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## MANAGEMENT SUMMARY

### **THIS REPORT COVERS**

the borrowing process from the SME's perspective, with detailed information about those who have had a need for funding and those who have been, or would have liked to have been, through the process of borrowing for their business. It also provides broader context information about SMEs including growth, profitability and perceived barriers to running the business. This is the second report since the re-design of the questionnaire in Q1 2018.

Levels of growth and profitability remained broadly stable, but fewer SMEs had been innovative. Use of finance and the proportion of Permanent non-borrowers with no apparent appetite for finance remained stable and attitudes to finance remained cautious, with slightly more concern about an uncertain future. 3 in 10 SMEs said their need for finance was reduced by either £10,000+ of credit balances or the availability of trade credit:

<b>Most SMEs made a profit and improving their profit margin is an increasing priority</b>	<p>78% of SMEs reported making a profit, down slightly from the 82% reporting a profit in 2017 but maintaining the longer term improvement seen from 2012 when 69% reported making a profit.</p> <p>A new question in 2018 asked if improving the profit margins of the business was a priority. In Q4 2018, 36% identified it as a priority, up from 22% in Q1 (30% for 2018 as a whole).</p>
<b>4 in 10 SMEs have grown but an increasing minority reported a decline</b>	<p>39% of SMEs reported having grown in the previous 12 months, including 2% who grew by more than 40%. The proportion of SMEs that have grown remained stable (39- 42% since 2013) but since 2016 an increasing minority of SMEs have reported a decline (10% in 2016 to 17% in 2018) albeit not quite back to the levels seen in 2012, when 21% reported a decline.</p>
<b>A stable proportion of SMEs plan and trade internationally but fewer have been innovative</b>	<p>15% of SMEs traded internationally and 56% plan, both stable over recent years. The proportion of SMEs that have been innovative has declined steadily from 40% in 2012 to 33% in 2018 and across all size bands.</p>
<b>Credit balances and trade credit continue to provide an alternative to external finance while 3 in 10 injected personal funds</b>	<p>23% of SMEs in 2018 held more than £10,000 in credit balances. The proportion of larger SMEs holding such balances has increased steadily over time (to 75% of those with 10-49 employees and 91% of those with 50-249 employees) while the proportions for smaller SMEs are lower and more stable over recent years (15% of 0 employee SMEs and 42% of 1-9 employee SMEs).</p> <p>34% of all SMEs were using trade credit in 2018, up slightly from 31% in 2014 and increasing by size of SME (29% of 0 employee SMEs to 67% of those with 50-249 employees).</p> <p>82% of SMEs with £10,000 of credit balances and 68% of those using trade credit said that this reduced their need for external finance. Overall, 29% of all SMEs had their need for finance reduced by one or other of these sources of funds.</p> <p>29% of SMEs reported an injection of personal funds into the business (16% as a choice to help the business grow and 13% where they felt they had to) and this proportion has been stable for several years. Personal injections remained much more common amongst smaller SMEs than larger ones and also amongst younger SMEs.</p>

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**36% of SMEs were using external finance, predominantly one of the 'core' forms**

In 2018, 36% of SMEs were using external finance, almost unchanged from 2017 (38%). Use of finance increased by size of SME from 34% of those with 0 employees to 77% of those with 50-249 employees.

32% of SMEs were using a 'core' form of finance (loan, overdraft or credit card). This proportion has varied over time – in 2012, 36% were using core finance and this proportion then declined to 29% in 2014 before increasing again slightly to the current 32%.

Use of core finance amongst the largest SMEs has increased over recent years from 53% in 2015 to 70% in 2018 and amongst the smallest SMEs from 25% to 29% over the same time frame. For those with 1-9 or 10-49 employees the proportion has declined steadily over time, to 36% and 46% respectively in 2018.

Use of other forms of finance (such as leasing/hp) remained lower than previously seen (12% in 2018 compared to 16-18% previously).

**Half of SMEs met the definition of a Permanent non-borrower**

48% of all SMEs met the definition of a Permanent non-borrower with no apparent appetite for external finance. PNBs were as likely as other SMEs to be profitable and hold £10,000 or more in credit balances, but they were less likely to have been innovative or to have plans to grow.

0 employee SMEs remained more likely to be a PNB than to use external finance (50% v 34%) and this was now also the case for those with 1-9 employees (44% v 42%).

Those with 10-49 employees remained more likely to be using finance (54%) than be a PNB (36%) but the 'gap' is closing over time. The largest SMEs were once again much more likely to be using finance (77%) than to be a PNB (19%).

**Attitudinally, SMEs remained self-reliant and somewhat more concerned about an uncertain future**

80% agreed their plans were based on what they could afford themselves and 73% would accept slower growth rather than borrowing to grow faster. Smaller SMEs were more likely to agree with these statements, but there was little variation by other demographics such as age or sector and there has been little change in sentiment over time.

32% were happy to use finance to help the business grow, increasing by size of SME from 30% of those with 0 employees to 57% of those with 50-249 employees. The proportion agreeing with this statement has declined from 42% when it was first asked in H2 2014 to 32% currently.

Half of SMEs, 53%, agreed with the new statement that they were being cautious because the future felt uncertain. Levels of agreement were somewhat higher in H2 2018 (56%) than in H1 (51%), with little difference by size of SME.

4% of SMEs reported a need for funding in the previous 12 months– most took some action as a result and around two-thirds made an application for finance. Overall, 14% had a borrowing ‘event’, the most common of which was the automatic renewal of an overdraft, but most SMEs were Happy non-seekers of finance in 2018:

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**4% of SMEs reported a need for finance**

4% of SMEs interviewed in 2018 reported a need for funding in the previous 12 months, with little variation by size (3-6%), or by quarter of 2018 (4-5%).

This need was most likely to be for working capital to help with cash flow (32%) or to fund expansion in the UK (26%), while 22% wanted to invest in new plant and machinery.

Smaller SMEs were more likely to mention cash flow and larger ones funding expansion. Mentions of funding for cash flow purposes were higher in the second half of 2018 (36%) than the first (28%) but otherwise there was little change over time.

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**Most took action as a result of this need for funding, and 63% of those taking action applied for finance**

93% of those with a need for funding took some action as a result, including 21% who spoke to their main bank, 19% who sought professional advice and 14% who discussed the matter within the business. 11% prepared a business plan or forecast.

4 in 10 spoke to someone externally about their finance need (their bank, an advisor or another finance provider), increasing by size of SME from 38% of those with 0 employees to 65% of those with 50-249 employees. Those who did so were more likely to consider applying for finance and then make an application.

63% of those who took any action on their need for funding went on to make an application for finance, predominantly to their main bank (40% of those taking action and 63% of those applying anywhere). Overall 8 in 10 of those who considered making an application went on to apply somewhere.

13% decided to finance all or part of the funding need themselves, 12% decided not to take any funding and 16% were still to make a final decision.

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**Overall, 14% of SMEs reported any borrowing event**

14% of SMEs interviewed in 2018 reported any borrowing event(s) in the previous 12 months: 4% applied for new or renewed finance, 2% had a facility cancelled/chose to cancel a facility early and 9% had an overdraft automatically renewed.

This increased by size of SME from 13% of those with 0 employees to 32% of those with 50-249 employees (due to the latter being more likely to see an overdraft automatically renewed, 27%).

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**8 in 10 SMEs had been a Happy non-seeker of finance. Very few SMEs had wanted to apply but didn't**

Most SMEs continued to meet the definition of a Happy non-seeker of finance (83% in 2018). The proportion of Happy non-seekers increased from 68% in 2012 to 84% in 2016 and has been stable since.

Happy non-seekers can and do use external finance, they just hadn't applied for any in the previous 12 months. In 2018, 28% of HNS were using external finance.

2% of SMEs met the definition of a Would-be seeker of finance – an SME that had wanted to apply for finance, but something stopped them. This was typically the process of borrowing (eg the expense) or discouragement (most of it indirect where the SME assumes they will be turned down) but there have been more mentions recently of the economic climate being a barrier to application.

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Most applications for new/renewed finance were made to the SME's main bank for a 'core' product. 8 in 10 applications resulted in a facility, with overdraft applications more likely to be successful than loans. Most were happy with the way the application was handled and its outcome:

**Two thirds of all applications for new/renewed finance were made to the main bank**

Across all the Type 1a and 1b applications for new/renewed finance reported in 2018:

- 64% were made to the main bank, 17% to another existing provider, 12% to a new provider, 3% to an online platform and 4% elsewhere
- 35% of applications were made online
- 48% were made by first time applicants for that product
- 64% were for either a bank loan or bank overdraft.

**8 in 10 applications that had received a response resulted in a facility**

80% of applications reported in 2018 were successful: 71% were offered the facility they wanted and took it, 7% had their facility after issues and 2% took a different product to the one they applied for. Larger SMEs, those not applying for the first time and those applying to an existing provider were all likely to be more successful, as were those applying for leasing/hp or a credit card.

5% were offered a facility but declined it, typically due to cost, or a better offer elsewhere.

15% were turned down for a facility. This was more likely to be the case for those applying to a new provider, for the first time, or for a bank loan. There was limited recall of appeals or referrals by those declined by their main bank and none had taken that next step.

Analysis by 18 month application period showed little change in success rates over time. Currently 81% of applications made Q3 2017 to Q4 2018 were successful, 80% of overdraft applications, 69% of loan applications and 97% of leasing/hp applications.

**8 in 10 applications had been handled well and had a satisfactory outcome**

82% of applications were thought to have been handled satisfactorily, ranging from 94% of those offered what they wanted to 28% of those who had been turned down.

Similarly, 80% of applications were thought to have had a satisfactory outcome, again ranging from 94% of those offered what they wanted to 22% of those that had been declined.

70% of all applications either had a very satisfactory outcome or no adverse effect on the business. Amongst those declined this fell to 28%, with 40% of those declined saying that running the business was more of a struggle, 42% that they had not expanded as they would have liked and 30% that they had made spending cuts.

Half of SMEs planned to grow, but the proportion planning growth-related activities was somewhat lower than previously seen. 4 in 10 could see political uncertainty, legislation and regulation or the current economic climate presenting a major barrier to their business in the coming 12 months, up from 3 in 10 for 2017. Demand for finance remained limited and three-quarters expected to be a Future happy non-seeker of finance:

**SMEs are more optimistic about future growth opportunities but slightly fewer are planning growth related activity**

In 2018, 49% of SMEs were planning to grow, the highest proportion reported since 2013 and increasing by size of SME from 46% of those with 0 employees to 79% of those with 50-249 employees.

Almost all of those planning to grow expected this to be achieved through more UK sales (98%), while 11% expected to sell more overseas.

34% of all SMEs in Q4 were planning one or more of a series of activities typically associated with growth such as taking on more staff, or launching a new product or service, increasing by size of SME from 30% of those with 0 employees to 64% of those with 50-249 employees. Those planning to grow were much more likely to be planning such activities (51%) than those with no plans to grow (17%).

The proportion planning activities has though declined slightly over time from 42% in H2 2017 when this question was first asked to 37% in H2 2018.

**Political uncertainty, regulation and the economic climate have become slightly more likely to be seen as future barriers**

The three main barriers to running the business as they would want remained 'political uncertainty/government policy' (24%), 'legislation, regulation and red tape' (22%) and 'the current economic climate' (also 22%). 41% of all SMEs mentioned at least one of these obstacles in Q4 2018, up from 28% for 2017 as a whole.

Mentions of other barriers were more stable over time, but the proportion mentioning cash flow/late payment as an issue, which had previously decreased as a barrier from 13% in 2012 to 7% in 2016, has increased again and was back to 13% in 2018.

Access to finance continued to be mentioned by a small minority of SMEs (5% each year since 2016).

**Future appetite for finance remains limited and slightly fewer SMEs are confident of success if they were to apply**

In 2018, 10% of SMEs planned to apply for finance in the next 3 months, continuing a slow decrease from 2012 when 14% planned to apply.

The key reasons for planning to apply for finance were to fund UK expansion and/or for working capital to help cash flow and/or for plant and machinery (all mentioned by 26% of those planning to apply).

Amongst those planning to apply for a bank product, 54% were confident that they would be successful, up from 50% in 2017 and back in line with 2015 and 2016 (53-55%). Across all SMEs, irrespective of their plans, 58% were confident that they would be successful if they were to apply. This has declined since the question was first asked in 2016 when 65% were confident.

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**Future would-be seekers are put off applying by the current economic climate**

While 10% of SMEs planned to apply, 13% of SMEs met the definition of a Future would-be seeker of finance (who wanted to apply but thought something would stop them). The biggest group continued to be the Future happy non-seekers (77% of all SMEs).

Amongst Future would-be seekers the key reason for not applying was the current economic climate, mentioned by 57% as their main reason for not applying. 20% cited issues with the process of borrowing while 13% felt discouraged from applying.

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**Those trading internationally or employing overseas staff have some concerns**

SMEs that trade internationally remained more likely to be planning to grow and to apply for finance than domestic only SMEs but also more likely to cite political uncertainty as a barrier, as well as the value of sterling and, to a lesser extent, the current economic climate. Over time, such international SMEs have remained more likely to be planning to grow than their domestic only peers but their appetite for finance has declined (although still ahead of their peers).

16% of all SME employers employed staff from overseas, predominantly from the EU (14%) rather than further afield (5%). The proportion employing overseas staff was somewhat lower in 2018 than it was in H2 2017 when this question was first asked (23%).

51% of SMEs with overseas employees were concerned about possible changes to migration rules (the equivalent of 8% of all employers) and this was higher than in H2 2017, when 42% were concerned.