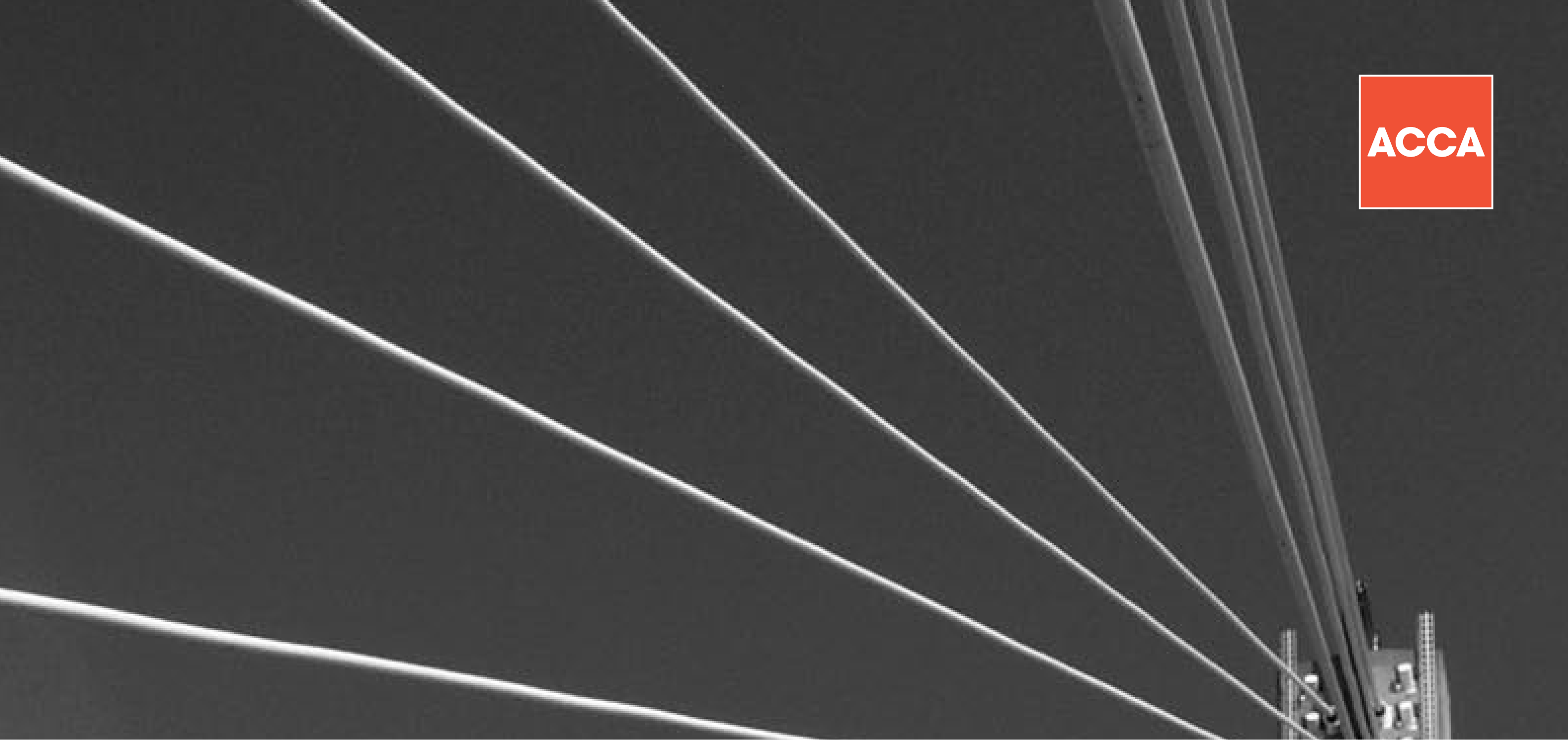

ACCOUNTANCY FUTURES

Quarterly SME credit update: Q1, 2010

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ABOUT THE QUARTERLY SME CREDIT UPDATE

The Quarterly SME Credit Update is a digest of information on SMEs' access to finance. Regular sources of information include:

- The BBA monthly statistics on support to small businesses
- The ACCA Global Economic Conditions Survey
- The ABI trade credit quarterly claims statistics
- The ABFA quarterly statistics on asset based finance
- The BoE quarterly credit conditions survey
- The BoE monthly agents reports
- The BoE quarterly inflation report
- The BCC quarterly economic survey.

The full series of *UK SME Credit Updates* is available at **http://www.accaglobal.com/af**

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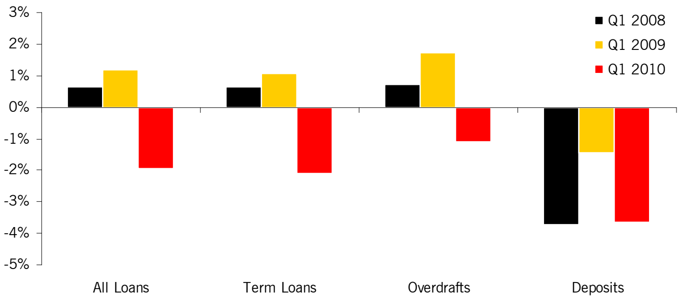
Quarterly SME credit update:
Q1, 2010

Lending and deposits down as small business recovery falters

After a sharp but partly seasonal fall at the end of 2009, outstanding loans to small businesses fell further in the first quarter of 2010. In real average terms, the stock of lending fell by 1.9% and is now back at pre-crisis levels. This fall was made up of a 1.1% reduction in outstanding overdrafts and a 2.1% fall in outstanding term loans.[1] These trends diverge substantially from what was observed in previous years and provide further evidence of small businesses deleveraging. Moreover, there is reason to believe that small business finances have deteriorated somewhat, with deposits falling by 3.6% against a rise of 1.6% in the last quarter of 2009.

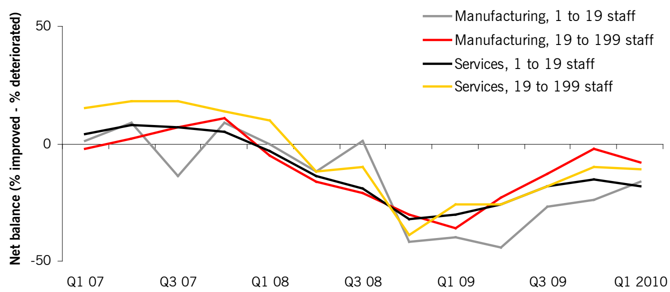
Once these trends are put into the appropriate context (see below), it is clear that the refinancing cycle is becoming amplified and deposits are falling short. Both facts suggest increasing liquidity risks for small businesses, even against the 2008/9 benchmark. The BCC data confirm that the recovery in cashflow conditions has hit a snag – at least for now.[2]

Change in the stock of small business loans and deposits



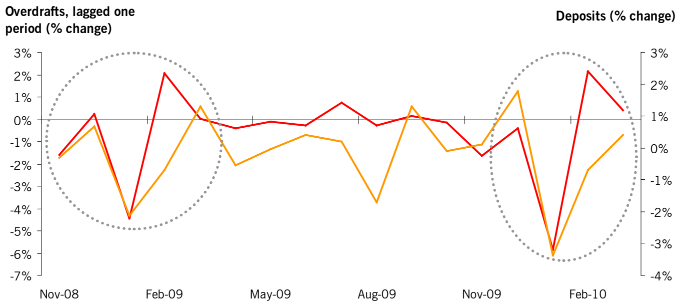
Note: All figures are adjusted for changes in the stock of businesses and CPI

Cashflow conditions for SMEs, 2007 to date



Source: BCC Quarterly Economic Survey

Financing working capital from deposits



All figures are monthly, adjusted for inflation and changes to the stock of businesses.
Sources: British Bankers Association, UK Insolvency Service and ONS

1. BBA, Bank of England, UK Insolvency Service and ONS. All figures have been adjusted for inflation (CPI) and changes to the stock of businesses with a banking relationship, but are not seasonally adjusted. For the purposes of BBA and BoE statistics, "Small Businesses" are banking clients with account turnover of £1m or less. This is not equivalent to the UK government's definition of "small business" and represents only a subset of the SME sector. Please note that all loan indices have been rebased to better reflect the influence of inflation, and hence figures cited in previous releases will not correspond to those cited here.

2. BCC Quarterly Economic Survey, April 2010

Credit demand up, lenders spooked by double-dip fears

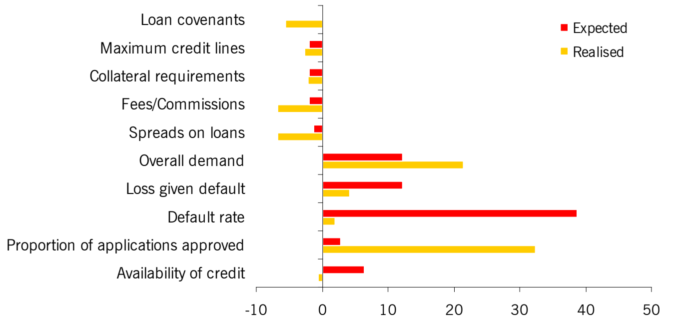
Demand for debt from small businesses is still growing, although it is now more heavily weighted towards secured lending as asset prices continue to rebound but uncertainty refuses to recede. According to the Bank of England, demand for non-card unsecured lending also recovered in the last quarter, and is now back in line with lenders' expectations. Given that the amount of term and overdraft lending fell regardless, it would appear that banks themselves reined in most types of lending in early 2010. Demand for credit card debt continued to rise – as it has done since the summer of 2008.

Using a new set of questions introduced to the Credit Conditions Survey, the BoE has reported that lenders were surprised by low small business default rates and strong demand for credit, both of which they expect will rise in 2010. In response, they appear to have increased approval rates far beyond what they had expected, but tightened supply in terms of spreads, fees, collateral, maximum credit lines and covenants by more than they had expected.[3] It is hard to account for this behaviour, unless lenders are concerned that the recovery is more fragile now than in past quarters and are eager to build up their balance sheets.

On the demand side, there is evidence of increasing resilience which may explain SMEs' continued appetite for debt:

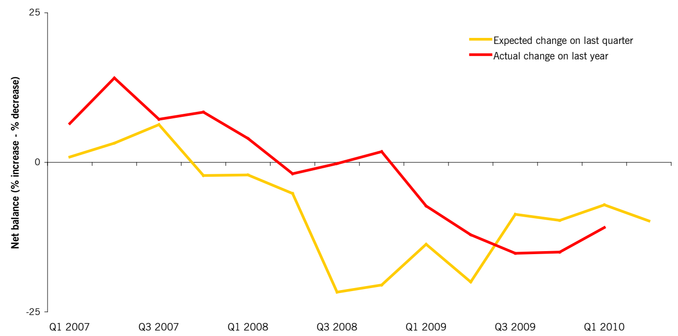
- Although pressures on cashflow did not ease further in the first quarter of 2010,[4] business insolvencies fell for a third consecutive quarter, reaching almost pre-crisis levels.[5]
- Business start-ups are holding up better than expected and the stock of businesses is still increasing.[6]
- Business investment appears to have bottomed out in the third quarter of 2009 and is now on the rise on a year-on-year basis.

Credit supply conditions, Q2, 2010



Source: Bank of England Credit Conditions Survey. Positive figures suggest increased supply/demand, lower default rates, lower spreads and fees, looser collateral requirements and covenants and higher maximum credit lines.

Investment trends, forward- and backward-looking



Source: Open University Quarterly Survey of Small Business in Britain

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3. Bank of England, *Credit Conditions Survey Q1 2010*, April 2009.

4. BCC, op. cit.

5. UK Insolvency Service, 'Statistics Release: Insolvencies in the first quarter 2010', May 2010.

6. OU Business School, *Quarterly Survey of Small Business in Britain Q1 2010*, April 2010.

Government support schemes: the state of play

Figures released by the UK Government suggest that some £1.47bn of credit is being either granted to SMEs or enabled by state guarantees on a quarterly basis.

1. Business Payment Support Service (BPSS). According to HMRC, the BPSS had extended £5.12bn of credit in ca. 292,000 arrangements with more than 160,000 businesses by March 2010.7 HMRC claims that the recovery rate on this debt 'has consistently been between 90% and 94%'.[8] Additional data suggest that the average successful VAT deferral application stands at just under £19,000, while the average rejected application stands at just over £117,000.[9]

2. Enterprise Finance Guarantee (EFG). The EFG had supported £862 of lending to 8,500 SMEs by March, against a projected total of £1.3bn.[10] The scheme is set to run until March 2011, and has been expanded to include a number of previously restricted types of finance and sectors.[11]

3. Working Capital Guarantee (WCG). This is a wholesale scheme whereby the Government offers banks a guarantee on portfolios of 'medium-risk' SME loans in exchange for commitments of increased SME lending. Two lenders, in whom the government has capital stakes, have sought guarantees for £2bn of SME loans, against a potential £20bn allocation.

4. Credit Insurance Top-Up Scheme (discontinued). The £5bn programme, which offered additional cover to businesses that had had their counterparty cover reduced but not removed, has now been discontinued. Only 78 suppliers had signed up to the scheme, obtaining £18m worth of cover as of 20 November.[12]

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7. S. Timms MP, written answer to Brian Binley MP, HC Deb, 1 March 2010, c915W.

8. D. Jetuah, 'Bookbinder folds as HMRC rejects time-to-pay plea', *Accountancy Age*, 29 October 2009. Also S. Timms, op. cit.

9. 'Time to pay' may be scrapped in budget', *AccountingWeb,* 18 June 2010.

10. 'Time to pay scheme keeps 160,000 businesses afloat', *Financial Times*, 5 March 2010.

11. For details, see 'Enterprise Finance Guarantee – Sectoral Restrictions Review', BIS, http://www.berr.gov.uk/whatwedo/enterprise/finance/efg/page50309.html and 'Pre-Budget Report Announcement 9 December 2009', http://www.berr.gov.uk/whatwedo/enterprise/finance/efg/page37607.html

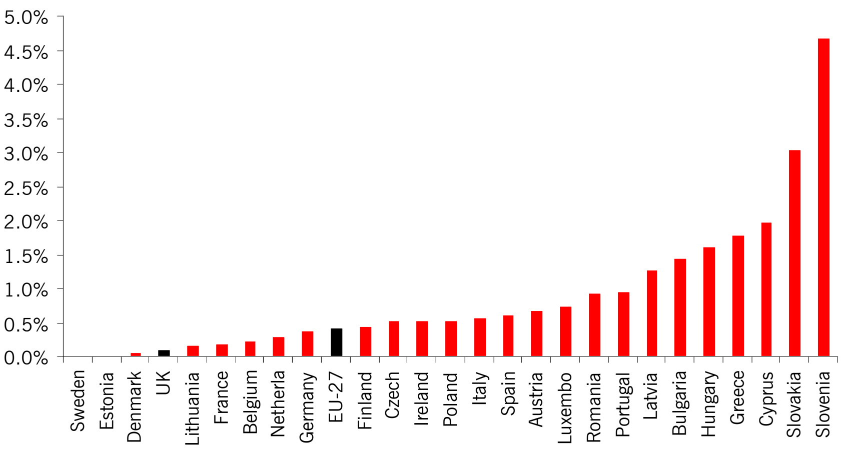
12. J. Pickard, op. cit.

A note on European funding for SMEs

According to its annual review, the European Investment Bank (EIB) released £597m of credit to SMEs in the UK through guarantees in 2009.[13] One quarter (25%) of this funding was directed to venture capital and loan funds to finance SMEs in Wales and the North East of England and was never made available to the rest of the UK, while the rest of the funds were delivered by just three institutions. Lloyds' TSB dominated the non-regional funds, with 65% of the total, while the state-backed banks (Lloyds TSB and RBS via Ulster Bank) accounted for just under a quarter (74%). The remaining funds were delivered by Abbey National, now part of Santander.

Further analysis suggests that UK SMEs are increasingly under-represented in the total volume of EIB-backed finance. UK SMEs secured 3.9% of the EIB's total credit lines to European SMEs, down from an average of 4.2% between 2005–8, and the total value of EIB support was equal to 0.1% of value-added in the UK SME sector. This is less than a quarter of the EU-wide ratio and lower than the ratio for France, Germany or any other large EU country (see below).

EIB credit to SMEs as % of SME value added



Source: EIB Annual Review 2009 and EIM Business and Policy Research estimates (2008) for the European Commission's annual SME Performance Review

13. 'Volume III – Statistical Report', in *EIB Annual Report 2009*, EIB, June 2010.

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