SME Confidence Tracker

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Foreword

SMEs: Not banking on finance

As we enter the final months of the year, it's even clearer that 2023 has been another turbulent period for the UK economy. Stubborn inflation - driven in part by energy bills - together with the highest interest rates in 15 years, have created a harsh environment for even the most resolute of businesses.

Challenges have been relentless and have fallen even heavier on SMEs, many of whom have had to battle with tighter margins, uneven cashflow and supply chain disruption. Notwithstanding the encouraging dip in inflation and stabilisation of interest rates, there's a real risk of an upsurge in insolvencies over the months ahead, and into 2024.

Adding to their trials, SMEs report increased difficulties accessing external finance, further limiting their growth ambitions. In particular, more than two-thirds (67%) of SME owners and decision makers believe banks are less prepared to lend to them today. Further still, of those using external finance sources, 42 percent say their bank or financier has reduced their credit availability in the past six months. These are worrying stats and reflect the reappraising of credit appetites among traditional lending sources.

The reality, however, is that there is an abundance of financing options available if SMEs are open to looking beyond bank-loans and overdrafts. Gone are the days when high street lenders need to be the first and only port of call.

The political landscape has a key part to play in the fortunes of SMEs. This is soon to feature prominently as UK politics shapes up for an election in 2024. Whatever the outcome, one thing is certain - SMEs are looking for more support from the Government than they feel they currently receive. Indeed, our data highlights the most pressing issues for SMEs when the election gets underway; economic growth and job creation, tax policies and incentives, and access to affordable finance.

Findings, however, demonstrate low confidence of business owners in the ability of any UK political party to deliver the changes they seek to provide growth opportunities, with more than a fifth (22%) unable to identify a political party of choice. For those that have a preference, there is a clear leaning to the left. A third (33%) of SMEs now believe that the Labour Party would best serve their needs, compared to one in four (26%) for the Conservative Party.

More than ever, UK SMEs are feeling the strains of uncertainty. Nonetheless, they continue to demonstrate their resilience and determination. This too is borne out in our latest SME Confidence Tracker, with 62 percent expecting sales to grow over the next six months.

As we look ahead to the election, it is evident that the party able to clearly convey a focus on policy and practical initiatives that improve economic stability will get the business vote.

Derek Ryan
UK Managing Director
Bibby Financial Services

Derek Ryan

Taking stock

Inflation remains the most pressing issue for UK SMEs, with 59 percent citing this as a key business challenge, marginally lower than the 61 percent who highlighted the same issue in the Spring. Half (50%) cited energy bills as a key concern. A further 34 percent flagged supply chain disruption, customers taking longer to pay (30%), and the ongoing challenges posed by Brexit (25%).

Key business challenges

59% Inflation / rising costs	**50%** Energy costs	**34%** Supply chain disruption
30% Customers taking longer to pay	**29%** Interest rates	**25%** Ongoing impact of Brexit

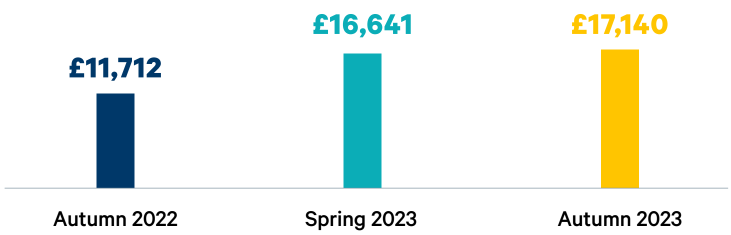
However, overall, optimism remains a key theme, with nearly two thirds (62%) of business owners expecting sales to increase in the next six months - a positive 15 percent uplift from the 54 percent reported six months ago.

Given the plethora of obstacles stacked against SMEs, it's laudable and encouraging that so many still seem to be expecting strong results. Fifty eight percent report that they are currently profitable - a slight reduction on the 59 percent of six months ago. Others have clearly found the environment more difficult to navigate, with 35 percent reporting that they are just about breaking even.

There's a mixed picture in terms of the perennial problem of cashflow management. Just under two thirds (61%) of businesses report that their cashflow is stable and meets their needs, while almost a third (32%) say that they don't have the cashflow needed to grow.

Supply chain pressure on the rise

Average bad debt SMEs have experienced in the last 12 months

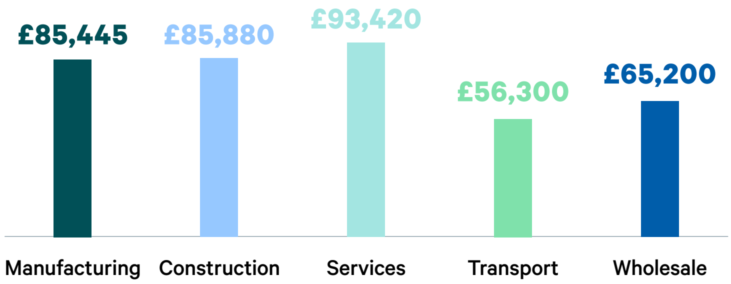


More problematic perhaps is the worsening challenge SMEs face from poor payment practices. Thirty percent report that they have suffered a bad debt in the last six months, up from 27 percent in the Spring. Not only has the scale of bad debt increased, but the average debt write-off is continuing to rise at a worrying rate. UK SMEs report having written off an average of £17,140 - up from £16,641 in the spring, and significantly higher than the £11,712 recorded in autumn 2022. This equates to a staggering 49 percent increase in the space of twelve months.

As the tally of corporate insolvencies continues to mount - the most recent figures from the Government's Insolvency Service published in August attest to a 19 percent rise in company failures compared with a year ago - SMEs are facing a significant ripple effect throughout supply chains, which is driving the uplift in bad debt. In fact, the Bank of England recently published a letter to lenders warning them not to underestimate the scale of losses they could suffer from defaults on bad loans.[1]

Over the last six months, 48 percent of SMEs say at least one of their suppliers has become insolvent, and 42 percent say the same is true for at least one of their customers. Undoubtedly, both government and economic analysts expect the situation to worsen over the coming months.

Average amount of unpaid invoices by sector



Many are also having to contend with slower payments. A concerning 68 percent say it's taking customers longer to pay invoices in full compared to a year ago - up from the 60 percent who reported this six months ago. Now, the average amount of unpaid invoices is £77,130, 13 percent higher than the £68,410 cited in the spring. This situation is most acute for businesses operating in sectors, such as manufacturing (£85,440), construction (£85,880) and services (£93,420).

With poor payment practices significantly impacting SMEs, evidently trading conditions have some way to go before many will be able to capitalise on their growth ambitions.

[1] Bank of England, Letter from Victoria Saporta 'Thematic feedback from the 2022/2023 round of written auditor reporting'

Finding the means

In the context of the current economic landscape, it is unsurprising that UK businesses are requiring more financial support in order to continue operating - in fact, almost half (43%) of SMEs report that their need for external finance has increased compared to six months ago. Nearly a third (30%) currently use external funding, and a further 22 percent plan to do so in the next six months.

The most common reason businesses use external finance is to fund expansion (49%). However, a significant proportion (38%) need the funding simply to ensure they can keep their businesses operating smoothly day-to-day, emphasising the tough trading conditions many are having to manage. A further 14 percent of SMEs require third-party finance to help them pay off debt.

But while demand for funding seems to be on the rise, access is proving tricky. Overall, more than half (54%) of SMEs believe that it is more difficult to access external finance now than it was six months ago. Depending on the sectors in which they operate, this perspective becomes more pronounced. Sixty one percent of small wholesale businesses say that accessing capital is a struggle, as do 57 percent of both construction and manufacturing businesses.

Similarly, there is an apparent imbalance based on geography. In London, 70 percent of SMEs report finding it hard to unlock funding sources. Though slightly less acute for businesses in the North East (63%), North West (58%) and the West Midlands (58%), the issue is clearly causing problems for a significant proportion of SMEs up and down the country.

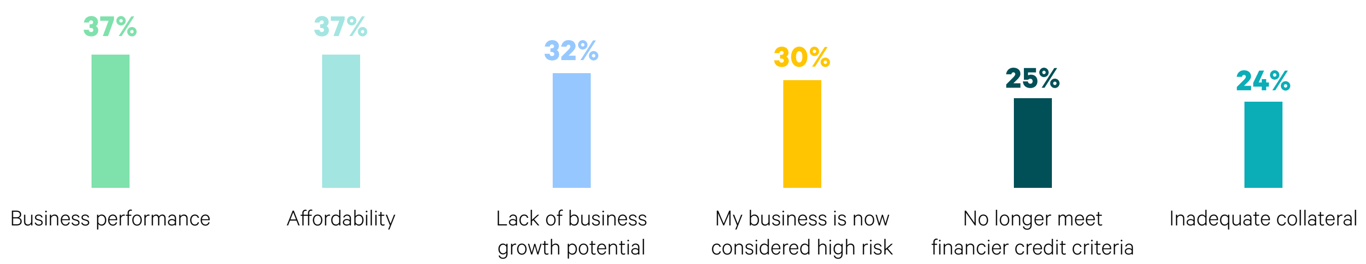
The data indicate that a substantial part of the problem lies in the fact that traditional banks seem less inclined to lend to small businesses than might once have been the case. Over two thirds (67%) of SMEs report this experience. Indeed, the Bank of England's latest Agent Summary reports that lenders are continuing to favour larger well established businesses.[2]

Again, geographic and sectoral splits suggest a potentially unlevel playing field. For example, the proportion of businesses hardest hit by the challenge of accessing bank finance is the highest in the West Midlands at 84 percent, while in the North West it is 75 percent.

This sentiment is echoed by wider sources. According to the BDRC SME Finance Monitor, more than half of funding applications are currently rejected by banks. And the BDRC SME Finance Monitor indicates that the funding success rate for SMEs has fallen to 46 percent, a significant decrease on the 74 percent seen pre-COVID.[3]

Alongside the apparent retrenchment of high street banks from the SME funding space, small businesses have experienced a reduction in the amount of funding their financiers are prepared to offer them. For those that already have external financing in place, more than four in ten (42%) say the funding levels have been reduced in the past six months. The issue is a particular challenge for nearly half (46%) of family-owned businesses, 47 percent of those in the construction sector, and more than half (55%) of businesses in the West Midlands.

Reason for reduction in credit provision



And financiers have provided several reasons for reducing their support. Chief among these are: business performance (37%), affordability (37%), and lack of business growth potential (32%). Overall, 30 percent of businesses have also been told they are now considered high risk, which rises to a third (33%) for family businesses. This is corroborated by external data, finding that banks are applying more cautious affordability tests to approving loans, and are continuing to favour larger, well-established businesses in strong financial positions.[4]

The twin impacts of fewer banks being prepared to lend, and existing financiers toughening their funding criteria, will likely feel like something of a body blow for the millions of SMEs currently operating in the UK. Given that these businesses play such a critical role in underpinning the UK economy, these findings should be cause for concern. The further erosion of access to third-party funding will do little to encourage growth.

> "We're a proud family run UK haulage business that has been operating for over 50 years. In that time, we've grown our fleet from one lorry to over 100 vehicles, and service a roster of major player clients across sectors.
>
> "However, running a business is most definitely not plain sailing. We've experienced many difficult patches since we started trading in 1969, and the business environment of the last few years is up there with the toughest. The support of external funding is crucial to our business, and without it we wouldn't have achieved the success we have to date."
>
> **Patricia Dole**
> Director, MJD Group

[2] Bank of England Agents' summary of business conditions, 2023 Q3
[3] BDRC SME Finance Monitor, Q2 2023
[4] Agents Summary of Business Conditions, Q3 2023

Crossing borders

Trading overseas is a key revenue stream for many UK SMEs. According to the data from this survey, over half (53%) of small businesses import and/or export. However, the international trading environment has undeniably become more complex in recent years. Brexit and, no doubt, the conflict in Ukraine, have added significantly to the administrative and logistical burdens of doing business overseas - not to mention increased cost.

Greatest challenges for those trading internationally

58% Tariffs, customs and trade barriers

49% Cost of doing business overseas

41% Currency fluctuations

23% Language barriers

21% Managing international money transfers

15% Political instability in target markets

11% Payment delays

Specifically, SMEs' top concerns in relation to their international trading activities are tariffs, customs and trade barriers (58%), the cost of doing business (49%), and currency fluctuations (41%).

The latter challenge seems to be delivering the greatest negative impact. Almost half (47%) of SMEs report that their business has lost out financially due to currency fluctuations over the past year, highlighting the impact of currency volatility on the bottom line of many UK businesses.

Nevertheless, SMEs adopt a typically resilient approach to managing this issue. The vast majority (89%) of small businesses trading overseas feel confident in their ability to manage their own foreign exchange requirements, and over a third (34%) say they feel very confident doing so.

When it comes to the task of overseas trading, UK SMEs adopt a variety of approaches. Sixty one percent favour spot prices, while 38 percent opt for forward contracts, and 17 percent use options contracts. However, given that currency prices constantly shift at a rapid rate, there is plenty of scope for all SMEs - especially those with more limited internal resources - to ensure they regularly review their foreign exchange strategies, so they can optimise their cost efficiencies and protect their margins.

Although the international trading environment is tricky currently, SMEs that buy and sell overseas retain a buoyant outlook on the future. A significant majority of both exporters (71%) and importers (68%) expect that their sales will increase over the next six months.

Given the appetite and ambition for international trade, SMEs are clearly eager for any policy initiatives from central government that could help smooth the trading environment. Indeed, 29 percent of small businesses say they would like to see the next UK government prioritise negotiating favourable trade agreements, in order to enhance international market access.

Reasonable expectations

What's crystal clear from the latest SME Confidence Tracker is that the UK SME community remains firmly focused on surviving and thriving, despite the challenges they are currently facing.

Evidently, the policies implemented by the next government will have a significant impact on whether this ambition can translate into business success. SMEs have no shortage of suggestions for how the Government could improve the business environment, with priorities including tax incentives (65%), access to low interest grants and loans to fund expansion and jobs (57%) and simplified regulatory processes (42%). Crucially, a third of SMEs are also keen to see new policies that foster innovation.

However, the UK's 5.6 million SMEs should certainly not simply sit and wait for policies from the next government to be announced. Instead, they can continue to show their resolve and take pragmatic steps to help set themselves up for success. In this context, SME leaders could do worse than take account of three practical considerations.

1. **Start conversations with financiers:**

   Traditional banks aren't the only sources of finance. The pool of specialist funders is greater than might be expected, and the broker and intermediary community is a good place for SMEs seeking to connect with funders with the specialist knowledge and expertise to meet their specific needs.

2. **Stay connected to supply chains:**

   Keeping an ear to the ground on issues associated with operations in different locations, and remaining in close contact with customers and suppliers is an effective way for SMEs to spot potential payment red flags, early. This, in turn, will provide businesses with a clearer line of sight across their own supply chains and income streams to make cashflow management more precise and more effective.

3. **Prepare for currency volatility:**

   For those trading internationally, undertaking a regular review of foreign exchange strategies will go a long way to managing the continuous volatility in currency markets. Ultimately, adopting a careful, considered approach to foreign exchange will go a long way to helping SMEs protect their bottom line.

Methodology

This study is based on a poll of 500 UK SME owners and decision makers across the manufacturing, construction, wholesale, transport and services sectors.

Research was conducted by independent specialists, Critical Research. The survey was completed by respondents between 29th August and 6th September 2023.

About Bibby Financial Services

Bibby Financial Services (BFS) is a leading family-owned financial services partner to over 8,500 businesses worldwide.

We provide specialist and adaptable trade, asset and working capital finance and FX solutions helping businesses grow in domestic and international markets.

Formed in 1982, BFS is part of the Bibby Line Group (BLG), a diverse and forward-looking family business delivering personal, responsive and flexible customer solutions for over 200 years.

To find out more about Bibby Financial Services, visit:
www.bibbyfinancialservices.com

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