

## SME Lending Monitor 2020 Q2 – Part 2

June 2020



# “Revival of the Fittest”

This edition of Funding Xchange’s Quarterly Lending Monitor comes as the Herculean effort across the sector to get loans out to small businesses continues unabated.

As of 14th June, the Bounce Back Loan scheme (BBLS) - aimed at sole traders and micro businesses - has seen over £26 billion provided by lenders to 864,000 businesses. A further 50,000 have been supported through the Coronavirus Business Interruption Loan Scheme (CBILS) with £10.11 billion in lending<sup>1</sup>.

This unprecedented support for businesses has in the short-term stemmed a flood of insolvencies and maintained employment levels. However, it has also introduced huge structural distortions – for businesses, banks and lenders – that will need to be unwound to ensure small businesses have the chance to emerge from this crisis and continue to be supported by a robust banking and lending sector.

This edition of the Monitor focuses on the challenges that the short-term measures have introduced and the anticipated need for debt management and support as we emerge from the crisis. We are using Funding Xchange’s unique data to provide perspective on the unfolding market dynamics.



## Executive Summary

The coronavirus crisis has created unprecedented demand for funding from businesses to cover a steep fall in revenues.



The government response has succeeded in making funding available to support businesses throughout the shutdown. Whilst over 900,000 businesses have accessed debt support through BBLS or CBILS, there remain pockets of unmet needs for funding:

- **BBLS has transformed demand for <£50k funding.**

Applications through our platform show a clear skew towards businesses using challenger banks that are not (yet) providing access to BBLS. Since the launch of BBLS, 40% of businesses seeking <£50k hold their accounts with challenger banks that do not provide access to BBLS. Accredited banks have focused on serving existing customers and the limited number open to new-to-bank customers are indicating several weeks delay.

- **Funding requests for >£50k represents typically a third of overall demand - the profile of applicants has deteriorated significantly.**

Only 20% of customers are meeting fundability criteria and only one quarter of businesses have previously applied for BBLS/CBILS. Options for CBILS lending through accredited non-bank lenders remain limited: the accredited non-bank lenders tend to be focused on existing customers. There is limited evidence that the government guarantee scheme has extended the risk appetite of banks for lending. In fact, a significant increase in applications from businesses with a trading record between two and four years suggests access to funding in this bracket has become more difficult since the start of the crisis.

- **Businesses trading strongly during the crisis are finding it difficult to access funding.**

With most available lending backed by the government schemes, the focus has been on supporting businesses that have been negatively impacted by the crisis. A third of businesses seeking funding have not seen a negative impact. These businesses have very few market-based solutions available.

- **The return to market-based lending will be challenging as the key segments that non-bank funders have traditionally focused on have been severely disrupted by the crisis and subsequent government-backed debt funding through BBLS.**

With 25-40% of SMEs with outstanding loans having suspended payments, finance providers are looking to shore up existing exposure. While some lenders are encouraging businesses to use the lower cost BBLS loans to refinance more expensive loans, this 'flushing' through of government-backed funds to non-bank lenders does not appear sufficient to address the significant exposure.

While building a new book under these conditions is typically not a priority, lenders are also facing the challenge that the market segment that many non-bank finance providers have focused on is now saturated with easy to access BBLS funding. Many of these lenders are now accredited for CBILS which will push them into a segment of the market for higher value lending. Whether their lending models easily adjust to serving a different segment or there is enough demand for viable lending remains to be seen.





While the availability of BBLS funding has addressed the huge demand for funding from smaller and micro-businesses, the government backed funding may be only delaying rather than preventing the failure of some businesses:

- **While businesses are not making payments for 12 months on BBLS loans, a large majority of recipients with less than £500k turnover may be unable to afford repayment of loans even if trading returns to 2019 levels.**

Over 60% of businesses with turnover of up to £500k in 2019 will struggle to repay loans based on their free cash flow. While access to BBLS will have extended these businesses' lifespan, unless BBLS repayment terms are substantially changed, these businesses may be pushed into insolvency once loans become due for repayment.

- **Many businesses are likely aware of the challenges that repayment would cause – the Business Banking Resolution Service (BBRS) has found that 43% of those taking advantage of the scheme do not expect to repay the money<sup>2</sup>.**

The fact that normal consumer lending protections were suspended, and the government has insisted on waiving PGs while providing 100% guarantees to lenders, may have set the scene for borrowers to look at the scheme as grant-like funding.



The move to adopting digital processes has been disrupted by the crisis – however, managing existing exposure is creating the burning platform for lenders to shift to real-time monitoring of their exposure.

The early phases of the COVID crisis have disrupted the rapid transition towards digital lending processes that have been transforming access and speed of lending decisions. The roll-out of CBILS 'broke' most existing digital processes at banks and lenders by introducing manual assessment processes and offline reporting. Businesses have not been able to 'self-serve' while dependencies on call centres and frontline staff created vulnerabilities in the delivery of lending. Some smaller and mid-sized lenders have reacted by rapidly deploying digital onboarding journeys – though much investment will still be needed to transform processes and decisioning at the larger banks.



The starting point of the transformation is likely to be monitoring tools for existing portfolios. More than million businesses have outstanding debt, with many owing less than £100,000.

Engaging with these businesses and supporting them through the recovery by appropriately adjusting repayment terms and offering proactive advice would require an army of underwriters.

Intelligent, agile support will require access to live data – giving banks that are managing businesses' current accounts an advantage. Other lenders can achieve the same level of insight and drive intelligent decisioning through Open Banking and Accounting data – those lenders using live data to monitor businesses are likely to have a significant advantage as they are designing and delivering strategies to manage their existing portfolio.



- **Understanding the SME recovery trajectory and the speed with which a given business is returning to a pre-crisis norm is the foundation for effective unwinding of concessions:**

Recovery has been and will continue to be variable by sector and business – the engagement strategies must be tailored to the performance of businesses, balancing the need for businesses to demonstrate their commitment to servicing debt with the rapidly changing economic reality of the post-lockdown world.

- **Delivering these tailored engagement strategies requires simple, live access to transactional data to monitor trading performance.**

Live data enables review of businesses and appropriate adjustments to repayment levels throughout the recovery. Expectations are for a lengthy path to recovery with significant uncertainty about the rebound in consumer demand, impact on real estate prices and possible reshaping of the economy towards more digital services – from shopping to entertainment.

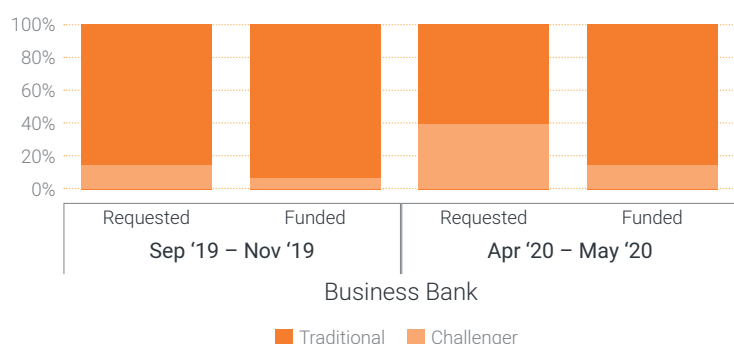
- **With large parts of the portfolio requiring regular reviews, we expect the rapid evolution of always-on monitoring of businesses to provide lenders with a fact-base** using access to Open Banking and Accounting data for adjusting lending terms without creating an unsustainable cost base.



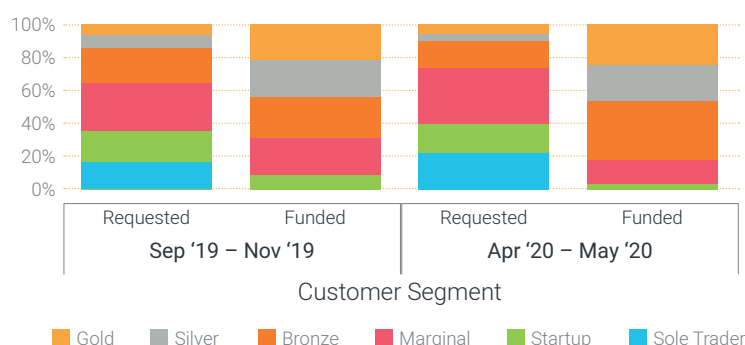


## Government response has addressed demand for funding from small and micro businesses – and driven a huge shift in the supply of funding by side-lining the non-bank sector

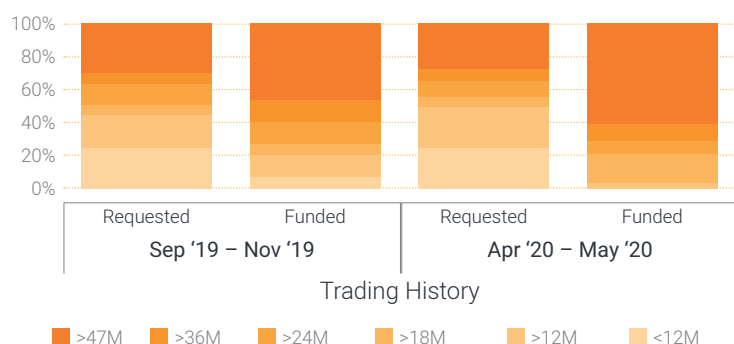
The crisis has created unprecedented demand for funding from businesses to cover a steep fall in revenues. The response of the government has succeeded in making funding available to support businesses through the shutdown. The remaining unmet need for funding is focused on smaller businesses not banking with a mainstream bank and those seeking to take out additional funding.



The proportion of funding requests received from businesses using challenger banks has shifted significantly from less than 20% to over 40%. This demonstrates starkly the unmet need from these businesses for funding – they are unable to access BBLS via their challenger bank, and the mainstream traditional banks are either providing existing customer solutions, or setting expectations of extended lead times. This leads to a jump in demand for funding via Funding Xchange from those businesses.



In parallel, we are seeing a significant jump in the quality of funded applications, as measured using FXE's proprietary segmentation which combines company and personal data to determine fundability. The proportion of Gold/Silver/Bronze businesses, effectively the cream of the crop, has jumped substantially – indicating these businesses are accessing CBILS funding, but only if impacted by the crisis.



The third and final pocket of unmet need we are observing is younger companies. The proportion of businesses successfully seeking funding has shifted significantly post-crisis to four or more years of trading history. This has effectively cut off younger companies from accessing funds. Where those companies are also using challenger banks with limited access via those banks, the negative effect on ability to seek debt is compounded.



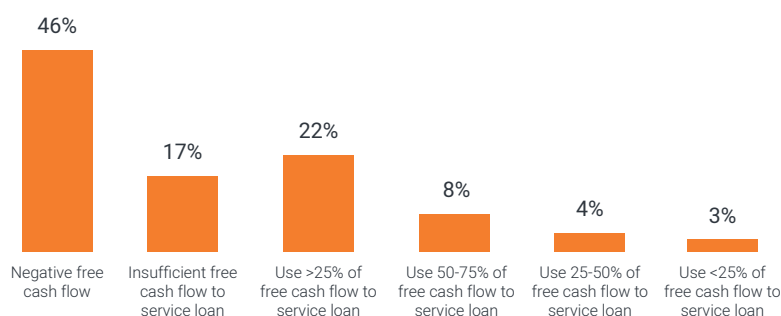


## Impact of government supported lending remains uncertain

While the availability of BBLS funding has addressed the huge demand for funding from smaller and micro-businesses, the government backed funding may only be delaying rather than preventing the failure of some businesses.

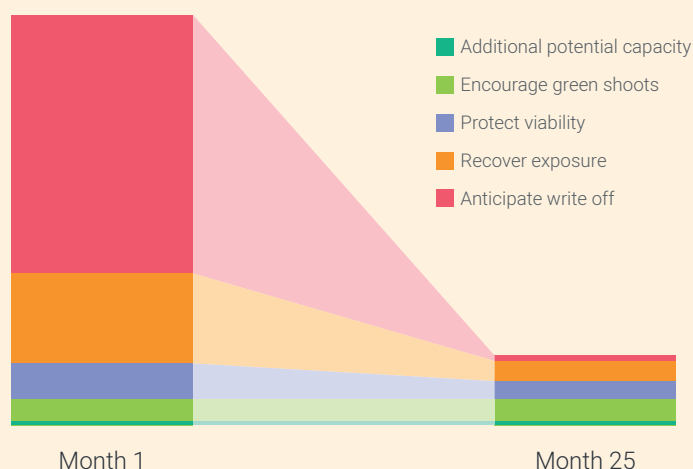
➔ We estimated a business' ability to service a typical BBLS loan based on their 2019 free cash flow. This demonstrated that in a large majority of cases (63%), businesses currently have insufficient monthly free cash to service a BBLS facility once the repayment holiday ends at month 13, assuming no major changes to free cash in the next 12 months. Even where BBLS loans were affordable, they would place significant stress on a business' pre-crisis available monthly free cash. Only 7% of SMEs analysed could comfortably service BBLS repayments using 50% or less of their monthly free cash flow.

BBLS Affordability – Business' ability to afford a BBLS Loan  
(10% turnover up £50k, 60 month term), n=8,978



➔ We then estimated survivability of smaller and micro-businesses over the next 2 years. Five behaviours, and associated implications for lenders, emerge from this analysis:

The implications for lenders are clear; businesses will require differentiated actions, driven by real-time data insights.



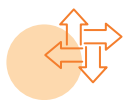
**Additional Capacity Potential** – these are the most resilient businesses that built strong financial profiles. They likely represent opportunities for new front-book lending and/or possible up-conversion for government loan scheme (BBLS to CBILS) dependent on size. This segment is also likely to be intensely competed as lenders seek to improve balance sheet quality.

**Encourage Green Shoots** – these businesses are robust and are on a path to return to healthy growth. In these cases, lenders may need to nurture the business to ensure repayment pressures do not jeopardise the likelihood of survival.

**Protect Viability** – a more vulnerable and low recovery trajectory group, likely to be in concessions, where lenders will need to exercise extreme caution in reinstating repayments at any level.

**Recover Exposure / Anticipate Write Off** – to different degrees, these are scenarios where lenders may need to focus on managing risk and exposure, and potentially adjust loss provisioning, to anticipate likely failure rates in certain businesses and sectors.

In the absence of an intelligent, structured concession programme for these predicted behaviours, we anticipate a significant shift in the overall market profile with over 60% mortality driven by heavy losses in the most stressed segments.



## Lenders will need to adopt new strategies

As a result of this systemic stress, the key challenge for lenders is to carefully manage engagement with customers to enable as many businesses as possible to remain viable and continue or restart repayments.

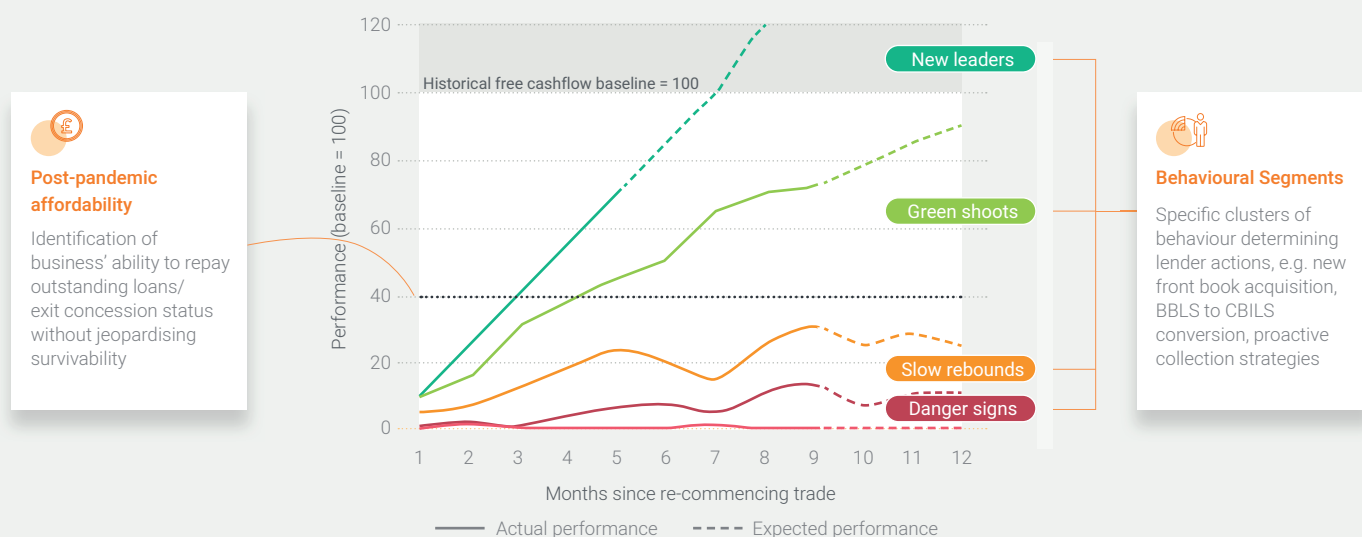
As we see the economy slowly opening up, businesses and sectors will recover at different speeds and will require different levels of ongoing support to meet their working capital needs, particularly as recovery for some businesses will see different rates of scaling up for costs and revenues.

The engagement strategies of lenders will therefore have to be tailored to different sectors and even individual businesses to create the conditions for businesses to remain viable.

While BBLS lending creates further complexity for the lenders' recovery strategies, all pre-crisis lending will require carefully managed engagement.

Funding Xchange has developed a potential solution for lenders to take a structured and scalable approach to manage these varying recovery trajectories and ensure the "revival of the fittest".

⬇️ This solution combines various data sources and techniques to deliver a simple, actionable monitoring tool for lenders:



Firstly, we leverage a combination of commercial credit and open banking data to determine both a reasonable historical baseline performance for a business, and the trigger point at which the business begins re-trading or scaling back up post-crisis.

This creates a recovery trajectory, which is then measured over time – the steepness of the slope reflecting the business' speed in approaching, or even exceeding, a pre-crisis norm. This slope is unique to each business; and the developing trajectory is used to define a set of recommendations for lender actions against that business, in combination with additional overlaid data, such as sector.

The velocity with which that slope approaches the pre-crisis norm, monitored over time and run-rate forecasted, determines the probable outcome for a given business.

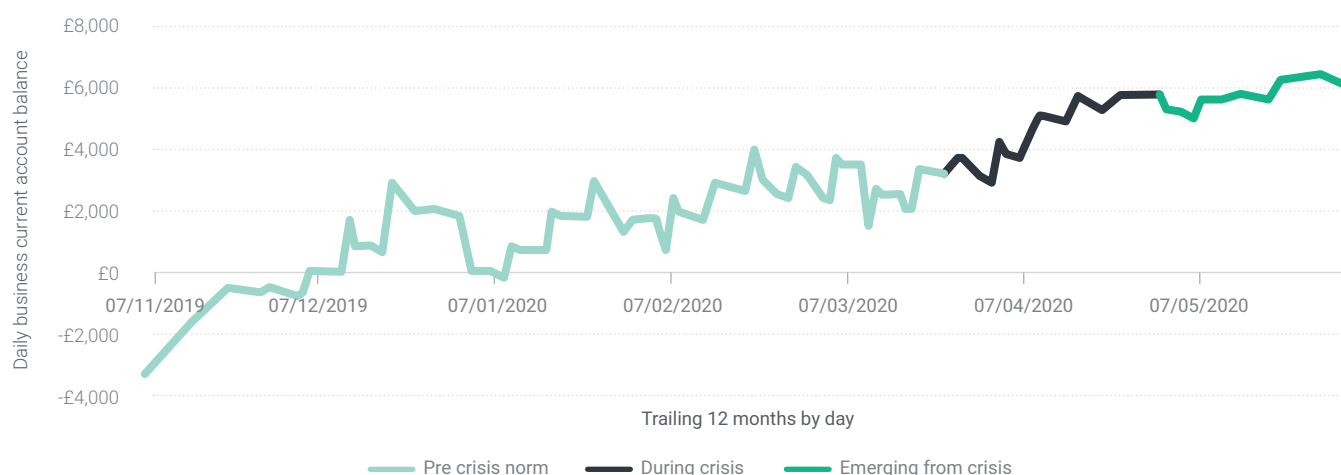
For example, one key cluster of businesses which we have named "New Leaders" is expected to outperform historical trends – either because the sector they are in is experiencing a surge in demand, or because they represent the "revival of the fittest" – meaning the upper echelon of firms that have not only ridden out the crisis, but found new customer audiences and revenue streams to thrive as a new normal emerges.

This ability to identify borrower behaviours and needs at micro-level enables a fully flexible concession management solution for lenders, where repayments can be tailored specifically to available free cash – ensuring repayments are reintroduced for the right borrowers at the right time. This ability to dynamically re-calibrate repayments is expected to minimise the additional financial stress on a business emerging from crisis and minimise a lender's long-term provisioning for losses.



To bring these concepts to life, we have run this analysis on actual businesses which illustrate the choices lenders will be faced with, and some proposed solutions, as we emerge from the current crisis:

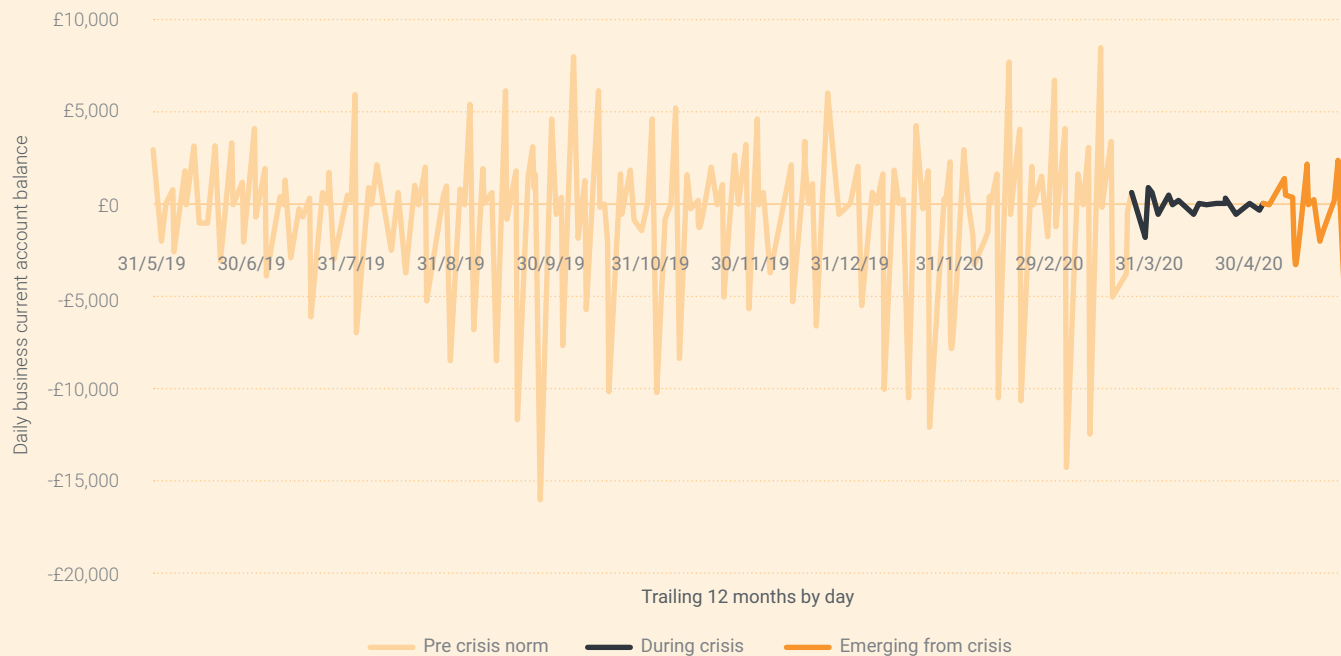
### New leader example



Here is a business that has apparently thrived during the crisis and continues to demonstrate a very positive growth trajectory – potentially due to offering a product or service that has resonated during CV-19, or because the competitive field has narrowed.

In this case, a lender could consider new front book borrowing, loan conversion (e.g. BBLs to CBILs) or, if this particular business were in concession status, to restart repayments without jeopardising survival.

### Slow rebound example



This business, in the “Slow Rebound” segment, has had a bare minimum of trading activity during the crisis – a very clear departure from the pattern pre-crisis normality. In the most recent weeks however, trading activity has re-commenced – though not yet to the scale of money movement pre-crisis.

This example shows the benefit of tailoring repayments to specific circumstances; in this case, the business may not yet be robust enough to take on the financial burden of full repayment amounts, but a re-structured repayment plan (e.g. 30% of typical monthly repayments) would generate some level of return to the lender without risking stressing the business to the point of bankruptcy.



SMEs are the backbone of the UK economy, representing 99.9% of all UK businesses and employing over 60% of the UK workforce<sup>3</sup>. Rapid reaction by government has mitigated the systemic failure risk of this critical segment of businesses; focus now needs to shift to the next phase of recovery.

Unwinding or granting of new concessions must be thoughtful, measured and balanced to the ability of a business to afford repayments – this will flatten the long-term business mortality curve and ultimately pay dividends for lenders in concessions management.

Informed, intelligent and digitally driven actions by lenders in this climate will help ensure that small businesses not only emerge from this crisis but thrive with the support of a robust banking and lending sector.

In the immediate future, integrated access to government and private funding initiatives will also become increasingly important to ensure SMEs can access the best solutions that are right for them, but also ensure that government schemes are not displacing market-based options.

We also believe that businesses will need to make structural changes to their operations and go-to-market strategies to adjust to the new normal. Businesses charting out this course will benefit from experience exchange and tailored advisory support. As lenders are traditionally not in the position to provide this type of support, the role of accountants and advisors is likely to expand – with businesses seeking help with more strategic decisions as well as tactical management of costs. By connecting the ecosystem SMEs will be able to receive the appropriate support to allow them to navigate the challenges ahead. Funding Xchange is committed to continuing to work with all stakeholders to create the connectivity and support the survival of small businesses.





#### References:

1. <https://www.gov.uk/government/collections/hm-treasury-coronavirus-covid-19-business-loan-scheme-statistics>
2. <https://www.telegraph.co.uk/business/2020/05/21/half-bounce-back-loan-borrowers-do-not-expect-pay-money-back/>
- 3 . Source: BEIS, Business Population Estimates for the UK and regions 2019 Statistical Release, retrieved 15th June 2020



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: **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](http://www.fundingxchange.co.uk)**

#### **FUNDING XCHANGE**

Rise London  
41 Luke Street  
London EC2A 4DP  
**[www.fundingxchange.co.uk](http://www.fundingxchange.co.uk)**