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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 third report since the re-design of the questionnaire in Q1 2018.

Fewer SMEs reported growth with 1 in 5 SMEs reporting a decline. At the same time, more SMEs were expecting future growth, widening the gap between actual and planned growth. 4 in 10 SMEs saw political uncertainty, the economic climate and/or legislation and red tape as a barrier with all three having increased as barriers since 2016. Innovation is no longer on the decline and international trade is stable, but those employing overseas staff were somewhat more concerned about changes to migration.

Slightly fewer SMEs have grown as an increasing minority reported a decline	YEQ2 2019, 36% of SMEs (excluding Starts) reported having grown, increasing by size of SME from 32% of those with 0 employees to 66% of those with 50-249 employees. This is somewhat lower than the 4 in 10 previously seen since 2013 (39% in 2018). 19% of SMEs reported a decline. This proportion has increased from 10% reporting a decline in 2016 to 20% in H1 2019, a return to the levels seen in 2012 (21%). The smallest SMEs remained the most likely to report a decline (23%).
The gap between current and future growth has widened and fewer SMEs planned growth related activities	As reported growth declined slightly, the proportion planning to grow increased to 50% in H1 2019, driven by the smallest SMEs (from 41% in 2017 to 48% in H1 2019) although the largest SMEs remained the most likely to be planning to grow (74% of those with 50-249 employees). As a result the gap between current and future growth has widened for the smaller SMEs (15 percentage points for those with 0 employees and 10 percentage points for those with 1-9 employees in H1 2019, compared to 2 and 6 points respectively in 2017). 37% of SMEs planned any growth related activities in H1 2019. This proportion is somewhat lower than previously seen (42% in H2 2017) and has also declined amongst those planning to grow (61% to 52%).
The proportion of innovative SMEs has stabilised after previous declines as a steady 1 in 6 traded internationally	Between 2012 and 2018 the proportion of SMEs reporting innovative activity (a new product or service and/or improving an aspect of the business) declined from 40% to 33% and across all size bands. In H1 2019, 36% reported that they had been innovative, with more SMEs having improved an aspect of the business. 16% of SMEs traded internationally, in line with most years since 2014. In H1 2019, 9% of SMEs were exporters: 18% of them made half or more of all their sales overseas and 27% made all or most of their overseas sales to the EU, both little changed from 2018.
Most SMEs made a profit and improving their profit margin is an increasing priority	YEQ2 2019, 80% of SMEs reported making a profit in the previous 12 months, and this is little changed since 2015. Larger SMEs were somewhat more likely to have made any profit (87%) and to have made a larger profit (around £300k for those with 50-249 employees compared to around £6k for profitable SMEs with 0 employees). 35% of all SMEs said that improving their profit margins was a key priority and this proportion has increased over time (30% in 2018 to 36% H1 2019).

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4 in 10 saw political uncertainty, the economic climate and/or legislation/red tape as a barrier

In Q2 2019, the three key barriers to running the business remained political uncertainty (25%), the current economic climate (22%) and legislation/red tape (20%). 41% of SMEs cited one or more of these as a major barrier.

All three have increased as barriers since 2016: political uncertainty from 10% in 2016 to 23% in H1 2019, the economic climate from 12% to 20% and legislation /red tape from 10% to 19%.

16% of SMEs with any employees had staff from overseas, predominantly from the EU. Amongst those with overseas staff, concern about possible future migration changes has increased from 42% in H2 2017 when the question was first asked to 54% in H1 2019.

In H1 2019, for the first time since 2014, there were more SMEs using finance than meeting the definition of a Permanent non borrower: 46% of SMEs were using external finance, up from 36% in 2018 while 41% met the definition of a PNB, down from 48% in 2018. There has not though been much change in attitudes to finance and SMEs remained risk averse, with trade credit and/or credit balances providing a third of SMEs with a means of reducing their need for finance.

More SMEs were using finance	42% of SMEs were using finance YEQ2 2019, ranging from 40% of those with 0 employees to 77% of those with 5-249 employees. After a period of stability 2015-2018, use of finance increased from 36% in 2018 to 46% in H1 2019, the highest level reported to date on the SME Finance Monitor. This was due to more of the smaller SMEs using finance and more use overall of both core (39% from 32%) and other forms of finance (16% from 12%).
The proportion of Permanent non-borrowers declined	44% of all SMEs met the definition of a Permanent non-borrower of finance (an SME that is not using finance and shows no appetite to do so). Having increased from 34% in 2012 to 47% in 2015, the proportion of PNBs then remained stable to 2018 (48%). In H1 2019 however 41% met the definition and so for the first time since 2014 there were more SMEs using finance (46%) than there were PNBs (41%). Compared to their peers, PNBs were as likely to be profitable, have a minimal/low risk rating or trade internationally and more likely to hold £10,000 or more of credit balances (27% v 19%). They were though less likely to be planning to grow (37% v 59%).
However attitudes to finance were no more favourable	Over time, the proportion of SMES that were happy to borrow to help the business grow has declined from 45% in 2015 to 29% in H1 2019 and to some extent across all size bands, sectors and amongst those using finance. The recent increase in the proportion of SMEs using finance did not result in an increase in the proportion "using finance and happy to borrow to grow" but instead in the "using finance but not happy to borrow to grow" category (20% in 2018 to 28% in H1 2019). Other attitudes to finance remained fairly consistent YEQ2 2019, with larger SMEs generally more positive and smaller SMEs somewhat more cautious: Overall, 73% would rather grow more slowly than borrow to grow more quickly, 55% were being cautious because they felt the future is uncertain and 51% never thought about using (more) finance.

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Trade credit, credit balances and personal funds continued to provide alternative forms of funding	A third of SMEs (34%) were using trade credit YEQ2 2019, increasing by size of SME to 6 in 10 of those with 10-249 employees. Over time this proportion has increased slightly (from 31% in 2012 to 36% in H1 2019). 22% of SMEs held £10,000 or more of credit balances YEQ2 2019, ranging from 15% of those with 0 employees to 93% of those with 50-249 employees. The proportion holding such sums increased from 16% in 2012 to 24% in 2015 and has remained broadly stable since (22% in H1 2019). 30% of all SMEs said that trade credit and/or £10,000+ of credit balances reduced their need for external finance, increasing by size of SME from 24% of 0 employee SMEs to 63% of those with 50-249 employees. 27% of SMEs reported an injection of personal funds YEQ2 2019, with 15% having chosen to put funds in and 12% feeling that they had no choice. This proportion has been broadly stable since 2015 and lower than previously seen, mainly due to fewer SMEs feeling that they had to inject funds.

A minority of SMEs reported a need for funding but most of those who did took some action, of which 6 in 10 made an application for finance. In H1 2019 there were fewer applications than in 2018 and an increase in the proportion self-funding (in whole or in part). Three quarters of applications (76%) resulted in a facility – success rates were highest for leasing/hp (94% successful) and lowest for bank loans (63%) and this success rate has declined slightly over time. Most applications were thought to have been handled satisfactorily, but amongst those declined (18% overall) a third have not been able to expand as they wanted and a similar proportion have found running the business more of a struggle.

Need for finance remained muted	4% of all SMEs reported having a need for funding in the year prior to interview, unchanged in H1 2019 from 2018. 49% of such SMEs said the need for funding was cash flow related and this was more likely to be mentioned by smaller SMEs and in H1 2019 (52%) than in 2018 (42%). 58% of such SMEs said the funding was for business development purposes such as UK expansion or plant and machinery. This was more likely to be mentioned by larger SMEs and saw little change over time (58% in 2018 and 60% in H1 2019).
Most took some action on the need. Over time, fewer needs for funding resulted in an application and more involved an element of self-funding	9 in 10 SMEs with a need for funding YEQ2 2019 took some action, with 4 in 10 speaking to an advisor or informally to their bank or another provider. Of those taking any action, 68% considered making an application for finance, while 28% considered funding all or some of the need themselves. In the end, 61% of those taking any action made an application for finance, with half of them (33% of those taking action) applying to their main bank. Larger SMEs with a need for funding were more likely to apply and to their main bank (87% and 58% of those with 50-249 employees). 21% decided to fund the need themselves (entirely or in part), 11% decided not to take any funding and 13% were still deciding what to do. A need for funding resulted in slightly fewer applications in H1 2019 (55%) than in 2018 (63%) and the proportion applying to their main bank was also lower (26% from 40%). There was however an increase in the proportion self-funding (all or in part) from 13% to 33%.

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	4% of all SMEs made any application for new or renewed finance in the 12 months prior to interview. Of all applications made Q317 to Q219 and reported Q118 to Q219: • 62% were made to the main bank and 63% were for either a bank loan or bank overdraft. • 49% of applications were the first time the SME had applied for that product. • 76% were successful – 69% were offered what they wanted and took it, 6% took a facility after issues and 2% took a different product at the same provider. • 6% were offered a facility but turned it down while 18% were declined for the facility they applied for, typically due to their current trading performance or credit issues. 1 in 10 of those declined recalled being offered a referral while 1 in 4 recalled being told about the appeals process. • Success rates increased by size of applicant from 74% of those with 0 employees to 91% of those with 50-249 employees and by product from 94% for leasing/hp to 63% for bank loans, where applicants were most likely to have been declined (27%). • Overall success rates have been broadly stable over the three time periods for which (partial) data is available across Q1 2017 to Q2 2019 (78% / 77% / 76%). This is also the case for bank overdrafts (77% / 79% / 78%) albeit these success rate were somewhat lower than the 85% success rate reported for the 18 months to Q4 2017 using the previous questionnaire. Loan success rates were slightly lower (65% / 63% / 62%) and also somewhat lower than previously seen (67% for the 18 months to Q4 2017 using the previous questionnaire).
76% of all applications resulted in a facility. Leasing/hp applications were the most likely to be successful, bank loans the least likely	
Two thirds were very satisfied with the outcome of the application or said there had been no adverse effects	8 in 10 were satisfied with the way their application had been handled, with little variation by size of applicant, but key differences by application outcome (94% if offered what they wanted compared to 39% if declined). 57% were very satisfied with the outcome of the application and a further 12% said that there had been no adverse effects on the business. This was much more likely to be the case where the applicant had been offered what they wanted (78%) compared to where the application had been declined (39%). Amongst this latter group, 37% had not expanded as they would have wanted and 3 in 10 mentioned running the business being more of a struggle, having to make spending cuts and/or not improving the business as they wanted to.

Most SMEs had been, and expected to be, Happy non-seekers of finance. Half of those that had been Would-be seekers were put off by the process of borrowing while, looking forward, the current economic climate remained the main barrier to Future would-be seekers. 13% of SMEs expected to apply for finance in the coming months but slightly more, 16%, expected to reduce the amount of finance they were using.

Most SMEs had been Happy non-seekers of finance in the past 12 months	YEQ2 2019, 14% of SMEs reported any borrowing event in the previous 12 months, including the 4% who applied for new or renewed finance reported above and 10% who had an overdraft automatically renewed. 2% of SMEs had been Would-be seekers of finance who had wanted to apply but something had stopped them and this proportion has changed little over recent years. The key barrier to application was the process of borrowing (time, hassle etc) cited by 47% of WBS in H1 2019, with more mentions of the principle of borrowing (37%) now ahead of discouragement (29% and almost all of it indirect). That leaves the largest group, as before, as the Happy non-seekers (84% of all SMEs YEQ2 2019). This proportion has been stable since 2016 having previously increased from 68% in 2012. HNS can, and do, make use of external finance, they have just not applied for any (more) in the previous 12 months. Typically around a quarter of HNS also used finance but in H1 2019 (with more SMEs using finance) this proportion was somewhat higher at 38%.
And most SMEs expected to be Happy non-seekers in the future	In Q2 2019, 13% of SMEs expected to be applying for finance in the coming months, increasing by size of SME from 12% of those with 0 employees to 19% of those with 50-249 employees. Amongst those planning to apply for bank products, 45% were confident of success, with larger SMEs more confident than smaller ones (70% of those with 10-249 employees compared to 43% of those with 0-9 employees). Over time, application confidence increased from 42% in 2012 to 55% in 2016 but has been somewhat variable since (50% in H1 2019). Whilst 13% expected to apply, slightly more SMEs, 16%, expected to reduce the amount of finance they were using and this has increased over recent quarters, from 7% in Q2 2017. 11% of SMEs in Q2 2019 expected to be a Future would-be seeker of finance, little changed over recent periods. Two thirds said they were put off by the current economic climate, which continued to be mentioned more as a barrier to future applications than as a reason for not having applied in the past (where the process of borrowing remained more of a factor). FWBS were the least confident that if they were to apply for finance they would be successful (34%). The largest group of SMEs remained the Future happy non-seekers with no plans to apply despite higher levels of confidence that they would be successful if they were to do so (63%). The proportion of FHNS increased from 63% in 2012 to 78% in 2017 and has been broadly stable since (77% in H1 2019).