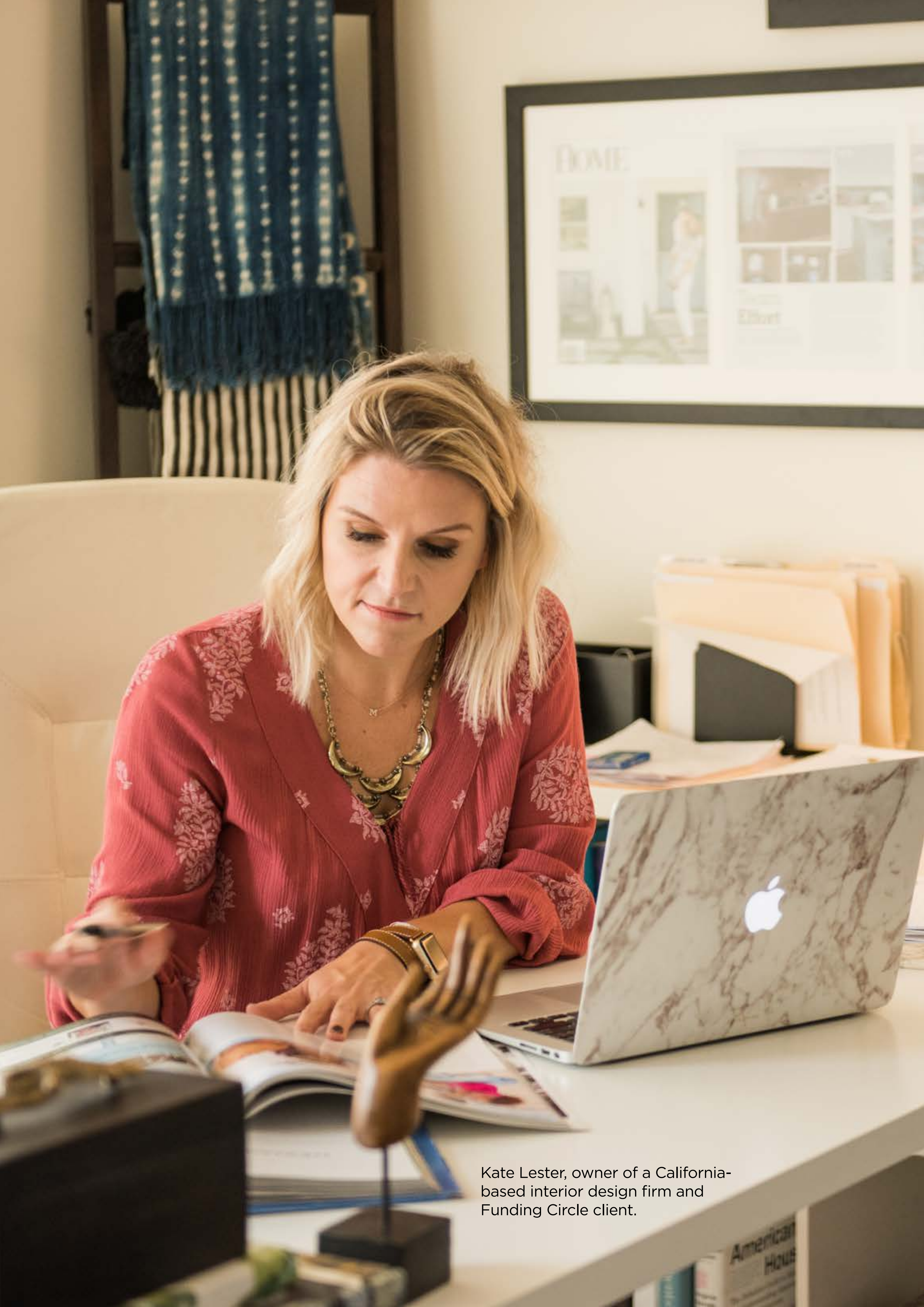
OXFORD ECONOMICS

Funding Circle

THE BIG BUSINESS OF SMALL BUSINESS

APRIL 2019



Kate Lester, owner of a California-based interior design firm and Funding Circle client.

FOREWORD

Small businesses mean big business. They keep our high streets bustling, connect us with our local communities, and power the economy on an incredible scale. Our business was founded to give them a better deal, and they remain at the heart of what we do every day.

An astonishing 99 percent of all firms are small businesses,[1] and they play a vital role in society by driving economic growth, employment and innovation. Despite this, they are often overlooked and underserved, with around 53 percent saying it's difficult to access finance for growth.[2] A factor at play here is the lingering effect of the financial crisis some 10 years ago, and the impact it has had on the small business lending market.

This report reveals that very little has changed since then. While the number of small businesses has grown steadily since 2008, they continue to represent a tiny proportion of banks' overall balance sheets. What this research also points to is a pattern of small firms being at a disadvantage in terms of the support they receive from the banks, compared to larger businesses across our markets. As a result, a growing number are moving away from thinking "bank first".

Part of the story here is the pace at which technology is transforming and evolving the financial landscape. This is particularly noticeable for consumers, with a third now using some form of FinTech. Small businesses are beginning to reap the rewards of this digital shift as well, with tech firms such as Square and Shopify now offering dedicated services to meet their needs. When it comes to accessing finance, online lending platforms offer the 21st-century approach: a simple online application powered by innovative technology and advanced data analytics, accessible no matter where a business is based.

When we give small businesses the power to go further, the economic output is enormous. Within this report, it's incredibly humbling to see the significant contribution that small businesses have on the global economy as a result of accessing finance through our platform. In 2018 alone, these businesses unlocked 115,000 jobs and contributed £6.5 billion to GDP across our four markets, with the benefits reaching all corners of each country.

From local cafes and quirky gift shops to trusted autobody shops and friendly accountants, small businesses keep our world running. That's why we've put their needs at the forefront of our mission. We're in the big business of small business.

Samir Desai
CEO and co-founder of Funding Circle

[1] Source: OECD, 'SMEs and Entrepreneurship' (http://www.oecd.org/cfe/smes/).
[2] Oxford Economics (2017), 'SME Strategies for Success': a global study for American Express.

EXECUTIVE SUMMARY

ACROSS THE WORLD, THE FINANCIAL LANDSCAPE IS CHANGING FAST

Technology is transforming the way consumers access their money and choose financial products. It is estimated that a third of all digital consumers around the world now use some form of financial technology ("FinTech")—from online banking to apps that allow you to take a loan, roll up savings each week, or invest in stocks and shares.[1]

Small businesses—poorly served by traditional banks for decades—are also catching up in their use of FinTech. The financial services landscape for these firms has changed drastically in the last 10 years, following innovations such as the introduction of payment apps for small retailers, and the emergence of online lending platforms.

Such developments are crucial to global economic prospects, given that small businesses comprise 99 percent of firms and account for more than half of all employment in industrialised countries.

"When changes in UK bank overdrafts are taken into account, net lending to SMEs was negative in 2018—meaning UK banks collected more in repayments than they gave out in new loans and overdrafts."

YET TRADITIONAL BANKS CONTINUE TO HOLD SMALLER FIRMS BACK

Small businesses continue to be relatively unimportant to banks. Lending to these customers makes up a very small proportion of banks' overall balance sheets, and this segment of the market is generally observed to be the most poorly served. **In all four countries studied for this report, we see a pattern of small firms receiving harsher terms on loans that are granted, relative to their larger peers.**

In the UK, the flow of net bank lending to small and medium-sized enterprises (SMEs) totalled just £518 million in 2018, compared with an annual average of £2 billion over the previous three years. When changes in bank overdrafts are taken into account, net lending to SMEs was actually negative in 2018— meaning the UK banks collected more in repayments than they gave out in new loans and overdrafts to SMEs.

[1] E&Y, (2017), 'E&Y Fintech Adoption Index 2017; The rapid emergence of FinTech'.

In the US, while bank lending to commercial and industrial customers is increasing, small businesses are again being left out. Banks relaxed their approval standards for loans to large and middle-market firms much more than to small firms in 2018, and further disadvantaged SMEs in how they changed the terms and conditions on these loans.

In the Netherlands, Dutch banks have yet to reverse the deterioration in terms offered to SMEs, relative to larger firms, that became evident nearly 10 years ago. Moreover, bank lending to non-financial businesses continued to fall in 2018—greatly affecting firms applying for smaller loans.

In Germany, the smallest firms face stringent terms and conditions and high administrative costs imposed by banks. While small and medium-sized firms have reported an easing of interest rates over recent years, charges for micro-businesses (firms with between one and nine employees) remain comparatively elevated across all types of funding.

SMALL FIRMS' DEMAND FOR FINANCE IS GROWING FAST—AND THEY ARE TURNING TO FINTECH

The stagnation in bank lending to SMEs is in stark contrast to the continued rapid expansion in SME activity across the four countries featured. The overwhelming majority of firms in industrialised countries are SMEs—and their numbers are growing all the time. In 2018, for example, the total number of UK-based SMEs was five percent higher than in 2015.

> **"The stagnation in bank lending is in stark contrast to the rapid expansion in SME activity. They are responsible for 60 percent of all jobs in industrialised economies, and almost the same proportion of GDP."**

Together, SMEs are responsible for 60 percent of all jobs in industrialised economies, and almost the same proportion of the billions in GDP that these countries generate. An increase in available finance will therefore have a major impact on all four economies in this study, helping to fund further job creation, boosting economic output, and raising significant extra tax revenues.

Against the backdrop of falling bank lending and a growing feeling that bank loans are not relevant to them, many SMEs are showing increased demand for other forms of external finance. The rapid expansion of online lending platforms is part of this trend, offering small firms greater choice and flexibility. Across the four countries, we see that SMEs are increasingly applying for, and gaining, loans through online platforms, as they move away from thinking "bank first".

FUNDING CIRCLE IS FAST BECOMING THE FIRST CHOICE FOR SMALL BUSINESSES IN ALL OF ITS MARKETS

Lending through Funding Circle has grown rapidly in 2018. Across its four markets—the UK, US, Germany and the Netherlands—the online lending platform enabled £2.3 billion in new loans to SMEs last year. The total value of loans under Funding Circle's management also grew markedly, reaching £3.1 billion at the end of 2018—some 55 percent higher than the previous year. This growth continues to reflect two key advantages, according to our surveys of Funding Circle clients in all four countries: both the speed and simplicity of its application and approval process.

Some 73 percent of customers approached Funding Circle first for their new loan in 2018, without having previously applied for a bank loan. In the UK, 84 percent of the surveyed customers said Funding Circle was their first port-of-call for a loan, while in Germany the figure was 75 percent. Furthermore, 82 percent of customers surveyed reported that they would approach Funding Circle first for finance in the future, rather than a bank.

THE ECONOMIC IMPACT OF LENDING THROUGH FUNDING CIRCLE

In total, Funding Circle's loans under management at the end of 2018 supported a £6.5 billion contribution to Gross Domestic Product (GDP) across its four markets. This is a year-on-year increase of 56 percent in real terms, and means that in 2018, every £1 lent through Funding Circle enabled small businesses to contribute more than £2 to the economies they operate in, in terms of additional GDP.

Loans taken through Funding Circle enabled 115,000 jobs in these four countries—54 percent higher than its loans were estimated to have supported at the end of 2017.

The activity and employment supported by these loans also raises significant tax revenues for local and central governments. **The total loans under management at December 2018 are estimated to have generated £2 billion in annual tax receipts in Funding Circle's markets**, up 39 percent in real terms on the amount raised in 2017.

£6.5 bn

Annual contribution to GDP supported by loans through Funding Circle across its four markets in 2018.

This is a year-on-year increase of 56 percent, in real terms.

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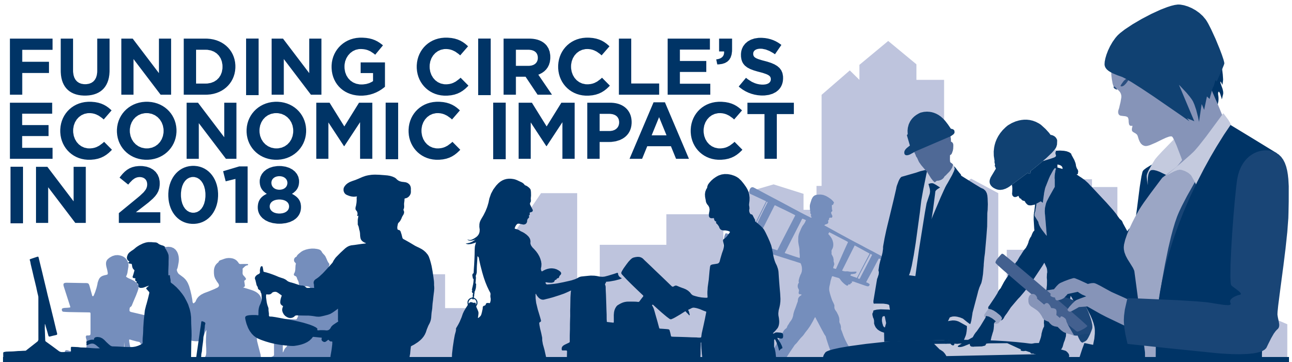
FUNDING CIRCLE'S ECONOMIC IMPACT IN 2018



TOTAL IMPACT

Direct · Indirect · Induced

GDP CONTRIBUTION

£6.5 billion

up 56% from 2017*

£3.2 bn · £1.1 bn · £2.2 bn

EMPLOYMENT

115,000 jobs

up 54% from 2017

62,800 · 18,700 · 33,400

TAX REVENUES

£2.0 billion

up 39% from 2017*

£1.0 bn · £0.3 bn · £0.7 bn

	GDP contribution	Employment	Tax revenues
	£4.1 billion	72,000 jobs	£1.0 billion
	$2.8 billion	38,000 jobs	$1.1 billion
	€216 million	3,200 jobs	€70 million
	€140 million	1,900 jobs	€47 million

55% growth in value of loans since 2017**

£3.1 billion Loans under management at end of 2018

Every £1 million lent through Funding Circle

... contributes **£2 million** to GDP

... supports **37 jobs**

... and generates **£635,000** in taxes.

* Increase in real terms; totals may not sum due to rounding

** Value of all loans under Funding Circle management, end 2018 vs end 2017

ECONOMIC IMPACT IN THE UNITED KINGDOM

Despite uncertainty as a result of the UK leaving the EU and fragile economic growth, SME demand for finance has remained strong. With net lending by banks falling so that the value of outstanding bank loans held by SMEs was 16 percent lower than in 2011, Funding Circle has more than doubled net lending to SMEs from £345 million in 2016 to £723 million in 2018, when the platform's net lending was some £200 million more than the entire UK banking system.

The value of loans under Funding Circle management in the UK has also grown strongly, reaching £2.2 billion at the end of 2018—up from £1.6 billion a year earlier—and supporting an annual contribution to UK GDP of £4.1 billion.

This is estimated to have sustained 71,900 jobs and generated some £1 billion in business and labour taxes in 2018.

115,000

Total number of jobs supported by lending through Funding Circle in 2018.

This is a 54 percent increase on the previous year.

ECONOMIC IMPACT IN THE UNITED STATES

With the US economy growing robustly in 2018, small and medium-sized firms have had a strong appetite for external finance. On average across the year, 60 percent of small firms had undertaken capital expenditure within the prior six months. New lending through Funding Circle has expanded to meet this demand, standing 54 percent higher than its level at the end of 2017.

Small US businesses continue to report difficulty in accessing credit, with the smallest firms facing the most severe difficulties. According to the Federal Reserve's Small Business Credit Survey, 32 percent of firms with between one and nine employees reported experiencing challenges obtaining credit over the previous year. This figure drops to 18 percent for firms with between 50 and 499 employees.

Lending through Funding Circle had a sizeable impact in the US economy in 2018. We estimate that it supported a $2.8 billion annual contribution to US GDP, some 38,000 jobs, and $1.1 billion in tax receipts.

ECONOMIC IMPACT IN GERMANY

The ECB's SAFE survey suggests that German micro-businesses (the "S" in SMEs) feel the onerous application procedures and substantial collateral requirements that banks and other lenders require limit their access to external finance.

In contrast, Funding Circle's operations in Germany continue to grow rapidly—responding to the needs of micro-businesses and other firms seeking loans of between €5,000 and €250,000. In all, 1,285 new loans were issued through the platform in 2018, over 85 percent more than the previous year. The total value of these new loans rose even faster, by 92 percent.

Based on the value of loans under its management at the end of 2018, Funding Circle is estimated to have sustained a €216 million annual contribution to German GDP, some 3,200 jobs, and €70 million of tax receipts to pay for vital public services.

ECONOMIC IMPACT IN THE NETHERLANDS

Against a backdrop of persistent decline in bank lending to Dutch SMEs, and banks' continued extension of inferior terms and conditions to SMEs relative to larger companies, some 83 percent of Dutch small firms regarded bank loans as irrelevant in the ECB's 2018 H1 survey on enterprises' access to finance. This was higher than the EU-wide average of 76 percent.

Small businesses are taking advantage of the greater choice of lenders, increasingly applying for credit at non-bank sources of finance. In the same survey, 19 percent of Dutch SMEs reported an increased demand for online and other types of non-bank lending over the previous six months.

Funding Circle is an increasingly important source of finance for these small businesses. We calculate that loans under its management at the end of 2018 supported a total contribution to the Netherlands' GDP of €139 million, enabled 1,900 jobs, and generated €47 million in tax receipts.

£2.0 bn

Annual tax receipts enabled by loans through Funding Circle across its four markets in 2018.

This is a year-on-year increase of 39 percent, in real terms.

CASE STUDY: BOBBIN BICYCLES

Sian Emmison is the co-founder, with her husband Tom, of the Bobbin bicycle company—established almost a decade ago because “we wanted to spread the joy of cycling to people who love life but aren’t bike nerds”. In other words, people just like them.

“From the start,” Sian explains, “we were trying to put the idea in people’s heads that cycling was a really good way to get around—particularly for women. Eighty percent of our customers are female, which is very unusual in the bike trade.”

These brightly coloured bikes gained an immediate following. Based in East London, their cottage business grew steadily through a UK distributor, who imported the finished bikes from Asia. Everything appeared to be going swimmingly—yet Sian and Tom knew a dramatic shakeup was needed if the company was to realise its full potential.

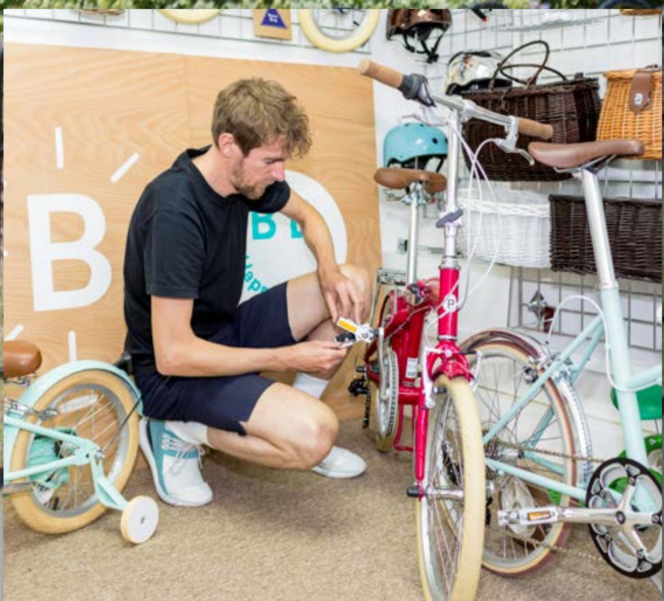
Sian describes the 2016 Brexit referendum as their snapping point. “We said, ‘We’ve got to start selling our bikes online, direct to the consumer. We’ve got to bring all of that business in-house.’”

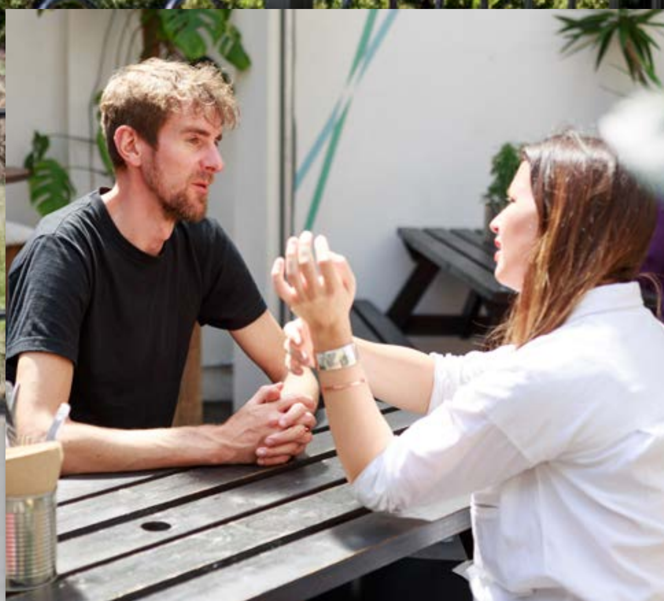
Transforming themselves into an online company that deals directly with individual customers was a huge challenge—and one that required significant upfront funding. “The bank we’d been with for years had been incredibly unhelpful—they just weren’t interested at all, which really surprised me. To them, we probably looked too small.”

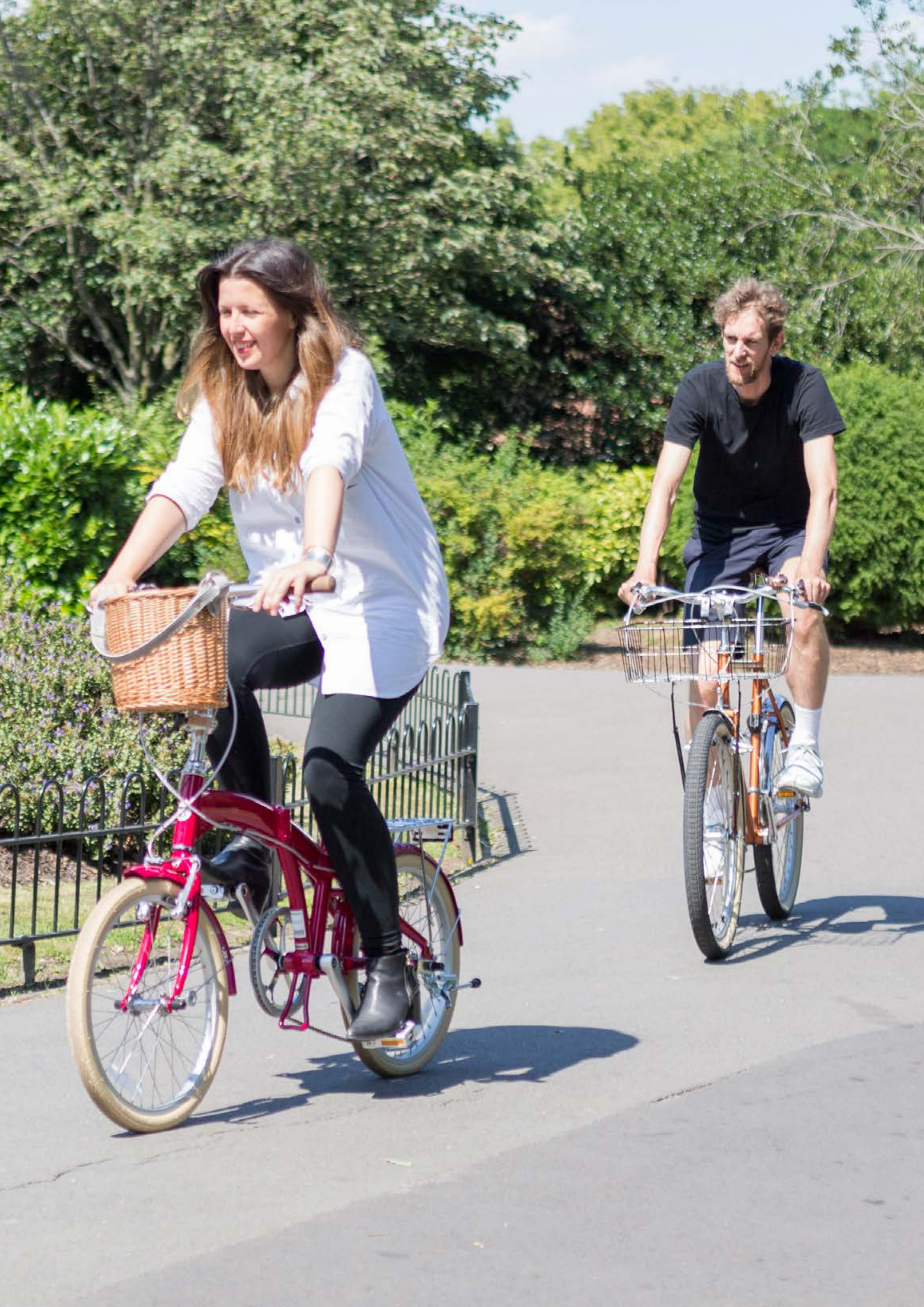
In contrast, Sian says, Funding Circle was much more open to their plans. The first loan was secured in December 2016, “in only a couple of weeks”—and the bright new Bobbin website launched the following June. “Since then our business has really taken off. The growth has been really steep.”

In the first year, however, they still had some very large trade commitments. To achieve the “full pivot” demanded a further loan, and the couple had no qualms about going back to Funding Circle in early 2018.

“We wanted to move as much business to direct-to-consumer as we could,” Sian explains. “We thought it was a no-brainer at the time, but we’ve actually gone way past our goal. We’d hoped to turn over about the same amount but make more profit. In fact, we’ve turned over a lot more, so things are looking very rosy.”







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