

THE FUTURE OF SME LENDING & BUILDING A MORE SUSTAINABLE MODEL FOR COMMERCIAL LENDING

A small and medium sized enterprise (SME) is any business with fewer than 250 employees. There were 5.9 million SMEs in the UK in 2019, which was over 99% of all businesses nationwide, according to UK governmental data. Out of these, 5.6 million were 'microbusinesses', with 0-9 employees, accounting for 96% of all UK businesses.

As such, SMEs comprise not only most of the businesses in the UK, but also make up a large segment of the overall UK business employment, turnover and therefore, GDP.

Simply, many consider SMEs in the UK to be fundamental to the overall economy. However, during the COVID-19 pandemic, many SMEs struggled

financially. With this high level of exposure, the UK government provided financial support to SMEs, in addition to the role Funding Xchange played in facilitating access to loans.

In a recent Fintech Club webinar, hosted by London and Partners, Alla Gancz (Capco – UK Head of Digital) and Katrin Herrling (Funding Xchange – Co-founder & CEO) explored the SME segment in the UK and how the government provided support, as well as Funding Xchange's role.

There is a focus on the state of collaboration with incumbents, progressing forward out of the pandemic, in addition to harnessing digital technology and data.

	Businesses 1000s	Employment 1000s	Turnover £billions	Businesses %	Employment %	Turnover %
No employees	4458	4835	305	76	18	7
SMEs (0-250 employees)	5860	16630	2168	99.9	60	52
Of which: Micro (0-9) employees	5613	9041	900	96	33	22
Small (10-49) employees	211	4117	629	4	15	15
Medium (50-249) employees	36	3473	639	1	13	15
Large Micro (250+) employees	8	10868	1982	0	40	48
Total all businesses	5868	27498	4150	100	100	100

The table shows businesses in the UK by size (in terms of employees and turnover)

Source: BEIS, Business Population Estimates, 2019

UNPRECEDENTED GOVERNMENTAL SUPPORT

Most of the governmental financial support came in the form of the Bounce Back Loan Scheme (BBLs) and Coronavirus Business Interruption Loan Scheme (CBILs).

- **Bounce Back Loan Scheme (BBLs)** – BBLs provides financial support to businesses across the UK that are losing revenue, and seeing their cashflow disrupted, as a result of the COVID-19 outbreak and that can benefit from £50,000 or less in finance. In total, **£43.54 billion has been paid** (at the time of writing) with close to 1.5 million businesses supported.
- **Coronavirus Business Interruption Loan Scheme (CBILs)** – Borrow £50,001 to £500,000 to manage the financial impact of COVID-19 and have nothing to pay for 12 months. In total, **£19.64 billion has been paid** with this scheme.

These schemes, alongside other financial schemes such as the convertible loan Future Fund, were introduced at a critical juncture: research from MarketFinance found that most small business owners believed they would not survive into 2021, with only a quarter believing they would make it. The factors underpinning this pessimism included depleted revenues, late payments, low levels of savings, and poor cash flow.

The British Business Bank, which is responsible for organising the CBILs, BBLs and other government emergency funding schemes, noted in their 2020 annual report: “While diverse types of finance and finance providers, including fintechs, have been an important part of delivering emergency schemes during the crisis, they will be even more important in the recovery, when the UK’s smaller businesses will still need to be served by a healthy, competitive and diverse finance market.”

However, this short-term funding, as discussed by Katrin Herrling in her conversation with Alla Gancz, explains that CBILs and BBLs may well have diminished all the good work that has been done in building the value of the fintechs as part of the SME lending ecosystem.

Katrin Herrling notes: “CBILs and BBLs have slowed down the growth of the fintech sector significantly, the digital processes that existed before the crisis that were working well have been entirely disrupted – they’ve been unplugged. There’s no doubt that the government needed to step in, but the way it’s been executed has fundamentally impacted the increased competition that fintechs had introduced, together with the options for finance available to SMEs.”

Essentially, the large banks were accredited to provide the government loan schemes – but if businesses banked with a smaller bank or digital challenger, the SMEs largely did not have access.

Herrling highlights that on the Funding Xchange platform, they have witnessed an “increase in customers coming from challenger banks looking for a loan: “Before the crisis, it was about **15 percent of customers and now it’s upwards of 40 percent.**”

The execution of the first wave of CBILs was criticised for alienating the digital fintech banking sector, such as Monzo and Revolut. Herrling adds: “Many of the fintechs, particularly the challenger banks, have been side-lined by the entire process. If you weren’t accredited and were therefore unable to provide funding, then your customers were unable to access the intervention funding.”

Overall, Funding Xchange found that **250,000 businesses were locked out of the Bounce Back Loan** Scheme because they banked with non-bank lenders and the banks that were eligible to provide funds were closed to new business customers.

THE NEXT PHASE

The exclusion of the fintechs and the non-bank sector could prove problematic going forward, especially when the governmental funding schemes are dismantled. It will then be the responsibility of the private sector and a market-based lending ecosystem to lead the transition and help rally the UK's finances.

This current phase, where the end of the pandemic seems almost in sight, and governmental financing is set to fade, the requirement now is the careful management of this transition. The government financing was vital to avoid the chaotic dismay of the UK economy, especially with the exposure of the SMEs; but this short-term remedy needs to give way to a more sustainable market-based lending approach.

Herrling highlights that the challenge here lies within the **unintended consequences of the government intervention**, as well as managing the still very-much volatile market landscape. Those challenges include the resetting of SMEs expectations – for example, the cost of lending (currently 2.5% APR), extended term lengths, automatic capital repayment holidays; the ‘unplugging’ of digital solutions in 2020 (as CBILS and BBLs solutions were not using existing infrastructure); and the ability of lenders to access wholesale funders – are key risks to address.

TECHNOLOGY

The pandemic has led to a **major acceleration of digital technology adoption** among large incumbents in the financial sector, with increased utilisation of digital technology and data – a ‘tech-celeration’ across all major incumbents. While it is no secret that technology will fuel the recovery of the economy through increased adoption, however, over half of the UK SMEs surveyed in [Asto's 2020 SME Cashflow Revolution Report](#) say that they find the information shared by banks and fintechs confusing. **Less than two in five said they felt confident about where to find or how to choose the right fintech tools for their business**, with 62 percent unsure of where even to start their search.

This is a challenge for the fintech sector to overcome if it is to promote increased adoption of technology and revitalise the recovery for the UK economy. Katrin Herrling concurs: “The pandemic has driven the need for a cooperative approach across the whole financial services sector, and high on the agenda now is the need to ensure that SMEs have an easily accessible, transparent way of reviewing all their options at the very start of their funding journey.”

CONCLUSION

We believe 2021 will be a year of reinvention, renewal and economic recovery, as many firms reassess their business models and reconfigure their digital capabilities, including the increased adoption of data and emergent technologies. The events of 2020 have accelerated the pace of digital transformation, and if innovative digital capabilities were previously a valuable differentiator, then they are now a core business imperative and vital to success.

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To find out more about the SME Lending environment and the FXE Lending Monitor, please visit:

<https://info.fundingxchange.co.uk/lending-monitor-q4-2020/>

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