: Number of SME loans and overdrafts approved



Source: UK Finance

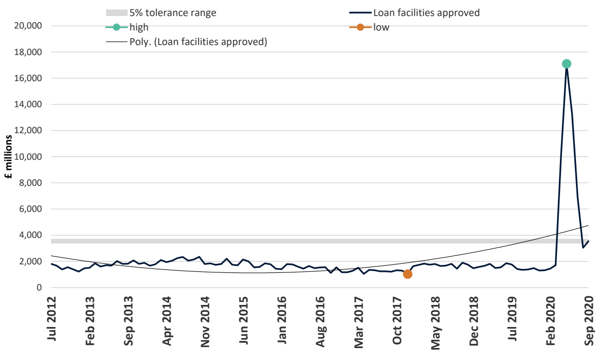
In the first quarter of 2020, demand for overdraft facilities rose significantly as businesses sought to cover their short-term cashflow (**chart 6**) but focus in the second and third quarters had clearly moved towards loan facilities, given the guaranteed nature of the government schemes and Bounce Back loans in particular because there is no set-up fee, a low interest rate and interest paid by the government in the first twelve months (**chart 7**). More than simply business interruption support, CBILS and BBLS were effective life--support measures for businesses in survival mode.

Chart 6: Value of overdraft facilities approved



Source: UK Finance

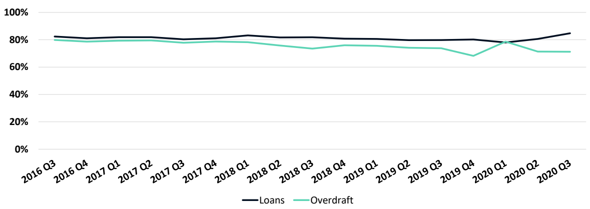
Chart 7: Value of loan facilities approved



Source: UK Finance

With no formal credit assessment involved in the provision of BBLS, the overall approval rate of eight in every ten loan applications was easily maintained through Q2 and Q3 (**chart 8**).

Chart 8: Borrowing approval rates for loan and overdraft applications

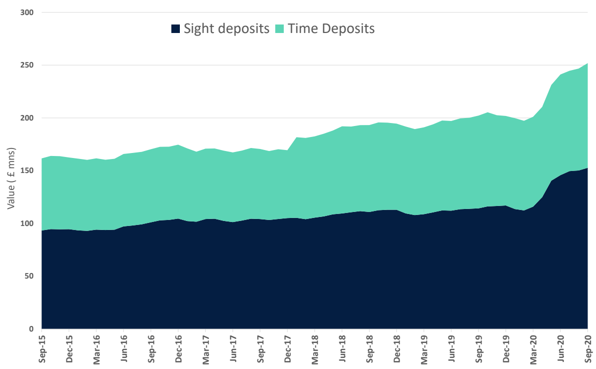


Source: UK Finance

Further government support was extended from 2 November 2020, when businesses that had initially applied and been approved for Bounce Back loans but for less than the maximum amount they could borrow, were able to apply for a 'top-up' to increase their borrowing up to the maximum. We estimate that a further £0.6bn of funding was made available through that topping-up facility.

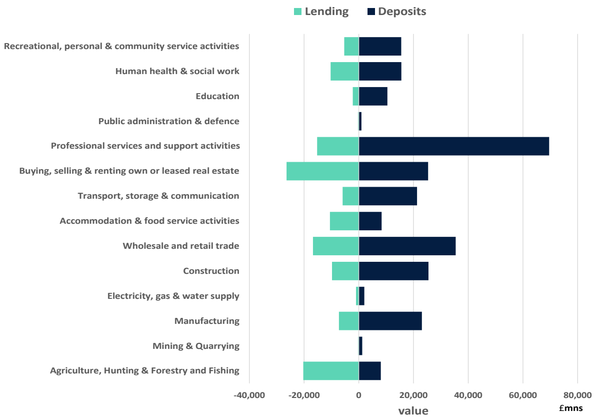
The receipt of funds from the direct government support for workers combined with reduced operating expenses and tax deferrals resulted in a substantial rise in cash deposit holdings for businesses (**chart 9**).

Chart 9: Sight and Time deposits to September 2020



By the end of Q3, total SME deposits were some 20 per cent higher than at the beginning of the year, to stand at a record £252 billion. **Chart 10** shows the general surplus of deposit levels over loan balances across most sectors.

Chart 10: Deposits and Lending stock balances as at end-September 2020

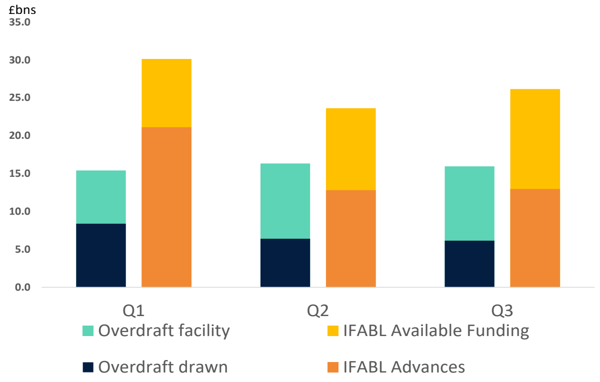


Source: UK Finance

With the focus of businesses firmly fixed on short-term replacement or preservation of trading cashflow, utilisation of overdraft facilities dropped from 54 per cent in Q1 to 39 per cent in Q3. This leaves substantial headroom to draw down available existing facilities if needed (**chart 11**).

The stable level of advances through invoice finance and asset-based lending facilities prior to the pandemic was adversely impacted in Q2 by reduced trading volumes for many businesses as supply chains were disrupted by lockdown measures or trading restrictions. Despite a pick-up in trading volumes for invoice finance clients back to close to pre-pandemic levels in some cases, funds advanced through commercial facilities remains significantly lower due to, amongst other things, the impacts of government interventions across the areas of tax deferrals and government guaranteed lending facilities which have bolstered many businesses' working capital availability for the time being.

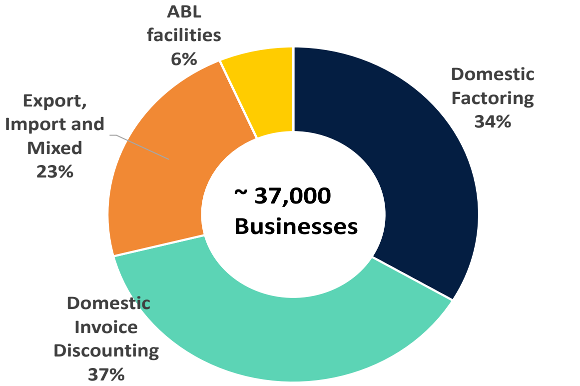
Chart 11: Overdraft and IFABL utilisation



Source: UK Finance

While the number of businesses using invoice finance reduced marginally, to 37,000 from around 40,000 before the pandemic, the product mix and sector spread has remained stable (**chart 12**).

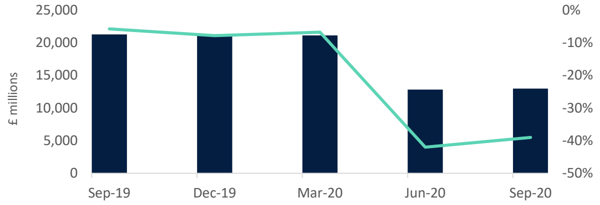
Chart 12: Invoice finance/asset-based lending product distribution



Source: UK Finance

However, as **chart 13** shows, advances fell by 39 per cent in Q3 from a steady level over the previous year.

Chart 13: Advances through invoice finance facilities at quarter-end



Source: UK Finance

Outlook for SME Finance

With business models and revenue projections undermined by Covid-19 impacts, attitudes towards finance are coming under intense scrutiny. Business investment is running around 26 per cent below the same time a year ago. So far, company failures have not reflected the constrained trading environment and monthly insolvencies are around a third lower than corresponding months a year earlier.

The SME Finance Monitor, which surveys 4,500 SMEs each quarter, has revealed that three in every four SMEs felt their business had been negatively impacted by Covid-19, with the self-employed feeling much more affected than larger businesses. Impacts on workforces increased in Q3, with 9 per cent of all businesses making staff redundant, while for SMEs with more than 50 employees, almost one in four had made redundancies. Not surprisingly, only one in four SMEs had seen growth over the past year but the proportion planning to grow had improved to 38 per cent. Following the lockdown-affected second quarter, business sentiment had improved in Q3, although 40 per cent of businesses thought that worse impacts of the pandemic were still to come and that was leading to anticipation that their near-term business environment was more likely to revolve around threats rather than opportunities. The adverse impacts of the pandemic were clearly seen as the top barrier to business, followed by the economic environment, political uncertainty, cash flow and late payment. Being able to access finance is seen as a low concern for SMEs – indeed only 8 per cent of SMEs cited it as a major barrier to business.

Some 40 per cent of SMEs were using external finance in Q3. While this proportion had increased because of the take-up of government-guaranteed support and other commercial finance, a similar proportion of SMEs have no current use of, or interest in, external finance. This reflects the fact that other than using credit balances, injections of personal funds and the use of trade credit all reduce SME appetite for commercial finance.

Around 24 per cent of SMEs reported a need for finance or had approached their bank for funding over the past 12 months. Eight out of ten applications had been successful, while that finance was predominantly used to support diminished cashflow. Looking forward, 12 per cent of SMEs were actively planning to apply for finance, while a further 23 per cent expected to be seeking external finance in the future to support their business to grow or invest, subject to an improvement in the economic environment.