

A black and white photograph of a cable-stayed bridge, showing multiple white cables fanning out from a central point on the right towards the left. The background is a clear sky.

ACCOUNTANCY FUTURES

# Quarterly SME credit update, Q4, 2009



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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 on the ACCA accountancy futures:

<http://www.accaglobal.com/af/>

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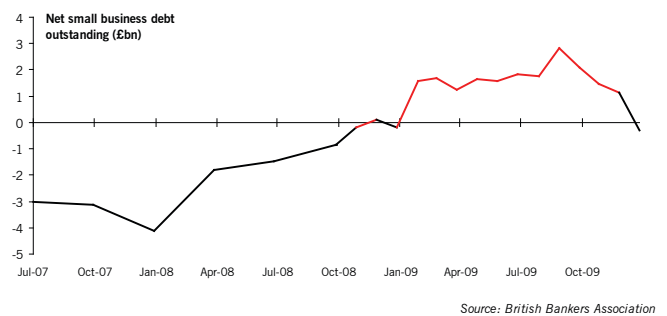
# Quarterly SME credit update, Q4, 2009

## Small businesses net creditors once again as deposits rise and stock of lending plummets

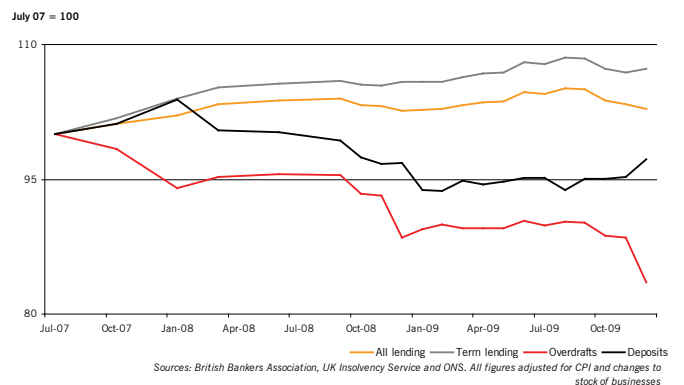
After months of stagnation since the April 2009 trough, **small business lending fell substantially** in the final quarter of 2009. Overall, the stock of lending fell by 2.1%, comprising a 7.3% fall in overdrafts and a 1% fall in term lending.<sup>1</sup> Although these figures are highly seasonal and should be read with caution, they suggest that **small businesses are still delivering**, albeit not over a cycle short enough to excite policymakers or the media. However, there is reason to believe that **small business finances have recovered somewhat**, with deposits rising by 2.3% against a fall of 2.6% in the last quarter of 2009.

This change, continuing for the fourth consecutive month, means that small businesses are once again –briefly– net creditors to the UK’s banks, to the tune of ca. £300m.

### Small business racing back to black



### Key UK small business lending figures, July 2007 to December 2009



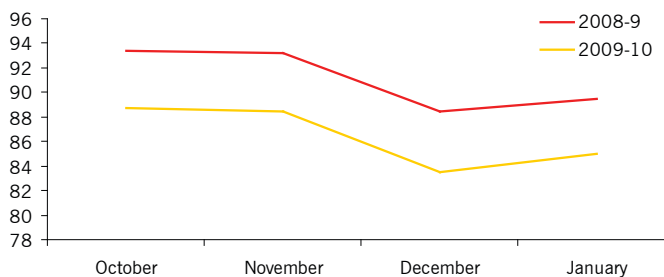
1. BBA, Bank of England, UK Insolvency Service and ONS. All figures have been adjusted for inflation (CPI) and changes to the stock of businesses with a banking relationship, but are not seasonally adjusted. For the purposes of BBA statistics, ‘Small Businesses’ are banking clients with account turnover 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.

## Refinancing away from debt is New Year's resolution once again

Fourth-quarter data on small business lending can be easily misrepresented as they typically show a sharp decrease in loans and a strong rise in deposits. This is a seasonal effect, brought about by small businesses seeking to refinance their working capital.

When the year-end trends in overdraft lending for the last two years are juxtaposed, the patterns are remarkably similar (see below). In both cases, the November-December drop has more or less defined the average level of lending for the rest of the year. If this relationship holds, then the stock of overdraft lending in 2010 should remain around 5% lower in real absolute terms than it was throughout 2009 and around 15% lower than peak levels. Nor is this effect due to our routine adjustments for inflation and changes to the stock of businesses. The nominal stock of overdraft lending has itself fallen by ca. 3% in the past year and by 5% from peak levels. Tellingly, overdrafts now only comprise 15% of small business loans, down from 19% in mid-2007.

Year-end trends in stock of overdraft lending, 2008/9 and 2009/10 (Q2 2007=100)



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

## Improving fundamentals increase demand for secured loans only – while lenders tighten supply and brace for losses.

**Demand for debt from small businesses is still growing**, although it is now 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 fell in the last quarter, confounding lenders' expectations. Overall unsecured lending rose only marginally. Given that the amount of term lending fell regardless, it would appear that **banks themselves have reined in some types of term lending** in the last quarter of 2009, while the fall in overdraft lending is for the most part due to lower demand.

Using a new set of questions introduced to the Credit Conditions Survey, the BoE has reported that lenders saw default rates in small business debt rise and expect this trend to continue into 2010. In response, they appear to have reduced approval rates and tightened their terms of lending in terms of spreads, fees collateral, maximum credit lines and covenants.<sup>2</sup>

A number of factors may have contributed to the slight tightening in supply during the final quarter of 2009. Sales in the SME sector were still falling in the final quarter of 2009, if slightly more slowly, and the outlook for employment deteriorated significantly.<sup>3</sup> Despite these risks, however, there is evidence of increasing resilience which may explain SMEs' continued appetite for debt.

- Pressures on cashflow eased further in the final quarter of 2009, and appear to be on course for a full recovery within the next three six months.<sup>4</sup>
- Business insolvencies continued to fall for a second quarter in Q4 2009.<sup>5</sup> With fewer businesses anticipating supplier or customer insolvency, trade credit conditions have naturally improved.
- Business start-ups are holding up better than expected and the stock of businesses is still increasing.<sup>6</sup>
- 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.

2. Bank of England, *Credit Conditions Survey Q4 2009*, December 2009.

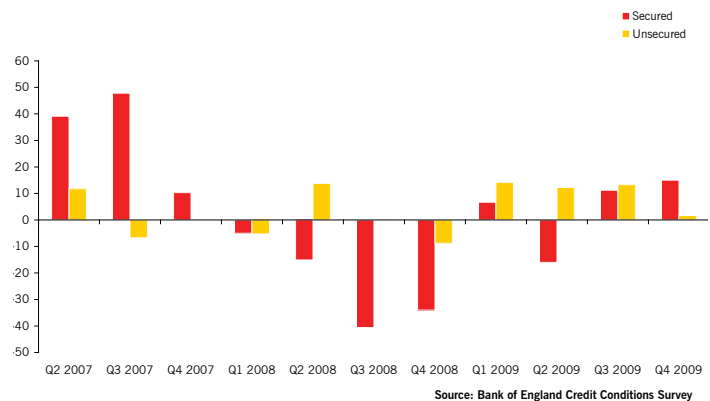
3. OU Business School, *Quarterly Survey of Small Business in Britain*, March 2010, and BCC *Quarterly Economic Survey, Q4 2009*.

4. BCC, op. cit.

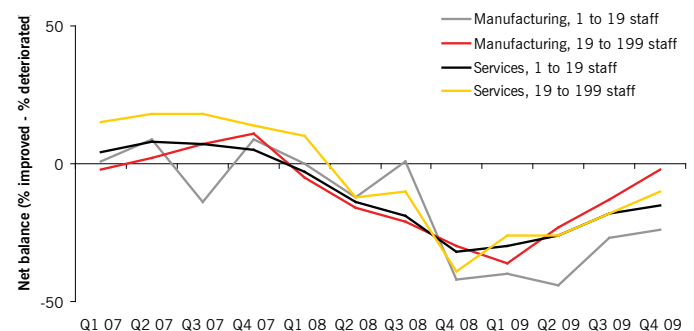
5. UK Insolvency Service, *Statistics Release: Insolvencies in the fourth quarter 2009*, February 2010.

6. OU Business School, op. cit.

### Demand for lending by small businesses



### Cashflow conditions for SMEs, 2007 to date



### Investment trends, forward and backward looking



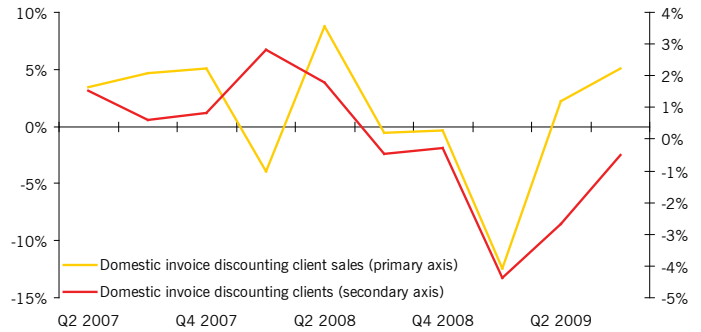
## Some notes on invoice finance

There has been some speculation that small businesses may have been substituting bank overdrafts for other types of credit faced with perceptions of a tightening in supply. Much attention has been focused, in particular, on invoice discounting.

Figures from the Asset Based Finance Association (ABFA) suggest that volumes of invoice financing peaked at the end of 2008. Then, following a very sharp (but partly seasonal) fall in early 2009, total advances started to stabilise, driven mostly by larger clients, and were virtually flat by last September. Throughout this time, the average maturity of the invoices involved has remained more or less constant at around 60 days.<sup>7</sup>

It is clear, then, that the demand for, and supply of, invoice financing did not surge in response to the contraction in bank lending, as some may have hoped for. While bank lending became more expensive during the recession, invoice finance itself had always been relatively dear. Because the cost of invoice discounting is shaped by both the risk and the likely timing of customer debts, it is always a problem for smaller firms and has become especially steep during a recession.

Domestic invoice discounting, clients and sales (% change)



Source: Asset Based Finance Association

7. Source: ABFA Quarterly Statistics on Asset Based Finance Time Series.

## Government support schemes: the state of play

Figures released by 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.<sup>8</sup> As of June 2009, a substantial share (42%) of all tax deferred was VAT – equal to 1.5% of the Government’s total predicted income from VAT.<sup>9</sup> HMRC claims that the recovery rate on this debt “has consistently been between 90% and 94%”.<sup>10</sup>
- 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.<sup>11</sup> The scheme will now be allowed to run until March 2011, following the PBR announcements, and has been expanded to include a number of previously restricted types of finance and sectors.<sup>12</sup> As of June, about 40% of all EFG loans had been issued by a single major bank in which the government does not have any capital stake.<sup>13</sup>
- 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.<sup>14</sup>

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

9. ‘Half of all deferred business taxes are VAT’, *Accountancy Age*, 16 June 2009.

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

11. ‘Time to pay scheme keeps 160,000 businesses afloat’, *Financial Times*, 5 March 2010.

12. 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>>.

13. G. Howes, ‘Barclays: EFG loan king’, *SMEWeb*, 16 June 2009.

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14. J. Pickard, op. cit.

**TECH-TP-SCU06**