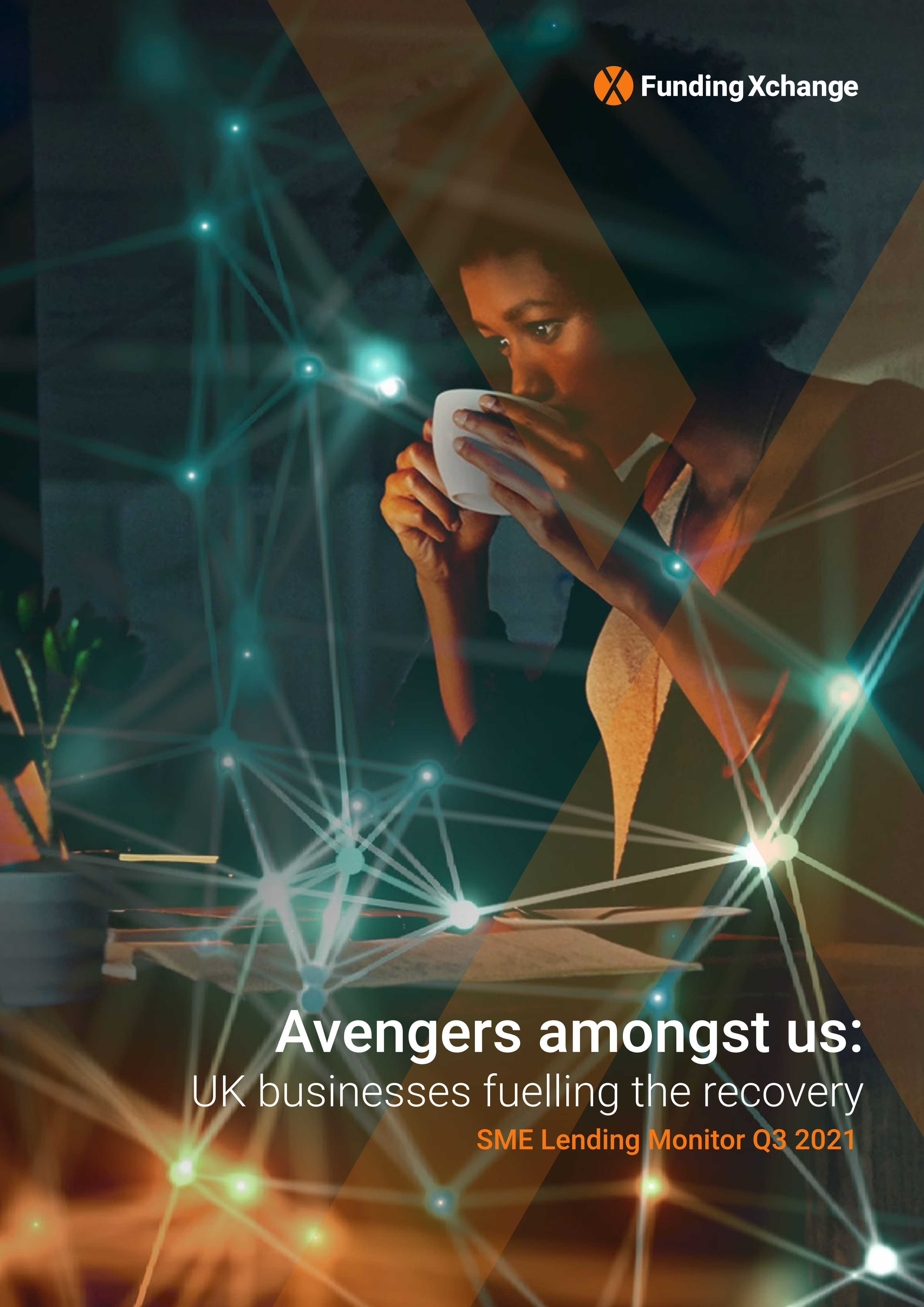


Avengers amongst us:

UK businesses fuelling the recovery

SME Lending Monitor Q3 2021

FXE Technologies

The need for digital technology in lending markets has accelerated in recent years, in significant part due to the pandemic. Digital eligibility and affordability has always been at the core of our marketplace and driven access to market insights that we share through publications like the Lending Monitor.

We are delighted to announce the launch of our technology division, FXE Technologies, which focuses on making these capabilities available to banks and lenders to support the instant assessment of funding applications and management of in-life portfolios.

Funding Xchange has been a leading provider in the digital assessment of SME lending applications since 2014. Leveraging this experience, Funding Xchange has created a platform which delivers assessment of eligibility and affordability across products. FXE Technologies makes these digital solutions available to banks and lenders to instantly triage customers against underwriting models while transforming customer conversion and engagement.

FXE Technologies today is providing white labelled solutions to a range of customers including Tier 1 banks and boutique lenders. The application of the solution suite enables these clients to realise a number of key value drivers, from increased conversion rates in the front office to optimised visibility of risks and opportunities in the back office.

Chief Commercial Officer, Ben Sher commented:

"As the financial services market continues to diversify, lenders are challenged to meet the growing digital experience demands of customers while facing into the threat of technology enabled competitors. FXE Technologies provides banks and lenders with easy to deploy tools to maximise customer conversion and reduce portfolio risk while delivering an experience to the end customer that secures stickiness in the relationship.

Customer insight is at the heart of everything we do, pulling in data from multiple credit reference agencies, management accounts providers, open banking, payments data and accounting platforms. All delivered within business applications that consume this data to yield customer insight relevant to the business context, be it pre-origination triage, portfolio risk assessment or broker driven intermediation."

Katrin Herrling, Co-Founder and CEO of Funding Xchange, added:

"Seeking out opportunities in an uncertain time requires greater insights into businesses' trading and payments performance. It is clear that there are attractive lending opportunities in the market and unlocking these will require digital capabilities to be able to identify and deploy funding efficiently. The use of real-time data to understand how businesses are performing is becoming even more important in these times. This is where FXE Technologies comes in to deliver digital capabilities to the SME lending eco-system."

View the FXE Technologies solution suite at:
https://fundingxchange.co.uk/fxe-technologies/

The FXE Technologies solution suite compromises:

EmbeddedLending

Digital triage for SME lending. Real-time assessment of customer eligibility and affordability to drive qualified indicative offers across all SME lending products.

SmartFinanceHub

More deals in less time. SmartFinanceHub enables funders and brokers to collaborate more effectively enabling efficient, compliant processes and freeing up time to build deep client relationships.

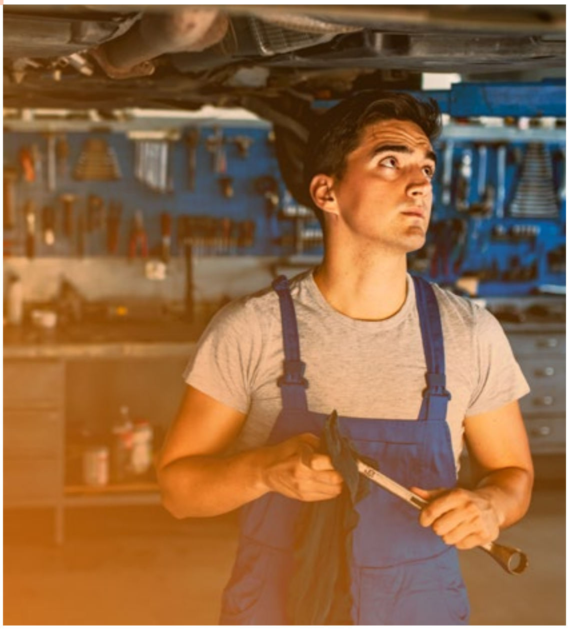
PortfolioMonitoring

Data-driven in-life client management. Developed in collaboration with credit and risk professionals, FXE PortfolioMonitoring provides real-time insights into risks and opportunities at portfolio, segment and account level.

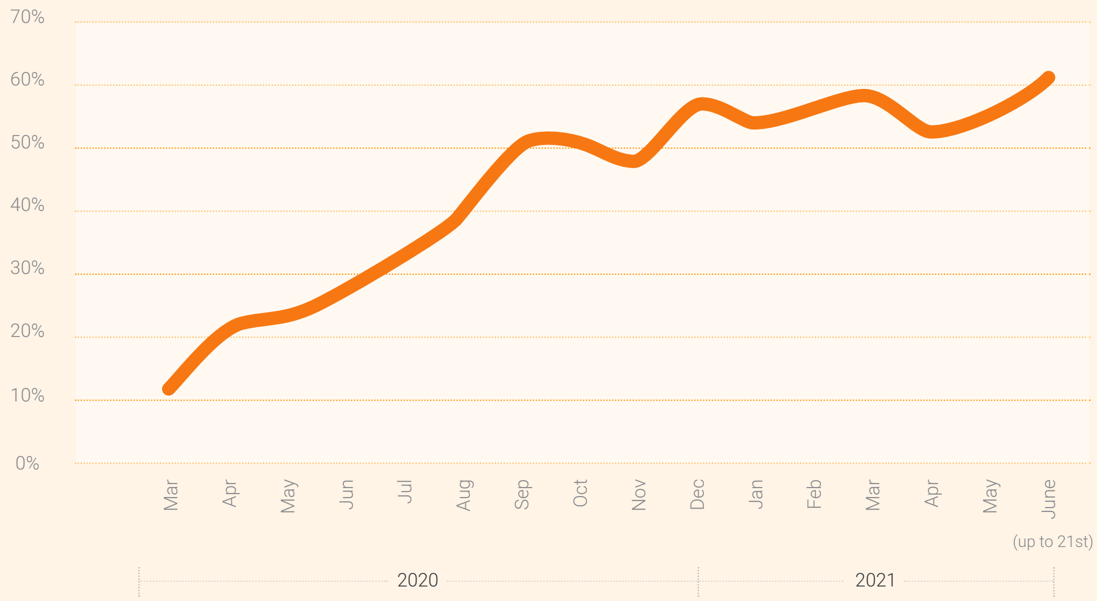
Avengers amongst us:
UK businesses fuelling the recovery

We saw in Q1 2021 the rise of the 50/50 economy with an almost equal split between UK businesses emerging from the pandemic that have weathered the immediate storm well and those that have been bruised. The good news is that the fate of UK businesses has improved in line with the gradual reopening of the economy – with today 60% of businesses reporting positive or neutral trading performances.

Businesses that have done well during the crisis can be found across all sectors – suggesting that even in sectors that have been significantly impacted by the crisis, opportunities have emerged. It is striking that the destiny of businesses has been strongly influenced by the strength of the directors that have been leading these businesses through the crisis. In particular, prudential management of directors' personal finances appears to show a direct correlation with the prospects of a business.



Pandemic impact is receding: 60% of businesses now reporting positive or neutral trading performance as the result of the pandemic – only a quarter of businesses were in the same position a year ago



Percentage of Businesses Reporting Positive Or Neutral Pandemic Impact

Source: Funding Xchange. Self-reported pandemic impact on business' trading performance.

A deluge of government funding, whether £79.3B[1] provided through government-supported lending or £57.7B[2] in the form of furlough payments, has dulled the immediate pain by putting entire sectors into hibernation. The subsidies have prevented business failures, even many of those that would have normally occurred - as the 38% decline[3] in insolvencies during the pandemic (Q1 2021 vs Q1 2020) has shown.

While cushioning the immediate impact, the funds were not deployed with the intent to facilitate the transition towards a more modern, digital economy where we live, learn, work and socialise in different ways. This transition is not new – however, in some areas, we may have witnessed 12 years of progress in the last 12 months. We have seen a leap in moving to digital 'office work,' digital access to health care consultations, digitally ordering meals and even digitally divorcing our partners. In the last year, we have re-engineered how we as a society function with much ingenuity and resilience.

Much of this transition is driven by Avengers amongst us, businesses who have re-invented or shifted their business models to respond to rapidly changing conditions and customer needs – creating new ways of serving customers and transforming the delivery of services. The last Lending Monitor showed that these Avengers exist in all sectors – including those that have been heavily impacted by the crisis – like hospitality and travel[4].

Using their ingenuity, Avengers have been largely unable to access government funding that focused on the weakest and sought to stem a rapid rise in unemployment and business failures. As the broader economy awakens and support schemes are scaled back, the continued recovery will require these businesses that have shown their agility and performed well to access the funding they need. However, the expected K-shaped recovery – with some businesses recovering quickly while others continue to lose cash as costs bounce back but revenues remain subdued – means that many funders are pausing to determine whether and where to deploy fresh funding.

This Monitor looks at the opportunities for market-based lending to fuel the recovery by supporting robust businesses that can power out of this crisis with more resilient business models and the agility to successfully seize opportunities. We are identifying the common profile of strong performing businesses – the Avengers – that are providing opportunities for funders to deploy funding.

Source:

1. HM Treasury Coronavirus Business Interuption Loan Scheme (CBILS) Statistics
2. The National Archive: Coronavirus Job Retention Scheme Statistics March 2021
3. Company Insolvency Statistics January to March 2021
4. Funding Xchange Lending Monitor Q1 2021

Deploying funding in uncertain times...

Our data shows a strong pulling apart in the performance of businesses. While many lenders have shunned certain sectors during the crisis, it appears that the profile of the director matters more to the survival and health of a business.

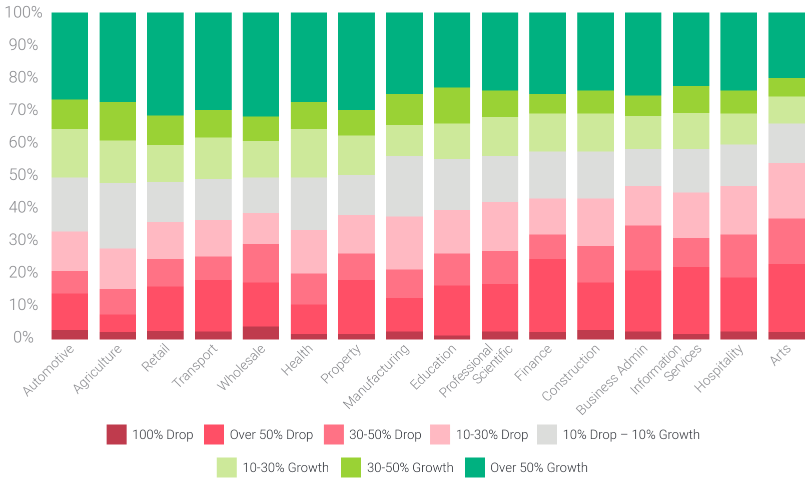
Businesses are adapting to a changing world across all sectors

Businesses that have done well can be found in all sectors – even the most challenged sectors like hospitality and arts. Suggesting that sector exclusions, introduced by many lenders during the pandemic, are too broad to provide protection while discriminating against potentially attractive opportunities. It is interesting that the funding needs of businesses also vary less across sectors than by the trajectory businesses are on.

For example, the demand for asset finance is fuelled by businesses that are doing well (40-50% of these businesses seeking asset finance compared to less than 30% of those that are struggling).

Avengers: even sectors most impacted by the crisis have strong performers

Revenue Trends by Sector (Mar 19 – Oct 19 vs Mar 20 – Oct 20)



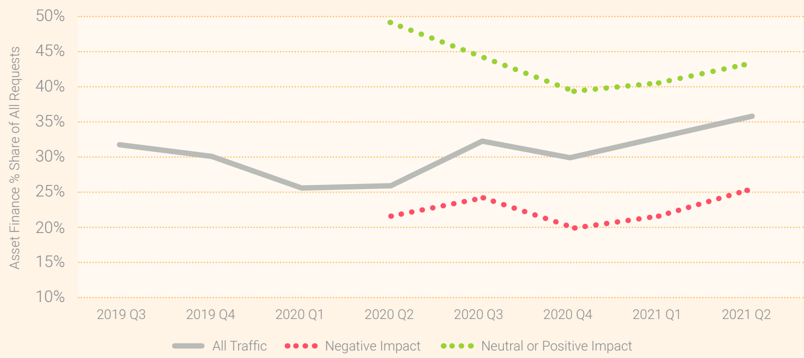
Source: Funding Xchange, revenue trends for businesses applying for funding

Asset finance in demand by businesses adjusting to crisis

Unsurprisingly, the gradual reopening of the economy has driven a boom in asset finance requirements – driven by businesses looking to invest in new delivery services/outdoor spaces. Asset finance providers have benefitted from this growth in demand - leveraging CBILS but also providing a significant share of market-based funding to expand balance sheets. To sustain the deployment, asset finance has benefitted from access to funding lines both from institutional investors but also the government.

While asset finance has grown rapidly during the crisis, the introduction of the government schemes significantly reduced the supply of market-based unsecured working capital for smaller businesses: available lending below £50K was pre-dominantly delivered through BBLS - displacing market-based solutions. This has had a disproportionate impact on growing businesses seeking access to working capital. Our data suggests, only 4% of growing businesses accessed government loan schemes

Mini-booms in asset finance as lock-downs ease



while more than a third of those negatively impacted businesses received government help[5]. Government schemes appear to have been effective in dulling the pain of the crisis but have not been there to support those Avengers that are driving the recovery.

Supply of market-based working capital in this space continues to be restricted even after the decommissioning of BBLS and CBILS as some unsecured lenders are continuing to await RLS accreditation, struggle to secure funding lines and are dealing with covenants restricting the risk appetite. A small group of accredited RLS lenders are starting to deploy funding – but are not showing the same appetite that we saw with the launch of CBILS.

Source:

5. Based on SMEs applying for funding to FXE. Growth trajectory and access to government schemes is self-reported data.

CBILS (Coronavirus Business Interruption Loan)
BBLS (Bounce Back Loan Scheme) RLS (Recovery Loan Scheme)

While funding rates are depressed, lending opportunities remain

While Avengers have a significantly higher need for Asset Finance, businesses that are struggling more often require access to working capital. However, working capital is typically accessed through unsecured funding, which struggling businesses are mostly cut off from. This is introducing additional challenges: these businesses often look overleveraged as BBLS and CBILS loans have replaced revenues. The combination of reduced risk appetite of lenders and challenging profiles of businesses means that funding rates remain severely depressed.

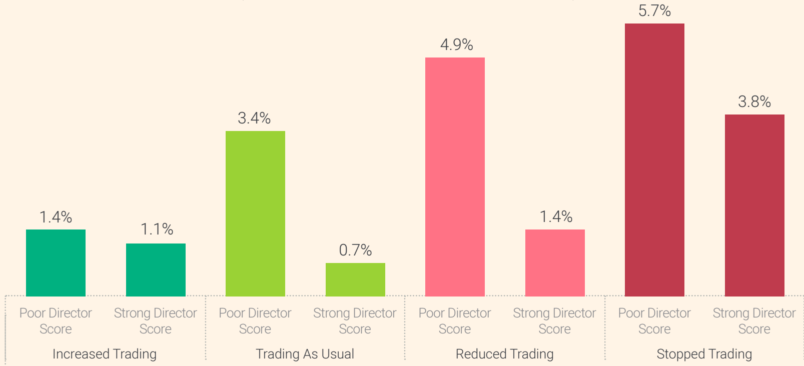
Yet, as we are coming out of the crisis, it is clear that significant opportunities are available to lenders. And some of these opportunities are in surprising places. One is focused on the personal background of directors - as small businesses' trajectory during the crisis has been strongly correlated to directors' prudential approach to the management of their **personal** matters.

While many lenders have taken a director's background into consideration for commercial lending decisions, it appears that the background of directors is even more critical during current times. Our analysis looked at the trading trajectory of businesses to understand how directors' management of their personal finances impacted commercial defaults. The analysis shows that some limited businesses led by directors with a weak credit profile are 3-4 times more likely to default on a payment in the last 12 months than those where the director has a good credit standing.

This suggests that lenders' ability to cross-reference a business' trading performance (e.g., through the assessment of CCDS) with the credit profile of directors can point at attractive lending opportunities.

Personal background of directors and business trading performance correlate with default risks

% of Businesses with Any Commercial Default in the Last 12 Months (by COVID-19 Impact and Personal Score)



Source: Funding Xchange. CAIS, personal credit scores for directors for businesses applying for funding between Oct 2020 and June 2021.

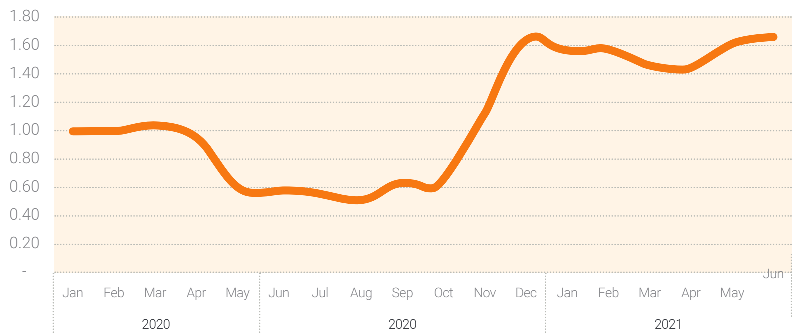
The shift to digital is unlocking finance and closing the funding gap

The acceleration of digital transformation is also opening up new opportunities to unlock funding. For example, the rapid shift towards digital payments – with a 60% increase of acceptance of cards since the start of the crisis – suggests growing opportunities to deliver lending solutions that leverage this flow of digital payments. Where traditionally businesses would have used invoice finance solutions, an increasing share of payments is migrating to digital flows that can be leveraged to unlock finance.

This aligns with how our attitude to work is changing: many more individuals have 'side hustles' – where they spend some of their time building a micro-business while also pursuing another career. This way of working does not fit well with the traditional 'commercial lending' or 'personal lending' solutions. And while challenger banks have started to provide banking facilities to these new types of entrepreneurs, the lending solutions are lagging behind.

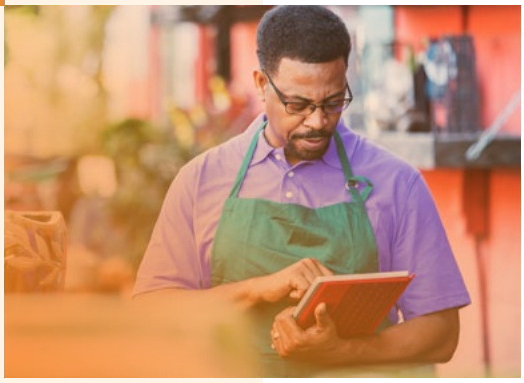
Acceptance of cards has increased 60% compared to pre-crisis levels

Proportion of Businesses Accepting Card Payments, Indexed to Jan 20



Source: Funding Xchange. Percentage of businesses applying for funding that report card acceptance, indexed to Jan 2020 = 1

The good news is that we are seeing new products that are tailored to these new ways of working coming to market – and expect the solutions to make a significant impact on the availability of micro-loans. These products are typically seeking to use digital payments and Open Banking technology to close the huge funding gap that exists especially for sole traders and 'side hustlers' who are often unable to access more conventional loan instruments.



Seeking out opportunities in an uncertain time requires greater insights into businesses' trading and payments performance – as well as their directors

It is clear that there are attractive lending opportunities for lenders – unlocking these will require digital capabilities to be able to identify and deploy funding efficiently. The use of real-time data to understand how businesses are performing is becoming even more important – leading to five key observations for the next phase in the development and deployment of funding solutions:

Going against conventional wisdom is offering significant opportunities – but requires insights that allow funders to identify attractive opportunities.

Winners and losers are not defined by sector, geography or established client relationships. The dislocation we have experienced is sudden, does not hit all businesses the same way. For example, 7% of businesses in the hospitality sector have grown and almost 40% are doing as well as pre-crisis. But finding these opportunities requires funders to take a view which goes beyond sector and examines the micro-level health of the business in question.

Risk models have never seen an economy that is awakening from hibernation and has just replaced a year's worth of revenues with £80B in business debt.

Historic data models are unlikely to provide sufficient insights into the unfolding story. As businesses are starting to trade again, are rebuilding their cashflow and are paying bills, the pattern of transactions and payments provides a strong indication of the prospects of a particular business – and the ability for funders to identify opportunities to support businesses that are coming out of the crisis stronger – as well as mitigate risks.

Affordability will be taking centre-stage as businesses face a mountain of debt and gain new FCA protections.

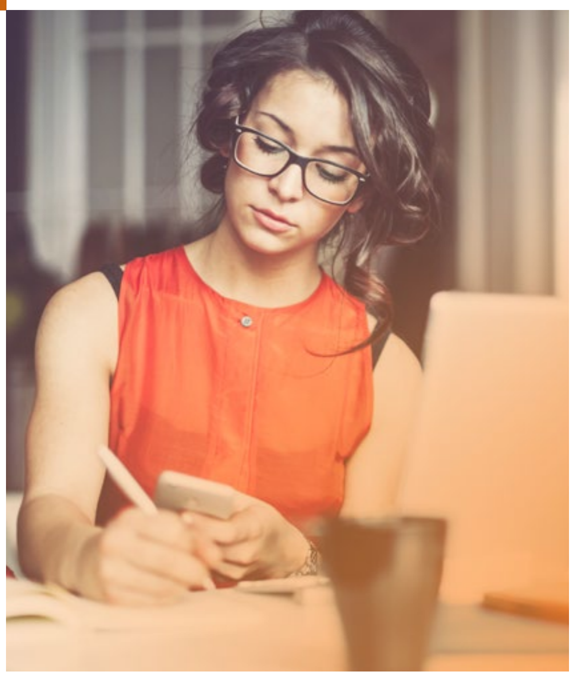
Reviews in the commercial lending market before the crisis already pointed to a lack of rigour in affordability assessments. With weak balance sheets, this concern will be even more pronounced. So are new data sources going to give comfort that a business is able to demonstrate affordability of fresh funding? As so often, the public attention given to Open Banking is quietly overtaken by the utility of Commercial Credit Data Sharing (CCDS) data that is providing visibility into account balances and movements. By creating the ability to demonstrate affordability, CCDS offers a low-customer friction, fast-track route into assessing a business' financial health – especially as some businesses are starting to re-emerge with a vengeance.

Access to trading data can be a powerful early warning flag – if used responsibly, it is creating the opportunity to benefit borrowers and protect lenders.

Understanding in real-time businesses' revenues, costs and payments behaviour has been the foundation of banks' assessment of risk – and is now equally available to lenders who are not holding the bank account relationship with a business. Understanding how a business is trading – its net cashflow – is the key predictor.

Experience and diligence matters.

While the trading patterns of businesses allow us to understand the immediate path they are on, the background of directors is one of the key survival drivers, determining whether a business is thriving. For example, we have seen that where directors have a higher personal credit score – a marker of financial prudence that appears to translate into robust business management – the business they run is less likely to report a negative impact from the pandemic, less likely to be delinquent, less likely to be suffering from cashflow problems.



Funding Xchange

Funding Xchange has been a leading provider in the digital assessment of SME lending applications since 2014. The Funding Xchange MarketPlace puts businesses in control of their funding, providing access to 70+ lenders from one simple funding request, enabling them to easily compare terms and apply with confidence and not impact their credit score.

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

FXE Technologies

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View the FXE Technologies solution suite at **fundingxchange.co.uk/fxe-technologies** or email **ben.sher@fundingxchange.co.uk**

FUNDING XCHANGE Rise London | 41 Luke Street | London EC2A 4DP