Funding Xchange

SME Lending Monitor Q4 2020

October 2020

Green Shoots in Autumn: A tentative recovery in UK SME lending

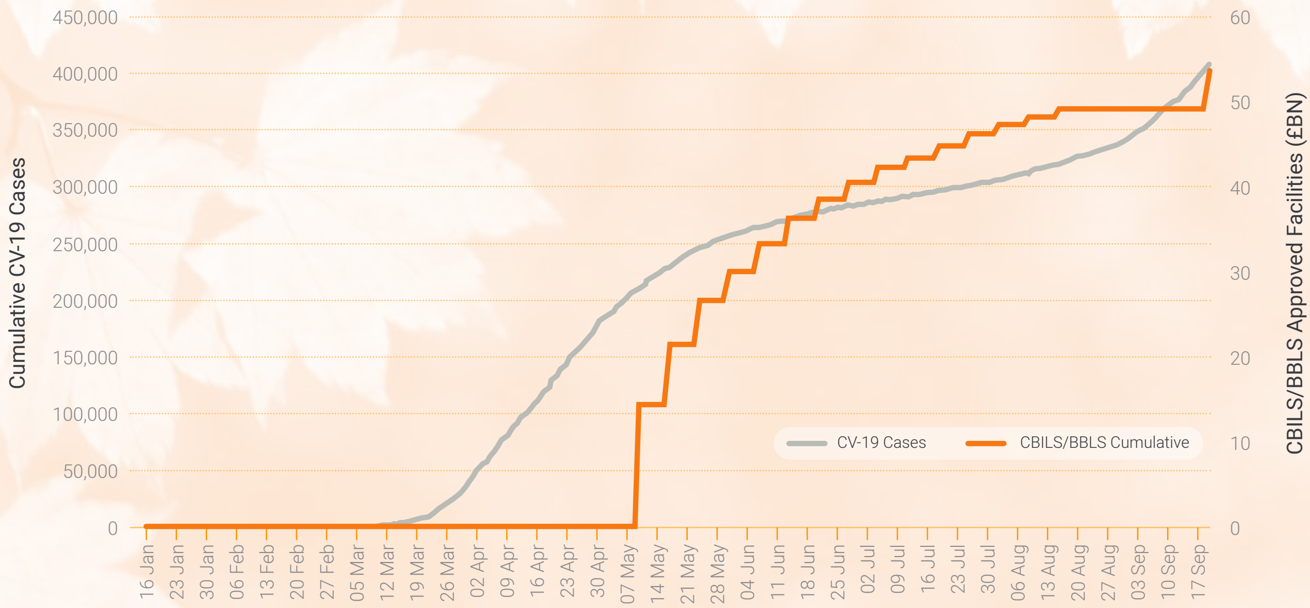
Market liquidity re-emerging as government eases transition

The immediate crisis is now developing into a chess game to contain the virus, with the government expanding the timeline for its lending support schemes to the end of November. As the spread of the virus slowed over the summer, we also saw the flow of funding from the schemes decline significantly. With the most recent resurgence of the virus, the schemes can offer a safety net as possible restrictions on economic activities are taking a further toll.

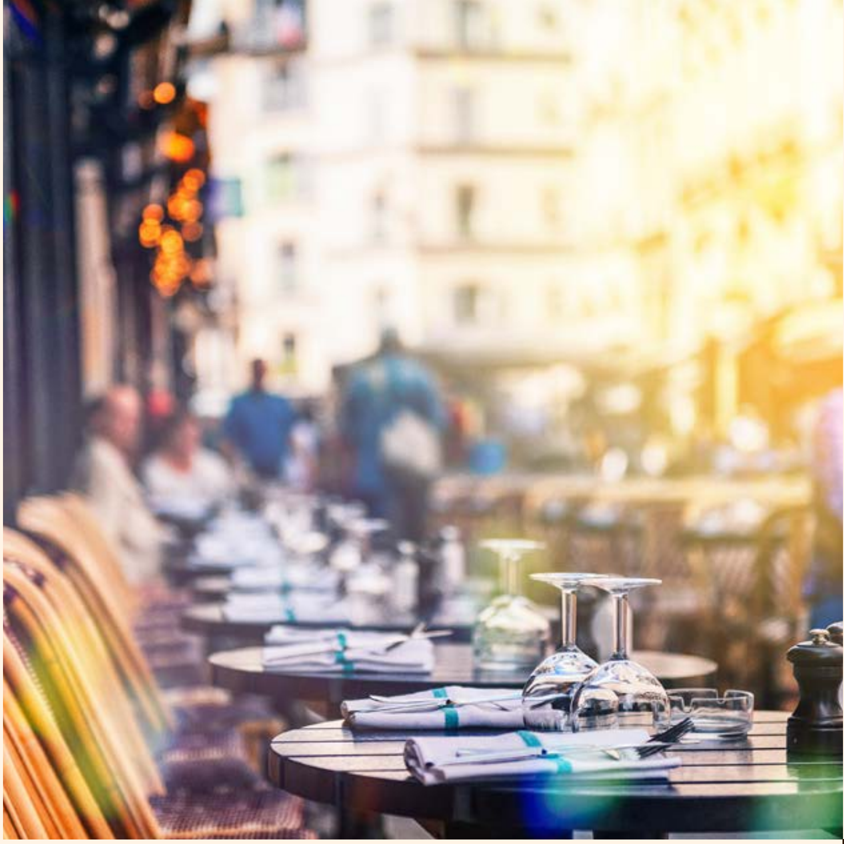
Over the summer, BBLS lending appeared to have drawn to a close as weekly approvals have steadily fallen from a quarter million at launch to less than 25,000 by mid-August. CBILS, while much more limited in reach, has not seen a similar decline in approved deals: since May, on average 1,500 loans have been approved per week – with September seeing a similar level of deal approvals.

Despite the continued uncertainty about the course of the pandemic over the coming months, the question remains how to transition back to market-based lending and support the fragile green shoots that are emerging as lenders are returning to the market – while avoiding government interventions that will hold back a return to functioning SME lending markets.

CV-19 Cumulative Cases versus CBILS/BBLS Approved Facilities (£BN)



Source:
https://coronavirus.data.gov.uk/cases
https://www.gov.uk/government/collrctions/hm-treasury-coronvirus-covid-19-business-loan-scheme-statistics



The government's interventions initially focused on getting banks to lend to SMEs. Yet, returning to sustainable market-based solutions will require a strong focus on non-bank lenders and challenger banks. Around 50%[1] of lending to smaller businesses is done outside of the High Street banks, supporting micro businesses, sectors with seasonal cashflow, younger businesses and sectors that have traditionally struggled to access bank funding.

How liquidity is 'building back' for these 95% of businesses[2] that have less than £2M in revenues will be critical to support the UK economy. This Lending Monitor focuses on how the supply side of the market is rebuilding. Even as the outlook for the broader economy remains uncertain, we are seeing encouraging signs of a sector that is adjusting to operate in this new environment:

Lenders have seen better-than-expected performance of their portfolios.

Lenders are reporting that a share of BBLS funding has been used to re-finance debt. It appears that especially higher-cost lenders have benefitted from this dynamic: as a result some portfolios with relatively high risk concentration have seen lower default rates than initially expected, and in some cases lower than High Street banks' SME portfolios as businesses are prioritising the repayment of more expensive debt.

However, the higher repayments have also reduced income of lenders significantly: this is now creating pressure to deploy funding to create a sustainable operating income.

Confidence in performance of existing portfolios is enabling a tentative return of liquidity outside of the government schemes.

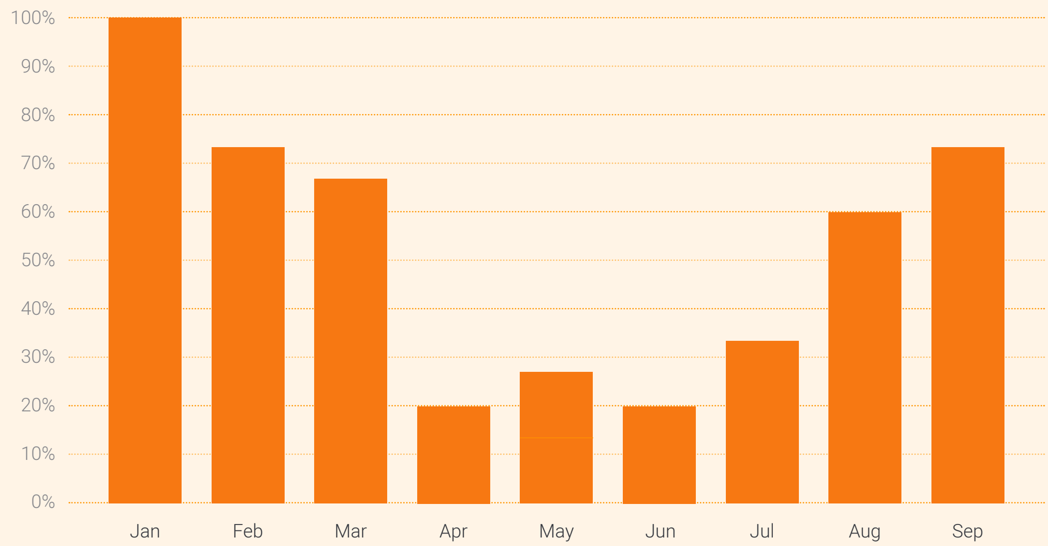
In September, we have seen a 3-fold increase in lenders providing funding outside of the government schemes, with the number of funders rapidly approaching a pre-crisis norm.

Sources:

1. Funding Xchange platform analysis, various AltFi market sizing estimates

2. https://www.ons.gov.uk/businessindustryandtrade/business/activitysizeandlocation/datasets/ukbusinessactivitysizeandlocation, retrieved 5th October 2020

Liquidity dropped by up to 80%
- current path suggests recovery to pre-crisis level.



Source: FXE platform. Number of Lenders Lending, indexed to Jan 2020, based on deal funded date. Includes CBILS/BBLS. Data retrieved 30th September.

Today almost 90% of offers on the FXE platform are for non-BBLS/CBILS solutions, compared to less than three-quarters in June[1]. Especially, where the CBILS scheme had pushed lenders out of their comfort zone into higher value segments, we are seeing lenders return to their roots by testing solutions and deploying funding with increased confidence in the sub-£50k space.

We are also seeing the return to market of a few lenders after 'sitting out' the crisis. Having kept their powder dry, these lenders are now exploring market opportunities by focusing on businesses that were not eligible for the government support schemes as they performed well during the crisis.

Liquidity has been given a boost by new players entering the market in search of attractive opportunities.

In recent months, we have seen liquidity emerge from lenders who have had no exposure to SME lending prior to the crisis – with a wide range of pedigrees coming to market or announcing their intention to launch new products. Examples include Asto (Santander's challenger bank), FIBR (looking to launch a range of SME products with a strong customer experience focus), Allica (a challenger bank entering the asset finance space) and MaxCap (a FinTech start-up).

These 'first time' lenders are deploying both secured and unsecured propositions. While their moves are still tentative, exploring opportunities, the surge in new lenders appears to reflect that a diverse set of funders are seeking to deploy funds in the SME space, backing diverse lending models.

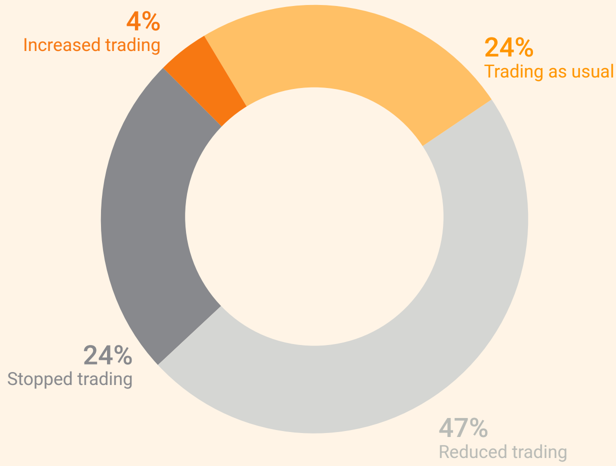
As a result, 15% of offers made via Funding Xchange today are from lenders new to the market and hence unencumbered by a legacy portfolio. These lenders are benefiting from lowered barriers to entry as customer acquisition costs have fallen dramatically, competition is less fierce and data series that show the performance of 'old risk models' have become less valuable. These players are typically engaging with available market data to launch propositions that reflect the 'new normal.'

The return of market-based lending is addressing unmet needs of businesses that have had a 'good crisis' and were excluded from the government support schemes.

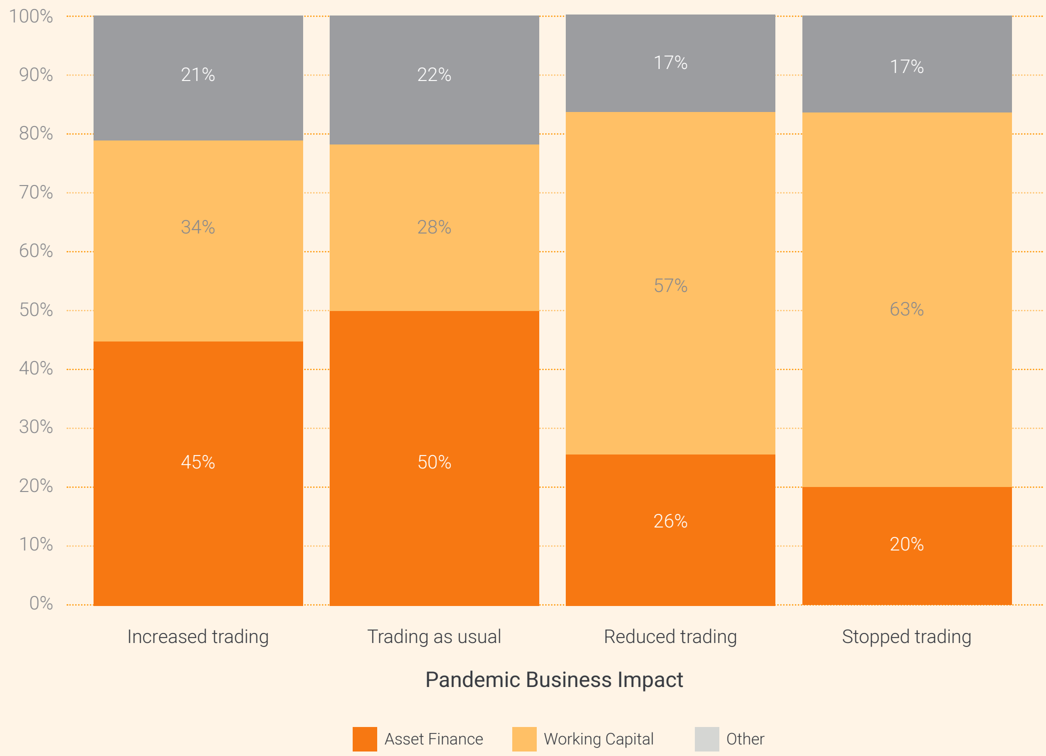
Lenders accredited by the government have been focused on supporting businesses adversely affected by the crisis. As a result, over half of all funded businesses between April and the end of August have seen a decline of revenues during the crisis. However, a quarter of those seeking finance through FXE had a 'good crisis' – where their business has either seen a steady or improved trading performance.

Source:
1. Funding Xchange proprietary platform data.

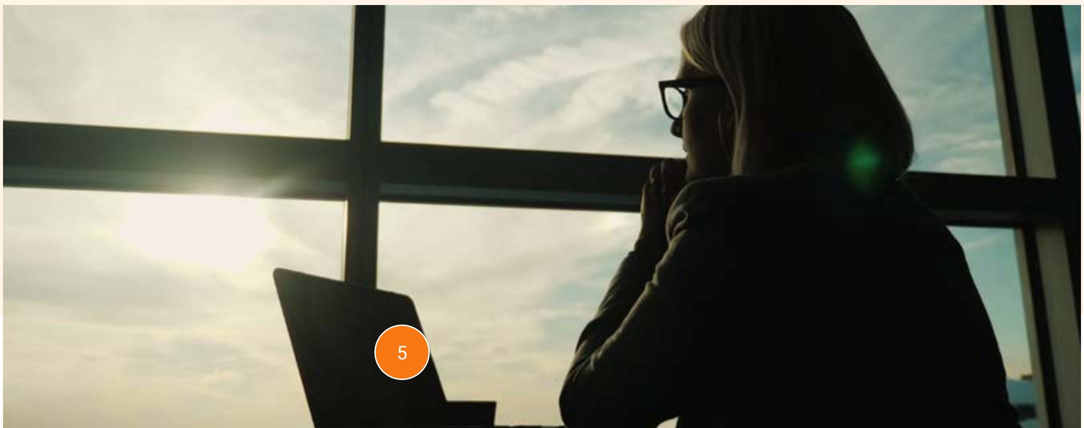
28% of businesses have had a good or neutral crisis – but have struggled to access finance as the government scheme sought to support those adversely affected.



With the return of market-based solutions, these stronger businesses are seeing much enhanced access to funding: lenders offering solutions that are not backed by the government scheme are generally looking to fund businesses that have had a 'good crisis'. These businesses, that generally displaying stronger credit characteristics than businesses that have been impacted by the crisis, are now receiving 3x as many offers as during the height of the crisis. The importance of intelligent product design, informed by up-to-date market insights, are more critical than ever to lender success in this newly competitive space.



Source: Funding Xchange, proprietary platform data, retrieved 5th October.

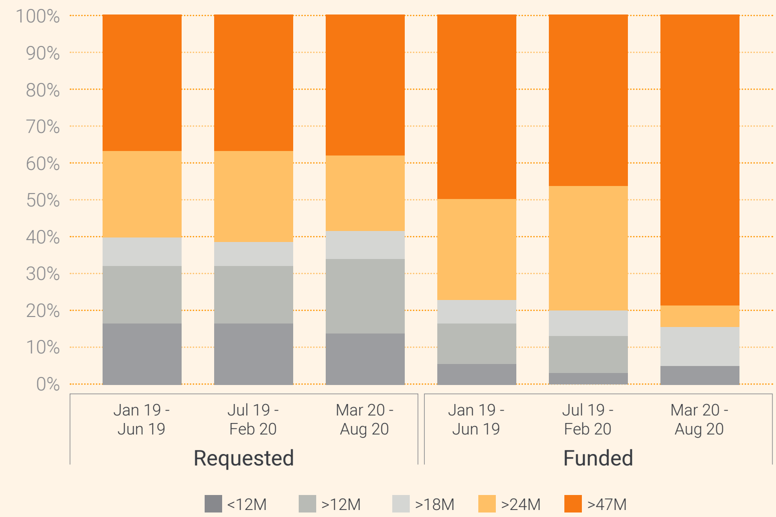


The tapering of BBLS funding is mainly impacting smaller, less established businesses whose access to funding is significantly more restricted.

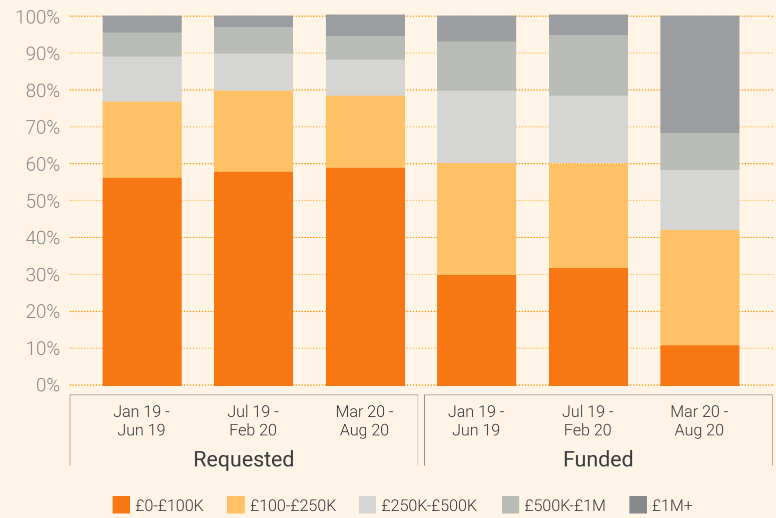
As stronger businesses are regaining access to market-based lending, the less robust businesses have severely limited access to liquidity. Outside of BBLS, available funding during the crisis was available to stronger companies: lenders reduced risk exposure by focusing on more established companies (more than 80% of funded businesses had at least four years trading history and 90% had at least £100k turnover) and directors with significantly personal assets.

This is where in previous downturns secured and receivables finance filled a gap. We have yet to see these 'recession' products play a strong role. In part we have seen Merchant Cash Advance lenders with existing exposure to sectors that are strongly impacted by the crisis make a very cautious return to the market while Invoice Financing solutions have had limited appeal to businesses that saw their sales pipeline dwindle.

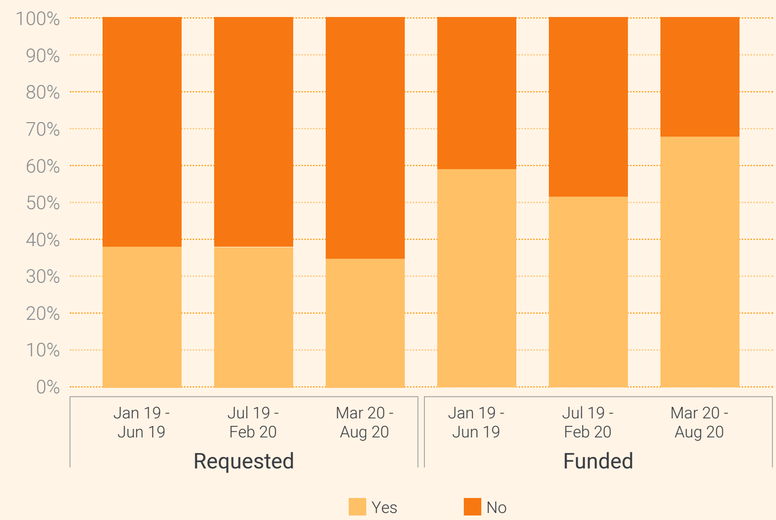
Appetite has shifted to more mature businesses...



...with higher turnover...



...and higher levels of personal assets



Source:

1. Funding Xchange proprietary platform data.

Sheltering green shoots in winter?

It is clearly too early to know how resistant the green shoots in the SME lending sector are to the inevitable challenges that a resurgent virus brings for the economy. However, it is clear that future support of the government for the SME lending sector should seek to protect and encourage these encouraging signs of resilience.

Nuanced support that nurtures a return to market-based lending rather than displaces it will be vital to ensure UK businesses are receiving the support they require to continue to navigate the path ahead. One key challenge is how the market might normalise following the low-cost, interest holiday, extended term length flavour of the government schemes, and BBLS in particular.

For example, the difference in available rates through BBLS (2.5% APR) and CBILS (average costs 8.34%) compared to non-government backed lending is stark: the cost differential of at least twenty percentage points is bringing into focus the difference of risk-adjusted costs of lending versus subsidised lending through the schemes. The average CBILS cost is lower than the base cost of funds for many lenders, before risk and operational expenses have been priced in.

The difference has not gone unnoticed by businesses: expectations of the costs of funding have been at least in part reset through the government schemes. As a result, many of the market-based solutions are currently suffering from low draw-down rates. We expect that this dampening of customer demand will continue at least as long as the government schemes are operating. For any follow up scheme, the government would be well advised to consider the impact of highly subsidised lending costs on the broader market.

We have seen the resilience of the finance sector as lenders are launching new solutions, adjusting to the new normal and are supporting creditworthy businesses. While the course of the pandemic is uncertain, the re-starting of market-based lending has to be protected.

Further government intervention will almost certainly be required to support the economy – especially where access to finance is restricted. However, interventions should build on and support the re-emergence of commercial solutions – ensuring that the finance sector has the opportunity to contribute to building back the economy. This will require targeted solutions supporting businesses that are unable to access commercial solutions. And it requires engagement with the bank and non-bank sector to empower the finance sector to support UK businesses.

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 technology. 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 (customer risk assessment) 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.

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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