Funding Xchange

# SME Lending Monitor Q1 2021

March 2021

Funding Xchange

# The 50/50 economy:

## How businesses' successful response to the  CV-19 crisis has left them too often unable to support their growth

A year into the pandemic, our data suggests that half of small businesses appear to have adjusted to the new reality while the other half continues to feel the brunt of the crisis.

**Government's support schemes have focused on staving off a meltdown of the economy in the face of unprecedented challenges.** 'Intensive care' interventions have been focused on supporting small businesses that have seen a significant negative impact on their trading performance. Yet, businesses that have been more agile and adaptive have struggled to access adequate financing solutions as key schemes were restricted to businesses that have seen a negative impact.

**Questions have been raised about the value of government schemes that are propping up non-viable businesses as well as the losses to fraudulent claims.** A more significant cost of the government interventions may not actually relate to these misadventures but the unintended consequence of the market distortions that have starved many agile and competitive companies of access to finance. The government schemes suspended 'normal' market lending from some of the largest lenders. While it is clear that the initial intervention was necessary to respond to an acute emergency, it is increasingly evident that the sustained interventions are holding back the delivery of market-based solutions and are starving companies not eligible for BBLS and CBILS of commercially driven lending.

We are looking in this Lending Monitor at how the SME sector is increasingly pulling apart into those businesses that have adjusted but are facing significant difficulties in accessing finance and those that have seen a sustained impact on their trading performance.

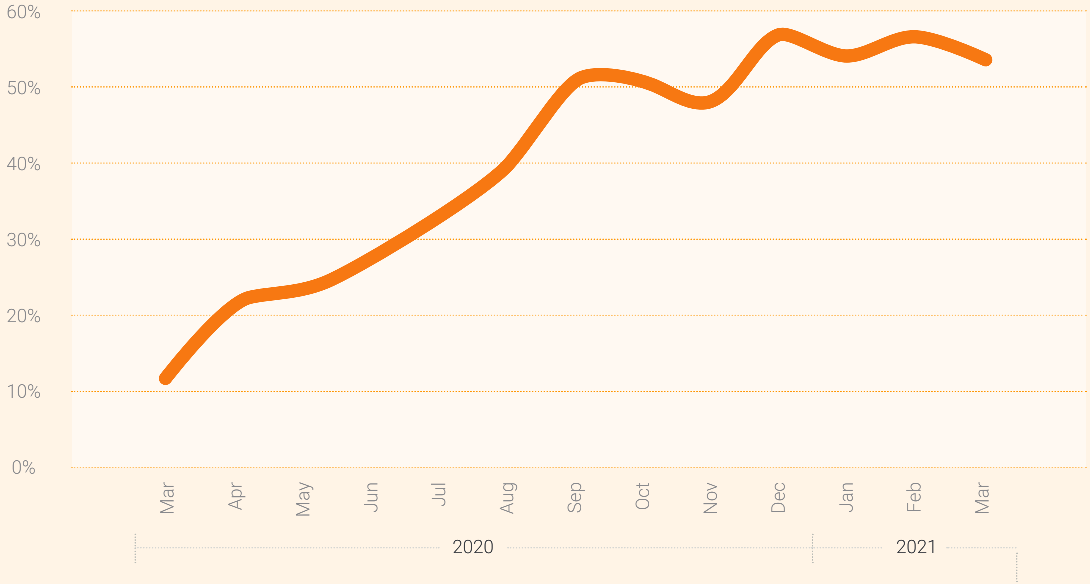
It is critical that the solutions, like the Recovery Loan Scheme that will launch on April 6th, are not extending these distortions but ensure that viable companies have access to adequate financing solutions.

# A contrasting picture of the state of the economy is emerging one year into the CV-19 crisis

**The most recent lockdown has changed surprisingly little when it comes to the profile of businesses seeking funding and the type of funding required.**

Though it is very clear that businesses are falling into two very different camps: those that are managing through the external challenges and are surviving or even thriving and those where the crisis has had a significant negative impact.

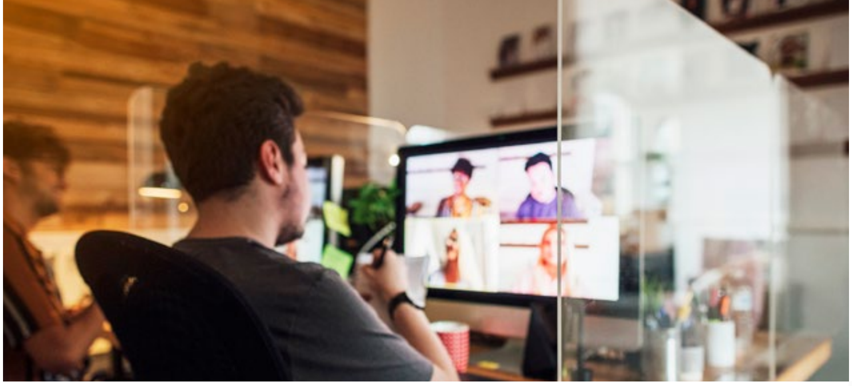
Since September 2020, less than half of businesses are reporting negative impact from the CV-19 impact




Percentage of Businesses Reporting Positive Or Neutral Pandemic Impact, Mar 2020 – Mar 2021

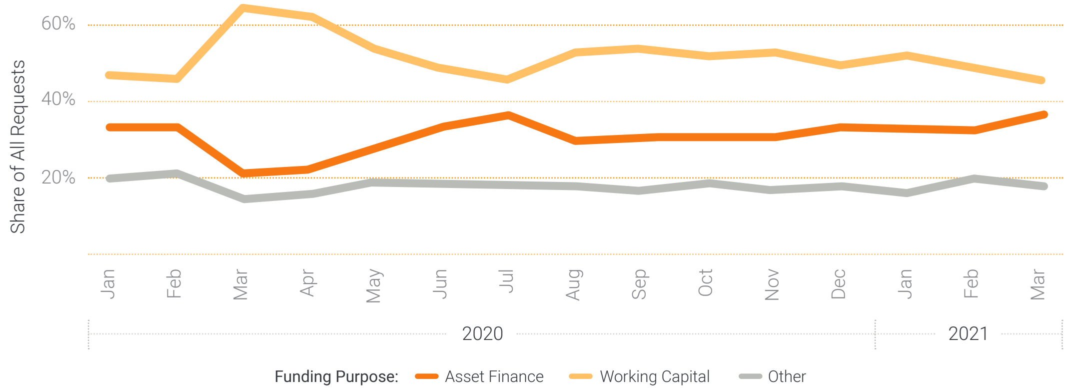
During the first lockdown 25% of businesses reported to Funding Xchange that they had not been negatively impacted by the crisis. Since September 2020, businesses have been almost equally split between those that have and those that have not been impacted by the crisis.

Interestingly, the number of businesses reporting a positive or neutral impact appears to have plateaued since September 2020. This suggests that most businesses put in place mitigations by then – or did not see an opportunity to do so. It is particularly striking that the latest lockdown has not changed the reported trading performance at all: potentially suggesting that businesses have accepted a ‘new normal’ that requires them to operate within the changing restrictions.



# Many businesses appear to have adjusted their business models to the new reality

**The sharp spike in demand for working capital early in the crisis has not been repeated during subsequent lockdowns**




Funding Demand By Purpose, Jan 2020 – Mar 2021

Further good news is that the profile of funding requests shows that the need for funding in Q1 2021 is not as acute as during the first lockdown. While we saw a significant jump in demand for working capital during the first crisis, we did not observe a similar spike during the latest lockdown. The existence of the BBLS scheme appears to have had a more muted impact during this latest lockdown: the total amount of funding disbursed through BBLS between December 13th and February 21st is only £2 billion – still significant but far less than the £30 billion disbursed during an equivalent period in the first lockdown.

Stepping back from the specifics, the overall picture that emerges is that many businesses appear to have adjusted their business models to the new reality – costs appear to be more flexible – reducing the need for working capital during the current lockdown – and many businesses have made the investments that allow them to trade through a lock-down, e.g., by offering take-away services and allowing employees to work from home.

While this is good news for those businesses that have flourished, worryingly, these are also the businesses that are experiencing significant challenges when seeking to access funding. Given the government funding schemes are explicitly excluding these businesses, they rely on market-based lending that has been severely disrupted. While we saw green shoots in our last Lending Monitor in early Q4 2020[1], the subsequent resurgence of CV-19 cases and extension of government loan schemes has significantly reduced solutions for these businesses. The analysis in this chapter highlights which businesses have been the most impacted.

Source:

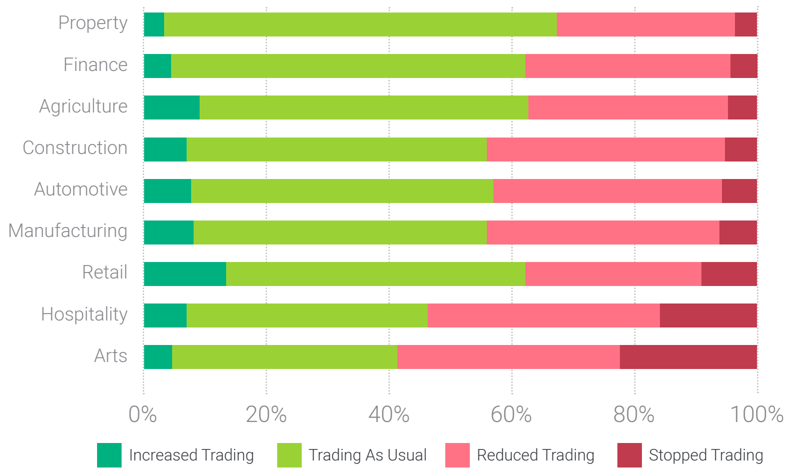
1. See https://fundingxchange.co.uk/wp/wp-content/uploads/2020/10/SME-Lending-Monitor-2020-Q4-fv.pdf

## Unsurprisingly, sectors are being impacted in different ways

The retail and agricultural sectors have weathered the storm better as ~38% of businesses in these sectors report a negative impact (reduced or stopped trading). The impact on hospitality and arts has been more devastating as 58% of businesses are seeing a negative impact. Lenders are acutely aware of the divergent performance across sectors – often reflected in their sector exclusions, e.g., for hospitality.

Yet, diving under the surface, even within challenged sectors there are winners emerging – e.g., 7% of hospitality businesses have seen a better performance than before the crisis and 40% are reporting a neutral impact – presenting opportunities that are today missed by lenders and funders.

CV-19 has impacted industry sectors very differently




Reported CV-19 Impact on Trading Performance, Jan 2021 – Mar 2021

## The most agile businesses are start-ups born during the crisis

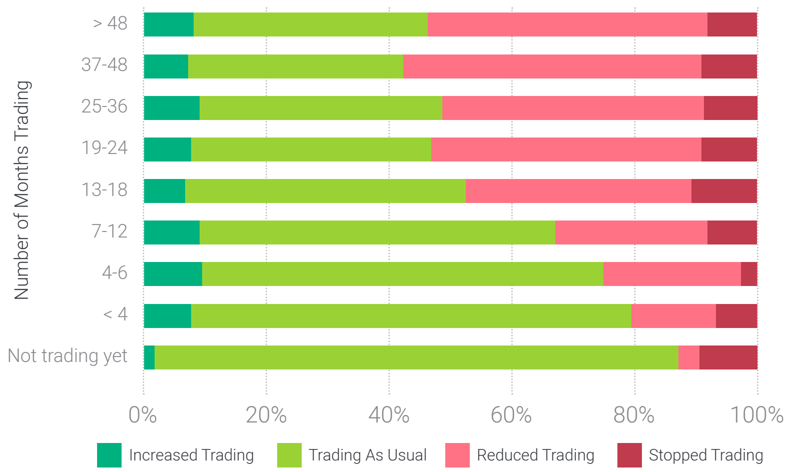
Only around 20% of start-ups report a negative impact from the crisis compared to 60% for more established firms.

Access to finance for younger businesses – with less than 12 months trading record – is limited even if there is no global pandemic. The efforts of the British Business Bank through Start Up Loans Company are critical to support the cohorts of young companies emerging.

While on the surface, it would appear sensible to enable these businesses to access the new government lending scheme, it is unlikely to make a substantial difference given that 71% of funding requests from younger businesses are for less than £25k. In most cases these businesses will only be able to access market-based funding when they have at least 12 months trading history.

Equally worrying is that over 50% of businesses that have been established for more than a year are reporting that they are negatively impacted. The ability of these more established businesses to bounce back will be tested as the economy gradually reopens in the second quarter of 2021.

Younger companies are far less likely to report a negative impact from the pandemic




Coronavirus Impact by Time Trading, Jan 2021 – Mar 2021

Beyond the economic consequences, these mature business also represent a significant unemployment risk as the furlough scheme ends. 20% of companies with over 12 months of trading history employ at least 3 staff, versus only 10% for start-up businesses with less than 12 months of trading history. This is compounded by more mature companies more likely to have staff on furlough – 40% of established businesses have reported furloughing staff, versus 23% of start-up businesses.

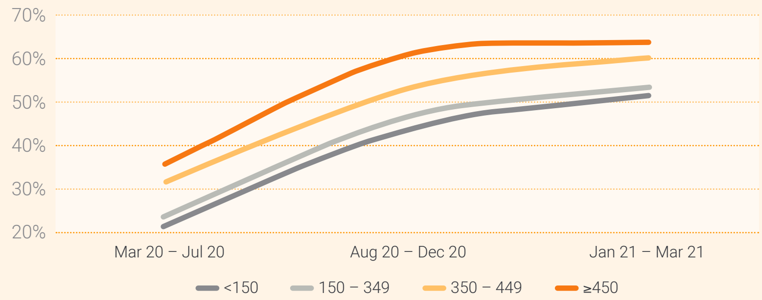
## However, the ability to effectively respond to the crisis does not appear to be pre-determined by firmographic characteristics - experienced and prudent management makes a significant difference

Directors who have shown prudent management of their personal finances report a better trading performance during the crisis – shown through the correlation between the strength of the director's credit score and the likelihood of the business thriving in the pandemic. This points at the continued relevance of the credit profile of directors – even in a crisis where entire sectors have been shut down.

This can be illustrated by zooming into a particularly challenged sector: performance of a hospitality business correlates strongly with the personal credit score of the directors.

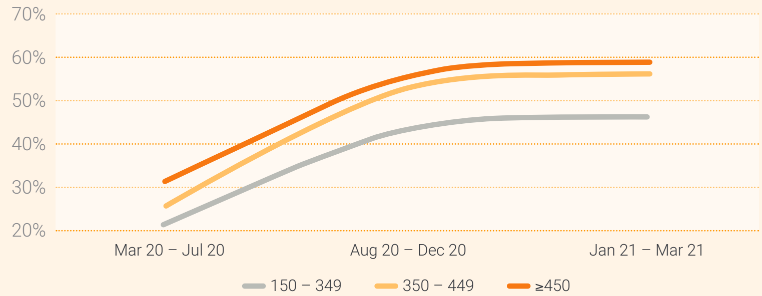
## Throughout the crisis, higher quality directors appear to have better managed the crisis - even in the most challenged sectors

All Sectors




Percentage of Businesses Reporting Positive Or Neutral Pandemic Impact by Director Credit Score, Mar 2020 – Mar 2021

Hospitality Only




Percentage of Businesses Reporting Positive Or Neutral Pandemic Impact by Director Credit Score, Mar 2020 – Mar 2021

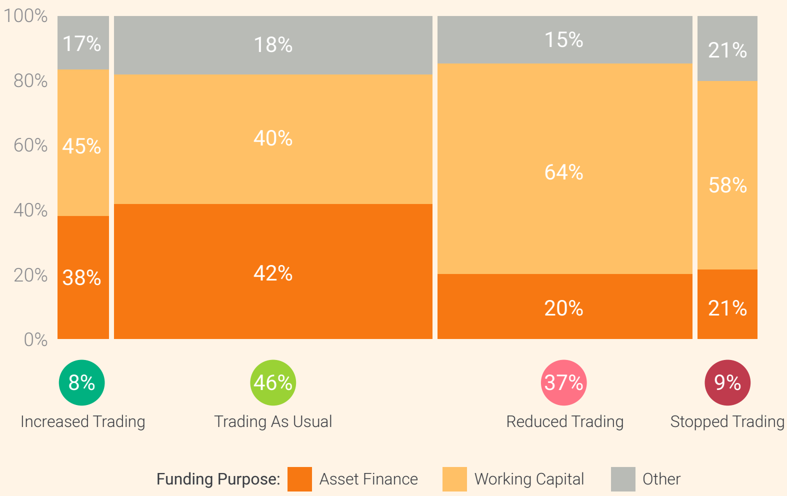
Note: Chart above excludes Directors with personal credit score below 150 in hospitality sector due to small sample size

## The crisis is also creating clear opportunities for funders to deploy funding: businesses that are trading well and benefitting from prudent stewardship are struggling to invest in growth

Businesses reporting a positive or neutral pandemic impact are making investments in growth, representing over 70% of all asset finance requests in 2021.

With the March budget introducing a 130% "super deduction" capital allowance on qualifying plant and machinery investments, demand could further strengthen.

## Businesses reporting a positive or neutral impact are now twice as likely to be seeking asset finance




Funding Purpose by CV-19 Impact, Jan 21 – Mar 21

# On the horizon

Katrin Herrling, Funding Xchange's CEO and Co-Founder, outlines how it is critical for the UK economy that the next set of interventions, to be launched in early April, actively enables the re-emergence of market-based solutions that support those businesses that have shown resilience and agility during the crisis as well as businesses that are emerging from hibernation

The Treasury's broad-based interventions managed to successfully stave off a collapse of the economy in the early stages of the crisis by accepting that the need to act swiftly meant some non-viable or even fraudulent activities would absorb resources.

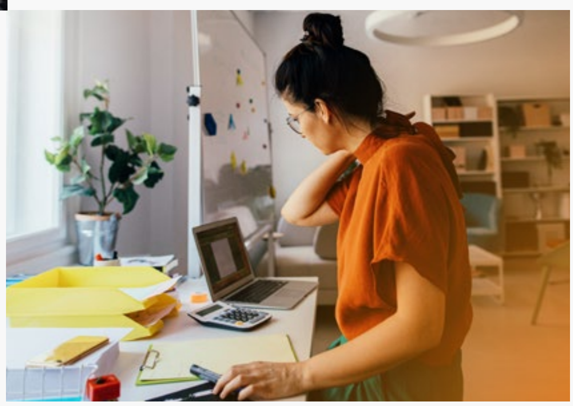
As a result of unprecedented interventions, insolvencies in 2020 fell by 27% compared with 2019 numbers[2] - suggesting that interventions stopped or delayed business failures that would have normally occurred.

The interventions are delaying the efficient reallocation of resources. The government may feel these inefficiencies are justified in the midst of a global pandemic as they are set against huge social costs and dislocation associated with crisis and the readjustment in response to the crisis.

**However, our analysis shows that it is not reasonable to assume that delaying needed adjustments is the same as avoiding the costs.**

It is almost inevitable that the failure rate of businesses is just delayed at significant expense to the taxpayer in the form of BBLS loans, grants and furlough payments rather than avoided. The recent option to request an extension of BBLS repayment terms from six to ten years[3] does not change these fundamentals.

Extending repayment terms of BBLS loans will make a difference to at most one in five businesses that have used the scheme: the extended repayment terms will make it theoretically affordable for 50% of businesses with BBLS loans to repay debt over the longer horizon[4]. However, considered that only around 40% of businesses survive for at least five years,[5] it would be sensible to assume that many businesses will simply not be around to make payments or may choose to 'phoenix' to leave behind debt by incorporating a new business.



Source:

2. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/ 956872/Company_Insolvency_Statistics__October_to_December_2020.pdf

3. Bounce Back Loan Scheme (BBLS) – Pay As You Grow - British Business Bank (british-business-bank.co.uk)

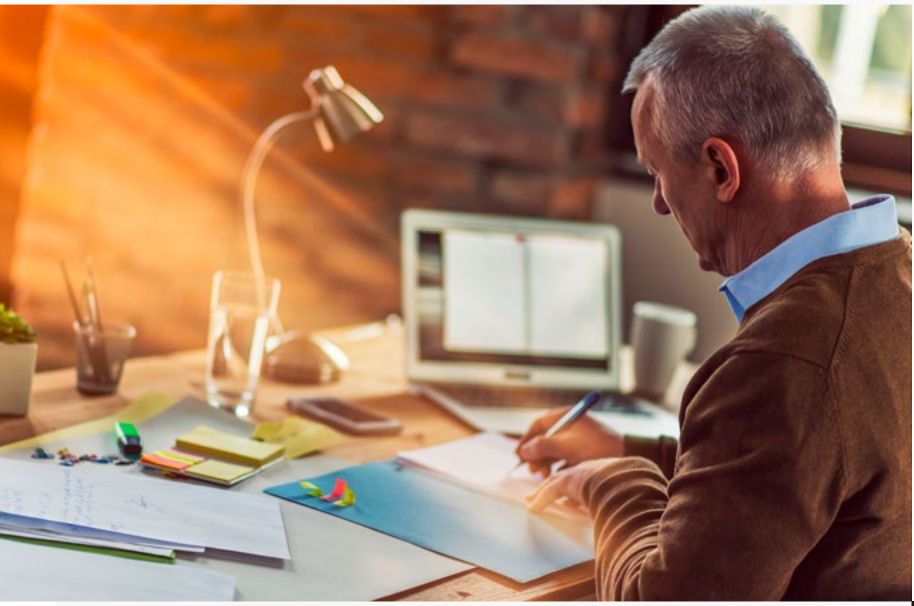
4. https://www.p2pfinancenews.co.uk/2021/02/08/bounce-back-loans-extension-wont-save-all-businesses/

5. The five-year survival rate for businesses born in 2014 is 42.5%

**The focus on the potential loss from unrecoverable loans ignores a potentially larger cost to the UK economy: the sustained, unmoderated interventions over the past year have had the unintended consequence that stronger and more agile businesses have been starved of funding solutions.**

These are businesses that are productive, have shown to be responsive to the changes in the economy and adapting their business models in response to the external shock. Yet, the loan guarantee scheme is not open to businesses that have done well. At the same time, many accredited funders have waited for the expected end of the government-schemes before re-introducing market-based solutions – only delaying the switch as schemes were extended. Our data shows that this huge funding gap has been felt in particular by those businesses that have maintained or improved their trading activities as they have been left with limited funding choices.

It is critical for the UK economy that the next set of interventions, to be launched in early April, actively enables the re-emergence of market-based solutions that support those businesses that have shown resilience and agility during the crisis as well as businesses that are re-emerging from hibernation. Leaving the market to deliver funding solutions for sub-£25k creates room for market-based funding solutions to emerge in this space, including solutions for those businesses that are doing well. It remains to be seen whether the design of the government-backed lending scheme will actually find prospects that can afford to take on further debt beyond their existing BBLS and CBILS commitments. Or even worse, if the scheme will continue to suppress market-based solutions for businesses that are trading well by requiring businesses to demonstrate that they have been negatively impacted.



Funding Xchange

Funding Xchange is a market-leading FinTech building intelligent SME lending infrastructure solutions for banks, funders and brokers to enable an end-to-end digital customer experience, increase conversion rates and improve portfolio risk management.

**Funding Xchange SME Lending Monitor**

We believe that collaboration between banks, alternative lenders, digital technology providers and policy makers is vital to ensure businesses have access to the critical lifeline that funding often represents. This collaboration brings together different capabilities, providing business owners with the ease of access to business finance that the consumer finance market has enjoyed for more than a decade.

Through our marketplace, which is used by over 30,000 businesses across the UK every quarter, we have a front row seat to observe any changes in funding needs – and the funding solutions available to them from more than 40 providers.

For more information, small business research, images or to arrange interviews, please contact: **ben.sher@fundingxchange.co.uk**

For further information on our capabilities and to learn how we help small businesses, please visit: **www.fundingxchange.co.uk**

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