SME Lending Monitor

October 2019

The SME lending ecosystem has become an integral part of helping small businesses get access to finance.

Small businesses are facing challenging times, and access to finance is critical to enable them to navigate through uncertain times.

Funding Xchange believes that collaboration between banks, alternative lenders and policy makers is critical to ensure businesses have access to the critical life-line that funding often represents. This has led to us publishing the first edition of Funding Xchange's 'SME Lending Monitor,' that tracks small businesses' ability to access funding against a background of increased economic uncertainty, changing needs for funding and a rapidly evolving landscape of providers.

Funding Xchange, the only marketplace that provides businesses with personalised, transparent quotes for business funding, has a unique perspective into these changes as we have visibility on the funding needs of businesses from across the whole of the UK, and the funding solutions that are available to them from more than 40 different providers. The monitor highlights changes in SME lending based on more than 30,000 businesses that are accessing our services each quarter.

Publishing this analysis is part of our mission to transform access to lending by connecting the separate elements of the ecosystem, and providing businesses with transparent access to the funding solutions that are available to them. This gives business owners control over choosing the lending products and terms most suitable for them.

Each edition of the monitor focuses on three key areas

Given the unique data Funding Xchange has access to, we will be providing insights into::

- The profiles of businesses seeking access to funding
- Sector or regional challenges in accessing finance
- Products or terms available to businesses with different risk profiles

Each edition of the monitor will also focus on a different element of the SME lending market to better understand it. The first monitor assesses the changing profile of businesses using the mandatory Bank Referral Scheme and the solutions these businesses can access.

What are the key findings?

The profile of businesses being signposted to Funding Xchange through the Bank Referral Scheme has improved. However, 80% of referrals are still finding it challenging to access funding or are not ready to successfully access debit finance.

The profile of businesses being signposted to Funding Xchange through the Bank Referral Scheme has improved in 2018 and 2019. Only 14% of companies accessing Funding Xchange through the scheme in early 2018 had a financial profile that suggests 'viable demand' where the provision of responsible lending is possible. This increased to 20% of referrals for businesses with the same profile in 2019.

The figures suggest that the risk appetite of the main banks has not altered significantly in 2019, in spite of the looming prospect of a possible no-deal Brexit. This is positive news for SMEs as it means that the main banks' credit assessment of businesses is largely unchanged, despite the external economic and political environment.

Around 80% of businesses currently using the scheme would find it extremely challenging to access debt finance from a responsible lender.

A key reason for this is that they have not yet built up a track record and legal structure that lenders require to extend debt finance. Some of these businesses will also find it hard to access finance due to an impaired credit history. These businesses will be able to benefit from access to tools that allow them to build a more robust financial profile which in the longer term will help them access finance

As an example of this, Funding Xchange, together with Experian, has launched access to tools that allow businesses to improve their credit profile and educate them about other actions that will help them build a stronger financial profile. As fewer SMEs benefit from relationship banking, we see the provision of digital advisory tools to SMEs by banks to be a key element of their customer engagement strategy.

Collaboration between banks and non-banks delivers a positive outcome for businesses in challenging sectors but is not a remedy to provide funding for all.

Banks make lending decisions based on the fundamentals of a business, as well as banks' obligations to regulators. This requires them to consider their overall exposure to specific sectors, and the monitor's data shows that this drives sectoral bias that is reflected in the profile of referrals. This has resulted in an increasing number of strong businesses from challenged sectors coming through the scheme:

- Non-bank lenders have proven to be highly effective in filling the funding gap present in challenged sectors such as retail, accommodation and construction. Within these sectors, fundamentally sound businesses have been unable to access funding through their bank..
- This additional funding will become even more critical in a downturn, where we predict that the collaboration between banks and non-bank funding sector will provide an effective safety valve for 'viable' demand. However, the non-bank funding sector cannot and should not extend access to funding to businesses that have failed to demonstrate prudent management of their finances.

Access to non-bank funding is better than ever... but only for some.

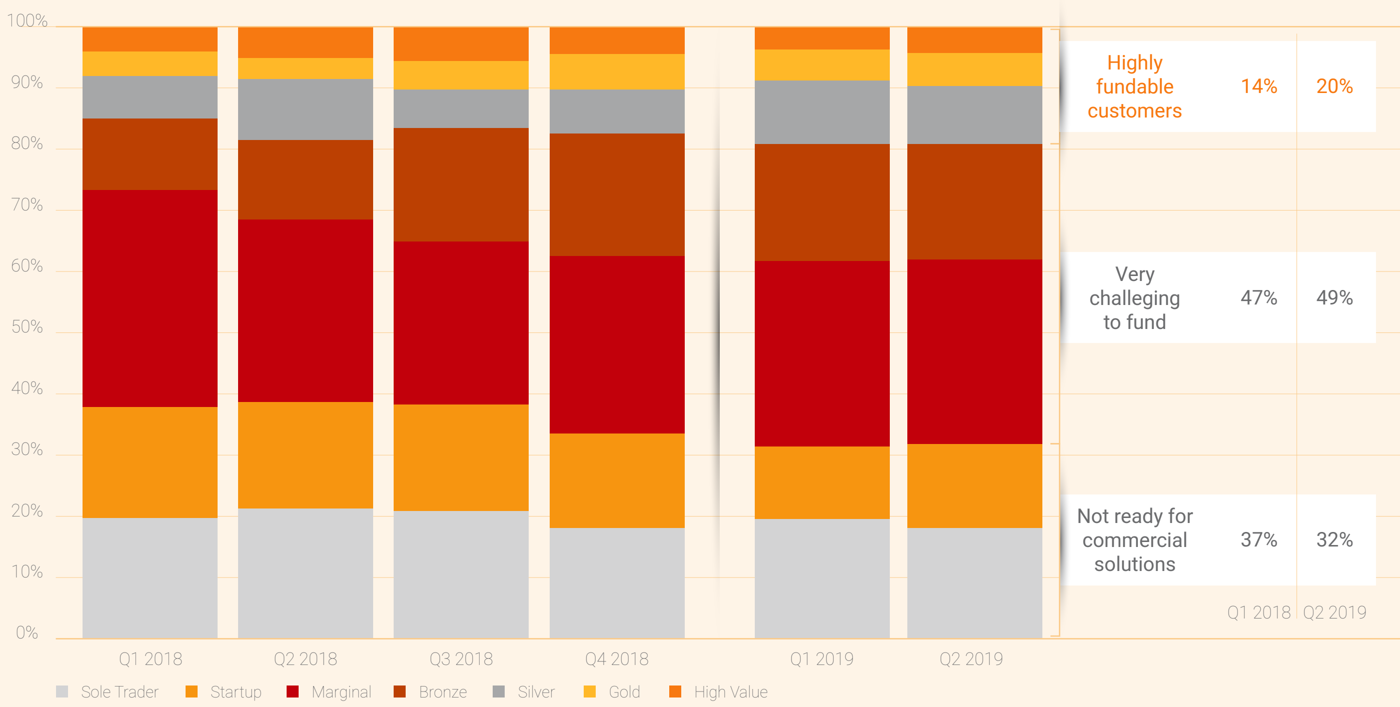
The non-bank lending market is experiencing a split of businesses into two stark categories. The first is businesses with stronger profiles being able to access lending products with highly competitive terms. Our data shows that for the first time this can result in applicants being offered better terms by alternative lenders, which are more competitive than the banks' which declined them in the first place.

Conversely, the second category consists of businesses with a limited track record, who are finding it increasingly challenging to access finance at all. This has the potential to diminish the efforts of the next generation of entrepreneurs before they have even had the chance to prove themselves.

Support for the youngest and most dynamic companies should come through the Start-up Loans Company and other government funded schemes that have a mandate to support the next generation of entrepreneurs. While the efforts of these schemes should be applauded they must find mechanisms to make it easier for these early stage businesses to access funding more easily.

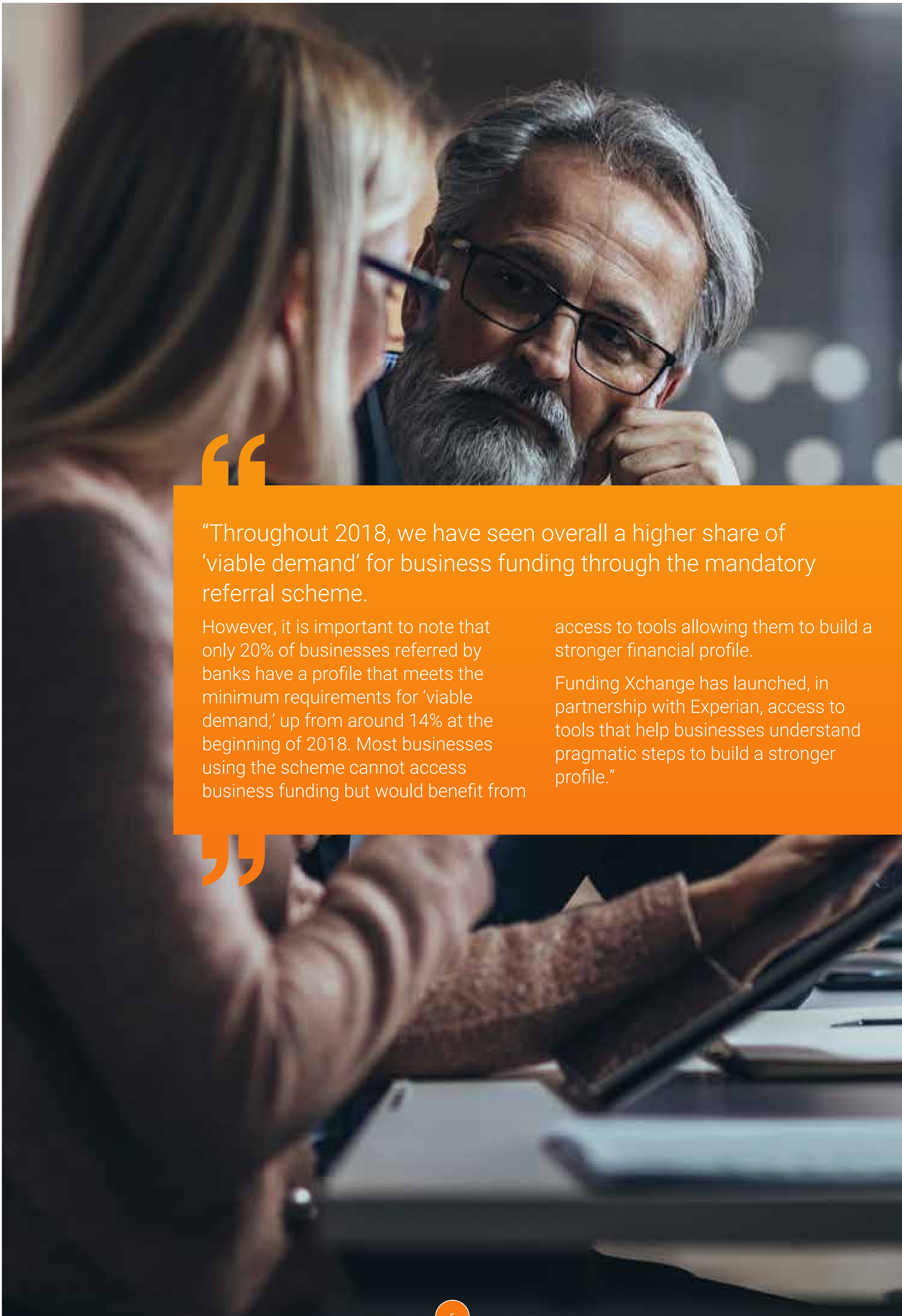
Profile of businesses referred by banks

Broader economic uncertainty appears to make it more difficult for some small businesses to access lending from their bank. Funding Xchange has seen the share of bank-declined customers with a 'viable profile' increase from 14% at the beginning of 2018 to 20% in 2019.



Profile of Funding Xchange customers unable to access bank funding

- In the first quarter of 2018, 14% customers referred by banks met criteria that we use to identify 'viable demand' for commercial lending. In the most recent quarter, this increased to 20% of referrals.
- The median credit score of a business director referred by a bank has increased from less than 250 to more than 300 points.
- However, 60-80% of businesses referred through the Bank Referral Scheme are failing to meet basic criteria to unlock lending and are unable to benefit from the scheme. For example, 43% have either an impaired credit record, have been trading for less than 12 months and/or generate less than £75k in revenues.



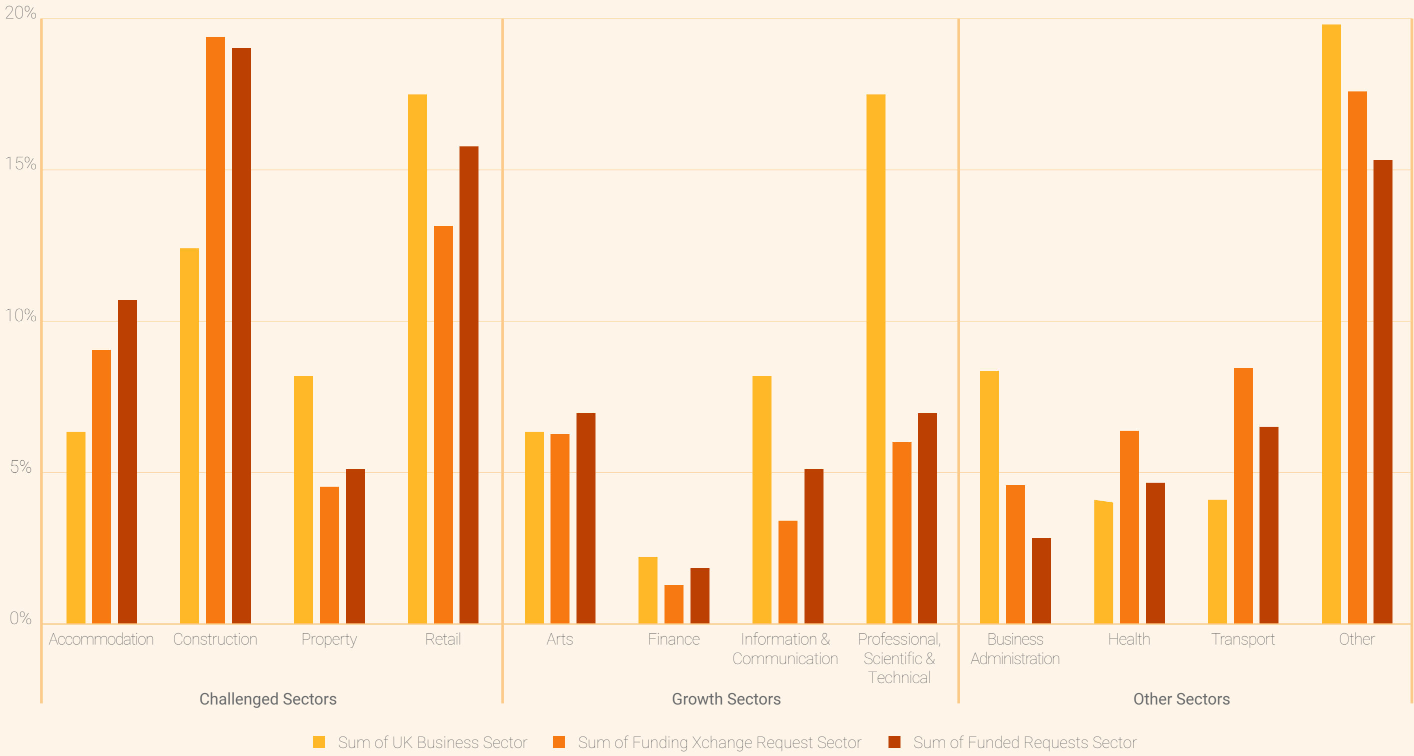
“Throughout 2018, we have seen overall a higher share of ‘viable demand’ for business funding through the mandatory referral scheme.

However, it is important to note that only 20% of businesses referred by banks have a profile that meets the minimum requirements for ‘viable demand,’ up from around 14% at the beginning of 2018. Most businesses using the scheme cannot access business funding but would benefit from access to tools allowing them to build a stronger financial profile.

Funding Xchange has launched, in partnership with Experian, access to tools that help businesses understand pragmatic steps to build a stronger profile.”

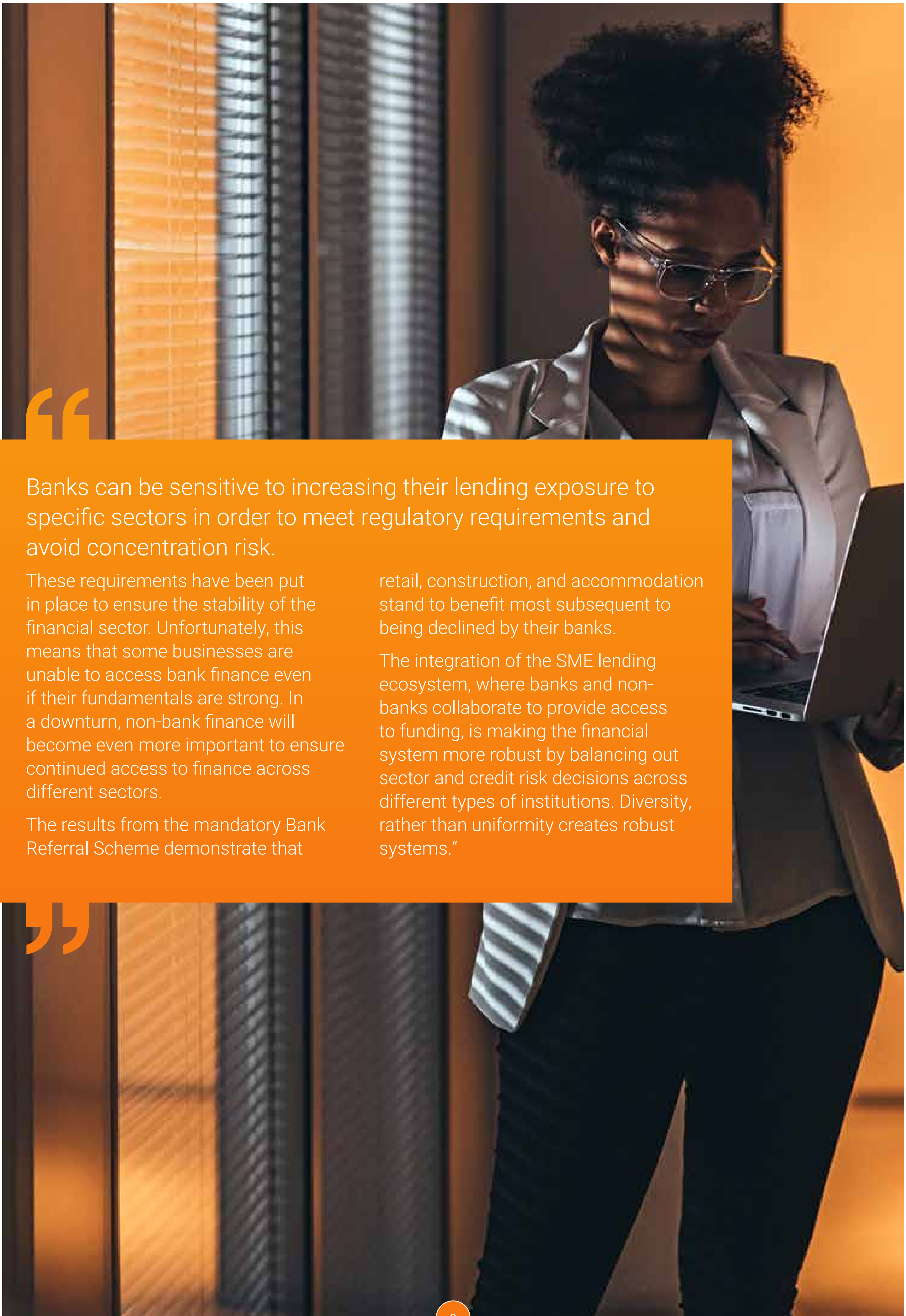
Ability of businesses to access funding

Funding Xchange provides access to liquidity for businesses in challenging sectors where banks are often overexposed. However, debt finance is not the right answer for all businesses.



Profile of bank referrals accessing funding through FXE

- Regulation can constrain banks from extending funding to specific sectors due to the systemic impact of concentration risk.
- A proportion of businesses in these sectors will, therefore, be unable to access bank funding even if the business has a strong track record and credit profile.
- This most noticeably affects sectors vulnerable to an economic downturn and includes accommodation, construction, property and retail. These sectors account for between one and a half and two times the share of referrals relative to the share of companies that operate in these sectors.
- Many of the businesses from these sectors have strong fundamentals and are successfully accessing funding through Funding Xchange, with them cumulatively representing 50% of referred businesses funded through the platform. Non-bank lenders find it easier to extend lending to these companies as they can base decisions on the merits of the individual business.



Banks can be sensitive to increasing their lending exposure to specific sectors in order to meet regulatory requirements and avoid concentration risk.

These requirements have been put in place to ensure the stability of the financial sector. Unfortunately, this means that some businesses are unable to access bank finance even if their fundamentals are strong. In a downturn, non-bank finance will become even more important to ensure continued access to finance across different sectors.

The results from the mandatory Bank Referral Scheme demonstrate that retail, construction, and accommodation stand to benefit most subsequent to being declined by their banks.

The integration of the SME lending ecosystem, where banks and non-banks collaborate to provide access to funding, is making the financial system more robust by balancing out sector and credit risk decisions across different types of institutions. Diversity, rather than uniformity creates robust systems."

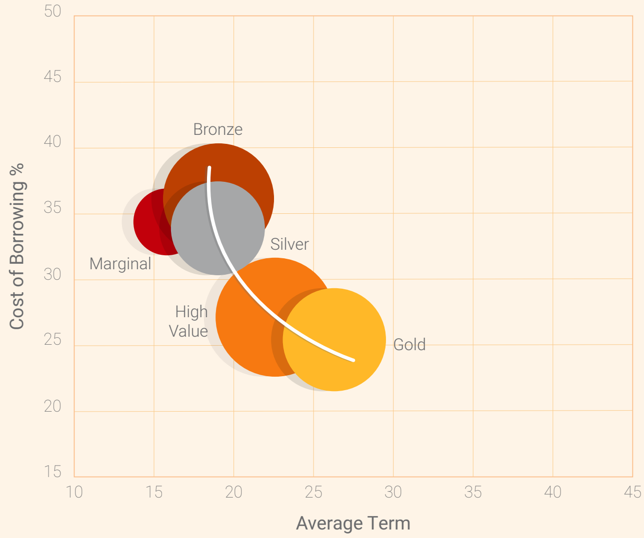
Terms available to small businesses

The non-bank lending market is experiencing a bifurcation as businesses with stronger profiles can access highly competitive terms, which in many instances are better than those offered by the banks that declined them for lending. Correspondingly, businesses with a limited track record are finding it increasingly challenging to access finance at all.

- Increased transparency between early 2018 and later in 2018/early 2019 in the SME lending market has driven clearer risk-based pricing strategies that are providing some customer segment with access to funding solutions that are priced below the costs of bank overdrafts.
- Increased competition means that providers are experimenting with solutions that provide businesses with solutions that address long-standing complaints from directors. One of the most common new solutions is access to longer-term business finance solutions and products that do not require a Personal Guarantee. However, at present these solutions are restricted to only businesses with the strongest credit record.
- 2019 has seen a marked deterioration in the availability of credit for companies with limited trading histories and/or credit impairments. While terms at the top end are highly competitive, the more marginal requests for credit are finding it increasingly difficult to access finance.
- There is an increasing need for the British Business Bank's Start-up Loans Company to provide financial support for young companies with less than 24 months trading record that have been increasingly cut off from access to commercial funding solutions.

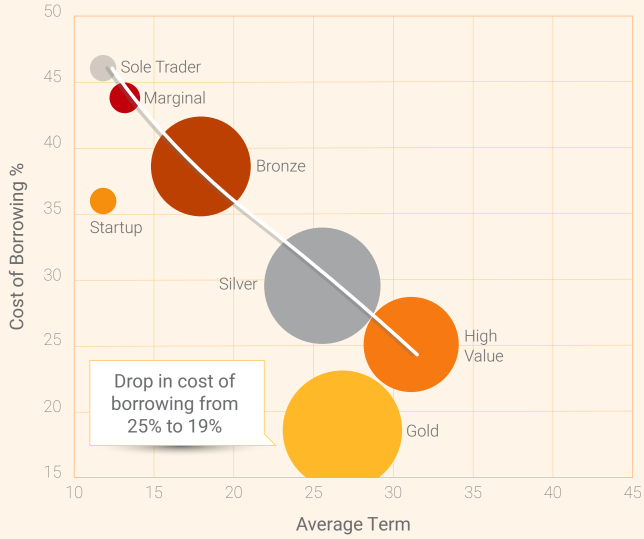
More limited differentiation of price and term

Jan 2018 – Oct 2018



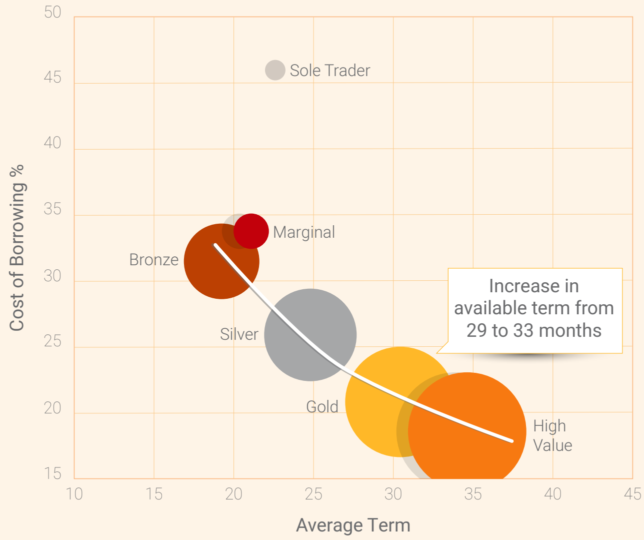
Clear, differential risk-based terms, with Gold customers highly contested achieving low cost

Nov 2018 – Feb 2019



Overall pricing has come down even as environment less certain – narrowed gap of Gold

March 2019 onwards



“A growing number of well-funded lenders are competing to extend funding to businesses with a strong track record.

Some of these businesses have been declined by the large banks but have good underlying fundamentals such as turnover of at least £100,000, over two years of trading history and no credit impairments. These businesses are benefiting from terms more competitive than the standard overdrafts and unsecured loans typically provided by banks.

In many cases, this enables businesses that have been declined by banks to access funding on better terms than offered through the bank that has declined them.

This enhanced competition has not gone unnoticed by business owners. An increasing number of businesses, 14% according to statistics released by the British Business Bank, look for non-bank finance before speaking to their main bank.

However, on the flipside fledgling businesses with less than two years of trading history, or turnover of less than £75,000 are finding it harder to access credit. As funding rates have plummeted for these businesses, our advice to them is to focus on building a strong financial profile and ensuring that the personal credit scores of their directors are strong. This will help them convince lenders that they are fundable. Though most lenders require at least two years of trading history, getting into these good financial habits will enhance their chances of them becoming fundable over the longer term.

About Funding Xchange

Funding Xchange is an intelligent decisioning platform that transforms efficiency in SME lending distribution by holding lenders' underwriting models and integrating with their decisioning. Funding Xchange accurately mirrors lenders' decisioning based on their credit policies, affordability models and risk pricing. By using access to live transactional data, including closed group CRA data, Funding Xchange provides accurate, personalised terms for SMEs – and is never more expensive than going direct. By holding decisioning within the Funding Xchange platform, applicants' personal data is protected, and businesses have full control over the funding process. Through deep integration with lending platforms, businesses can be fully approved for funding within 10 minutes without leaving the Funding Xchange site.

For more information, small business research, images or to arrange interviews, please contact: **Max.Firth@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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