



OXFORD  
ECONOMICS



# THE BIG BUSINESS OF SMALL BUSINESS

APRIL 2019







Tom Morris, co-founder of the Bobbin bicycle company.



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Kate Lester, owner of a California-based luxury interior design firm.

# 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,<sup>1</sup> 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.<sup>2</sup> 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.

A stylized, handwritten signature in black ink.

**Samir Desai**  
CEO and co-founder of Funding Circle

<sup>1</sup>Source: OECD, 'SMEs and Entrepreneurship' (<http://www.oecd.org/cfe/smes/>).

<sup>2</sup>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.<sup>1</sup>

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.



**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.

**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”.

**“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.”**

## 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.*



# FUNDING CIRCLE'S ECONOMIC IMPACT IN 2018



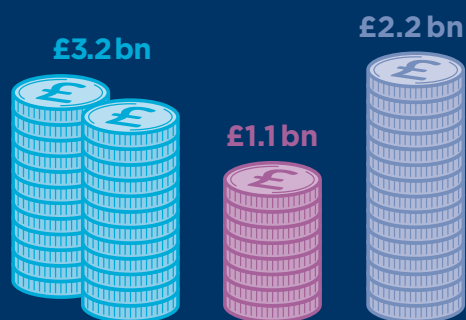
## TOTAL IMPACT

● Direct ● Indirect ● Induced

### GDP CONTRIBUTION

**£6.5 billion**

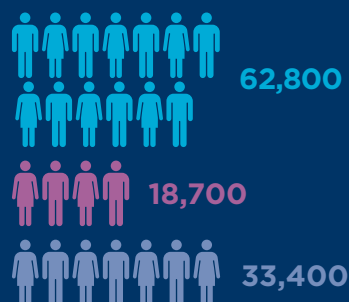
up **56%** from 2017\*



### EMPLOYMENT

**115,000 jobs**

up **54%** from 2017



### TAX REVENUES

**£2.0 billion**

up **39%** from 2017\*



**£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

# 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 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.



## 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.*



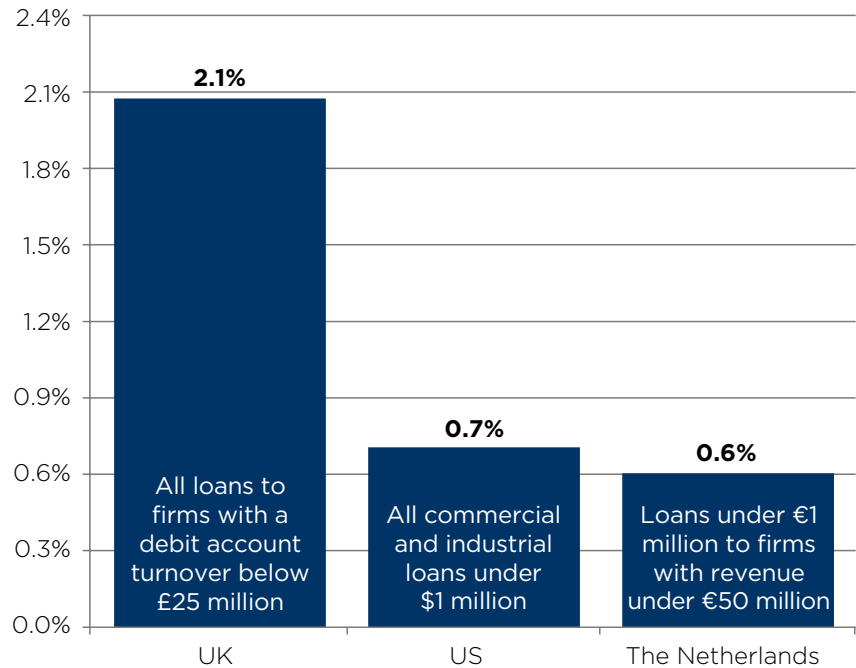
# 1. INTRODUCTION

**The overwhelming majority of firms in industrialised countries are small and medium-sized enterprises (SMEs).** Together, they are responsible for 60 percent of all jobs, and almost the same proportion of the billions in GDP that these countries generate.<sup>2</sup>

Historically, small businesses have depended on traditional banks for access to the credit they need to survive and flourish. But this has served them poorly since the financial crash. Over the past decade, banks' willingness to lend to small businesses has deteriorated markedly, with clear evidence of major disparities between their attitude to lending to larger businesses, versus what is being offered to SMEs.

**“Loans to small businesses are relatively unimportant to banks, comprising a very small proportion of their total balance sheet.”**

**Fig. 1: Loans to SMEs as a share of banks' total balance sheets, by country**



Source: Bank of England, US Federal Reserve, FDIC, ECB, De Nederlandsche Bank

For example, while the value of new bank lending to large businesses increased by 43 percent in the UK between 2015 and 2018, it *decreased* to SMEs by three percent over the same period. In part, this is because loans to small businesses are relatively unimportant to banks, comprising a very small proportion of their total balance sheet (Fig. 1).<sup>3</sup>

Across the world, today's SMEs are a crucial part of the future economic landscape, with many start-ups and small firms operating in tomorrow's growth industries. As an example, six percent of SMEs that were larger than sole traders operated in the digital sector in the UK in 2018.<sup>4,5</sup> However, because many of these firms are "asset light", they are not well catered for by traditional lending as banks typically require assets to secure finance against.

<sup>2</sup> OECD, (2017), 'Small, Medium, Strong. Trends in SME Performance and Business Conditions', 15 May.

<sup>3</sup> Data on German banks' stock of outstanding loans to SMEs was unavailable.

<sup>4</sup> ONS, (2015), 'What defines the digital sector?', 8 October.

<sup>5</sup> BEIS, (2018), 'Business Population Estimates for the UK and regions 2018', 11 October.

This is particularly significant in the digital sector, where economic output across the UK, US, Germany, and the Netherlands is forecast to grow by 43 percent over the next decade, in real terms.<sup>6</sup> This is more than twice the growth forecast for these four countries' overall GDP, which is predicted to increase by 19 percent in real terms over the same period (2018 to 2028).

The banks' adverse treatment of SMEs is clearly a concern for future prosperity, as it severely limits small businesses' pace of development. And this is an issue from the very start of the application process: the length of time taken to apply for credit and receive a decision from a bank can prove costly for SMEs, leading to foregone productivity—an issue highlighted repeatedly by small businesses around the world.

As a result, online lending has become a key source of finance for SMEs, with Funding Circle establishing itself as the leading small business loans platform in all four of its markets. The benefits of lending platforms, according to small businesses, include more focused products, faster credit decisions, improved funding chances, and the lack of collateral requirements.<sup>7</sup>

The next four chapters of this report focus, in turn, on each of Funding Circle's markets, starting with the UK. In each case, we begin by investigating the economic landscape for small businesses in terms of their access to finance, and other issues. We then present a profile of the loans extended through Funding Circle in that country, before revealing the total economic impact of the activity supported by these loans, in terms of GDP, jobs, and taxes.

Finally, we present the results of our latest surveys of small businesses that held loans under Funding Circle management at the end of 2018—both to understand what motivated them to seek finance, and to gain insight into their experiences with the lending platform.

These businesses were also surveyed with regard to their revenues, employment, procurement of goods and services, imports, and tax payments. This information, along with Funding Circle's loan book data, was used to calculate our economic impact results for each country.

**“Economic output in the digital sector is forecast to grow by 43 percent over the next decade, more than twice the growth forecast for the four countries' overall GDP.”**

<sup>6</sup> Forecasts are from Oxford Economics' Global Industry Model.

<sup>7</sup> The Federal Reserve Banks, (2018), 'Small Business Credit Survey 2017; Report on Employer Firms', 22 May.



# 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.”









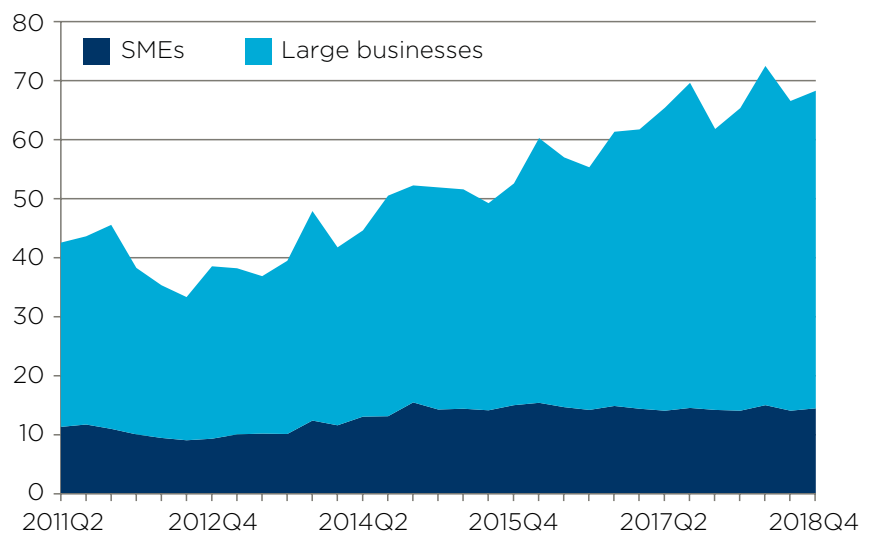
## 2. UNITED KINGDOM

### 2.1 SMALL BUSINESSES' ACCESS TO FINANCE

**Small firms have continued to miss out on the recovery in UK bank lending to businesses.** While gross lending by UK banks to the non-financial business sector has grown significantly—up 30 percent in 2018 Q4, compared to three years earlier<sup>8</sup>—these figures mask considerable disparity in the growth of new bank lending by customer size. This is evidenced by Bank of England data which shows that, while the value of new bank lending to large businesses has increased by 43 percent over this period, it has decreased to SMEs by three percent (Fig. 2).<sup>9</sup>

**Fig. 2: New UK bank lending to non-financial businesses of all sizes**

£ billion per quarter



Source: Bank of England

“While the value of new bank lending to large businesses increased by 43 percent over the past three years, the value to SMEs decreased by three percent in the same period.”

“Taking into account changes in bank overdrafts, net lending to UK SMEs was negative in 2018. Banks collected more in repayments than they gave out in new loans and overdrafts.”

Consequently, the flow of net bank lending to SMEs (i.e. new lending minus repayments) totalled just £518 million in 2018, compared with an average of £2 billion per annum over the previous three years. When changes in bank overdrafts are taken into account, net lending to SMEs was actually *negative* in 2018, at minus £95 million. Put simply, this means that the banks collected more in repayments than they gave out in new loans and overdrafts to SMEs.

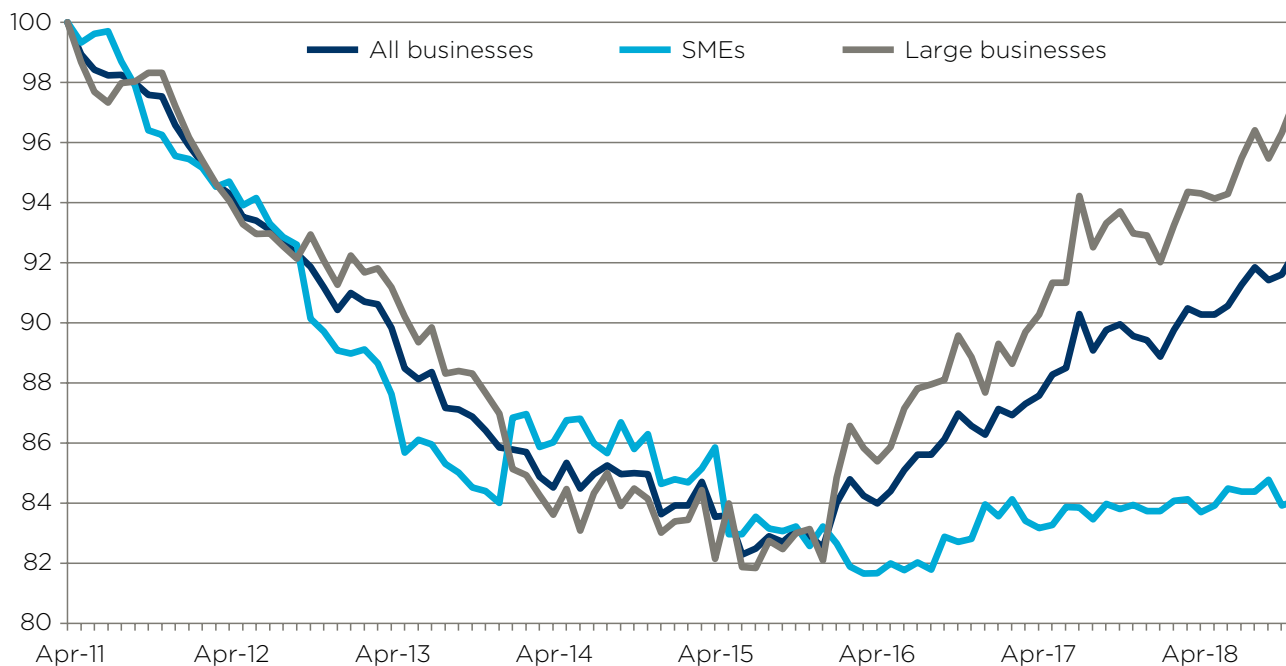
As a result, the value of outstanding bank loans held by SMEs—some £166 billion—was still 16 percent lower at the end of 2018 than in April 2011. As Fig. 3 shows, from 2011 to mid-2015, banks decreased the volume of lending to firms of all sizes. Since then, the loans they issue to large firms have recovered quite significantly, while those issued to SMEs have stagnated.

<sup>8</sup>Source: Bank of England. These figures relate to lending by all ‘monetary financial institutions’, but as the majority is accounted for by banks, we refer to ‘bank lending’ for the sake of simplicity. All lending figures are in cash terms, i.e. not adjusted for inflation. The figures for new gross lending exclude changes in overdraft levels.

<sup>9</sup>In the banking statistics published by the Bank of England, SMEs are defined as firms with an annual turnover on their main business bank account of less than £25 million.

**Fig. 3: Value of outstanding bank loans to non-financial businesses, by firm size**

Indices, April 2011=100



Source: Bank of England

**Banks also continue to treat SMEs differently from their larger counterparts in the terms and conditions they charge on loans.** The Bank of England's latest Credit Conditions Survey shows there was a significant easing in the interest rate spread that banks charged on loans to large businesses between 2013 and early 2016—but that this did not occur on loans to SMEs over the same period.

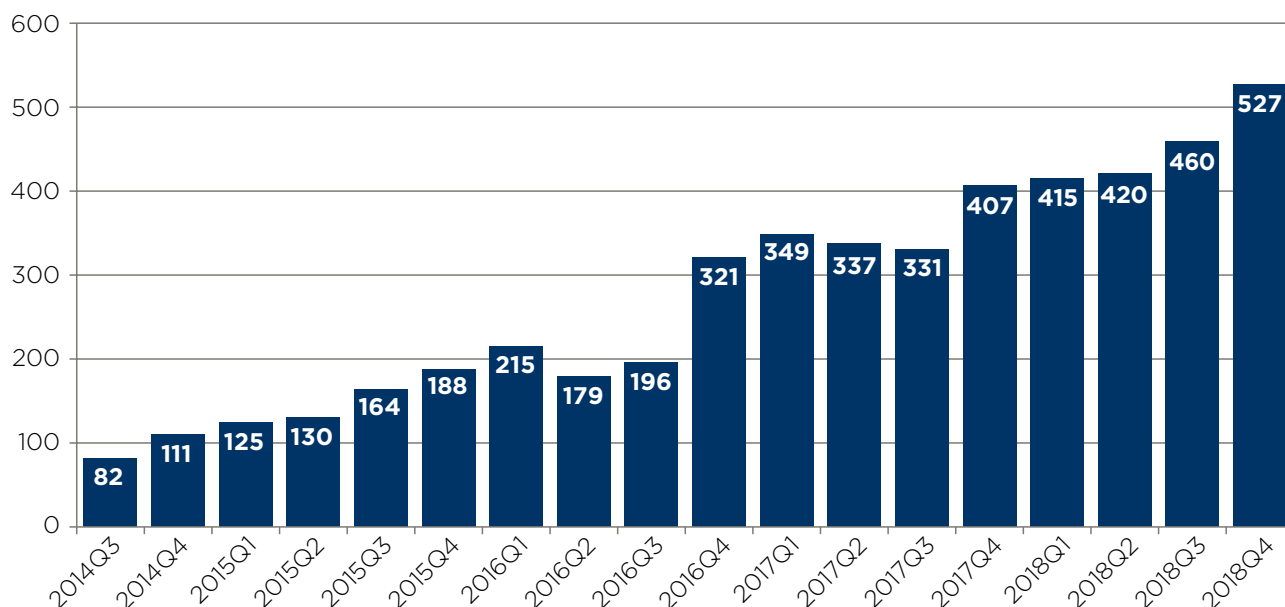
Since then, the survey suggests banks have continued to favour larger firms when changing their interest rate spreads, although to a much lesser degree—meaning that SMEs continue to pay higher interest rate spreads than their larger counterparts. The survey also points to a discriminatory policy on the fees and commissions that banks have charged on loans in recent years, again favouring large versus SME customers.

On the non-price side, the Credit Conditions Survey shows that banks have eased the covenants placed on larger borrowers to a far greater degree than on SMEs. This relates to the behavioural conditions that banks place on borrowers in order to obtain their loans.



**Fig. 4: New business lending to SMEs via the platforms of P2PFA members**

£ million per quarter



Source: P2PFA

**5%**

**Increase in total number of UK-based SMEs between 2015 and 2018.**

*The number of people employed by UK SMEs increased by four percent over the same period.*

**The stagnation in bank lending to SMEs contrasts with the ongoing expansion in SME activity.**

In 2018, the total number of UK-based SMEs (defined as firms with less than 250 employees) was five percent or 266,000 firms higher than in 2015—and there was a similar five percent rise in the subset of “small firms” (less than 50 employees).<sup>10</sup> Similarly, the number of people employed by small firms and all SMEs in 2018 were both four percent higher than in 2015. As a result, **employment across the SME sector now exceeds 16 million, accounting for 60 percent of the UK’s total private sector workforce.**

The lack of growth in bank lending to SMEs does not, therefore, reflect a lack of need for funds on their part. On the contrary, an increase in available finance would help fund the sector’s expansion and job creation.

**SMEs are increasingly applying for—and gaining—loans through online platforms, while moving away from thinking “bank first”.**

The latest available BEIS Small Business Survey, undertaken in late 2017, shows that five percent of SMEs applying for external finance over the previous 12 months had applied to a lending platform—up from one percent in 2014. The share applying for a bank loan fell from 48 to 38 percent over the same period.<sup>11</sup>

<sup>10</sup> BEIS, Business Population Estimates for the UK and regions 2018, 11 October 2018.

<sup>11</sup> BEIS, Small Business Survey 2017, May 2018. Here, SMEs are “SME employers”, with 1-249 employees.

Reflecting these trends, new lending to businesses via the member platforms of the Peer-To-Peer Finance Association (P2PFA—an industry trade body that includes Funding Circle and accounts for most of such lending) was £1.8 billion in 2018.<sup>12</sup> This was 28 percent higher than in 2017, and more than three times the value seen in 2015 (Fig. 4).

P2PFA members' flow of net lending reached £908 million in 2018—more than double the value seen two years earlier. This is in sharp contrast to net lending from the banks to small businesses, which fell by 104 percent over the same period.

**As well as offering a source of funds to expanding SMEs, lending platforms offer a potential economic lever for policymakers during times of economic uncertainty.** Amid heightened uncertainty about prospects for the UK in the face of Brexit and the decline in the growth of world trade, UK business investment in capital assets such as new buildings and machinery has declined. This has, in turn, acted as a drag on the national economy.

After adjusting for inflation, business investment was six percent lower in 2018 Q3 than in 2017 Q4. Furthermore, the January 2019 CBI Industrial Trends Survey showed more UK manufacturers expected to cut spending on buildings, plant, and machinery in the year ahead than to increase it. Some 58 percent of respondents to this survey also cited “uncertainty about demand” as a factor constraining their investment intentions.<sup>13</sup>

Given this outlook, it is reassuring that the importance of supplying funding to SMEs—and in particular, the supply of non-bank sources of finance—is recognised in the UK government-set objectives of the British Business Bank (BBB). The first two of its four prescribed goals are to “increase the supply of finance to smaller UK businesses where markets do not work well”, and to “help create a more diverse finance market for smaller businesses, with a greater choice of options”.

To help achieve these goals, in November 2018 the BBB announced a new commitment to lend up to £150 million to UK small businesses through the Funding Circle platform. This is expected to benefit some 2,000 firms, based on an average loan size of £70,000.

**However, there is arguably a case for further extending Exchequer-backed lending to SMEs via lending platforms.**

During the financial crisis of 2008-09 and its aftermath, the Asset-backed Securities Guarantee Scheme proved successful in supporting mortgage-backed lending, but had little impact on lending to small businesses. With the SME financing landscape having changed so significantly since then, lending platforms can offer a new means for the government to support small business activity, demand, and employment.

“In November 2018, the British Business Bank announced a new commitment to lend up to £150 million to UK small businesses through the Funding Circle platform.”

<sup>12</sup> This is the latest data available.

<sup>13</sup> CBI (Confederation of British Industry), Industrial Trends Survey, January 2019.

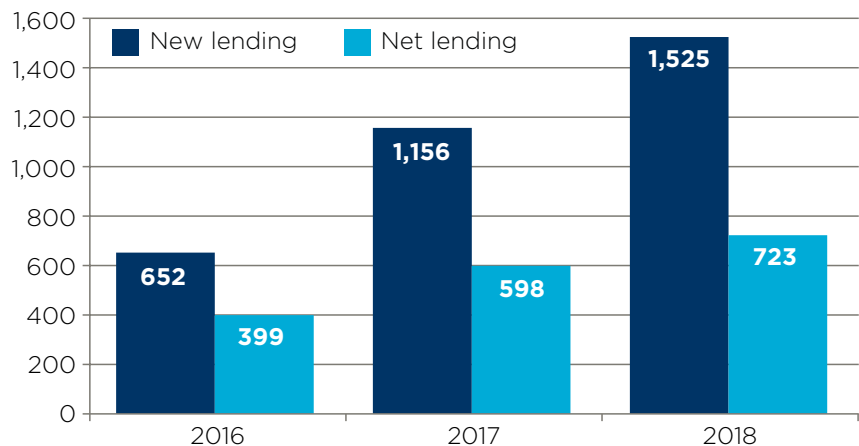
## 2.2 FUNDING CIRCLE'S UK LENDING PROFILE

**In 2018, the value of loans originated by Funding Circle to small UK businesses expanded rapidly.** Over the year, new lending by Funding Circle's investors amounted to £1.5 billion (see Fig. 5). Net lending through the platform (the difference between new lending and capital repayments) followed a similar growth trajectory, increasing from £598 million in 2017 to £723 million in 2018—a 21 percent increase, following the 50 percent gain seen a year earlier.

**In 2018, £723 million of net business lending was extended through Funding Circle—some £200 million more than the entire UK banking system** (see Fig. 6). This pattern is in complete contrast to that seen during the year to June 2016—just before the UK's referendum on EU membership—when net lending by the banks totalled £3.5 billion, compared with the £345 million lent through Funding Circle.

**Fig. 5: Flow of new and net lending to UK SMEs through Funding Circle**

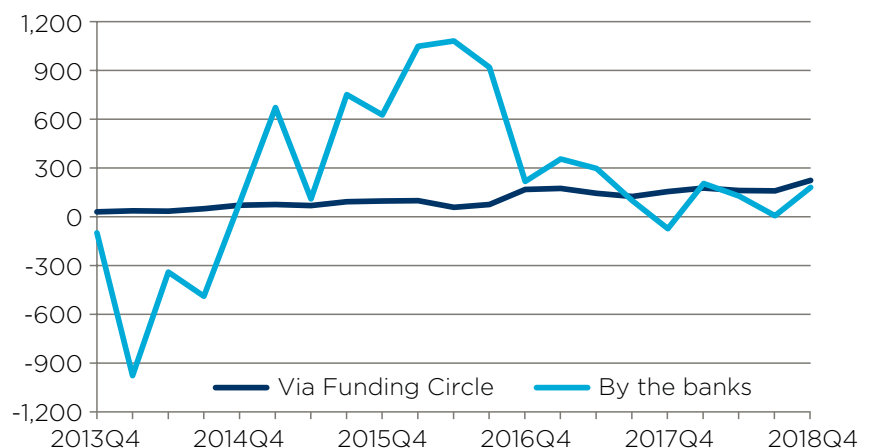
£ million per annum



Source: Funding Circle

**Fig. 6: Net lending to SMEs through Funding Circle, and by UK banks**

£ million per quarter



Source: Funding Circle, Bank of England

**£723 million**

**Total net business lending extended through Funding Circle in 2018.**

***This is some £200 million more than was extended through the entire UK banking system that year.***



**The total value of loans under Funding Circle's management has also increased, reaching £2.2 billion at the end of 2018.**

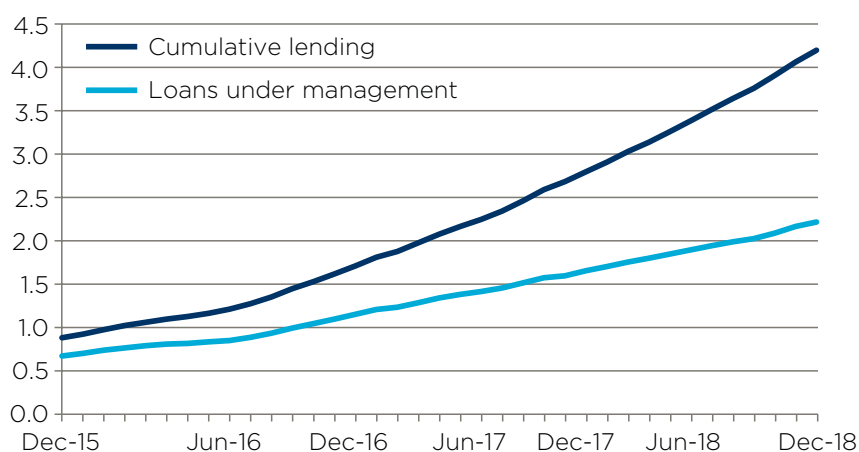
This represents a 175 percent rise since June 2016 (see Fig. 7). Cumulative business lending since the platform launched in August 2010 had reached £4.2 billion by December 2018, compared with £1.1 billion in June 2016.

**Funding Circle facilitates lending to businesses in all parts of the UK, no matter how rural.**

During 2018, nearly 21,000 new business loans were arranged through the platform. By country and region, the distribution of loans broadly matched that of the UK's SME population (see Fig. 8). Funding Circle's over-indexation in the North West is important, as *Which?*

**Fig. 7: 'Stock' measures of lending to UK SMEs through Funding Circle**

£ billion

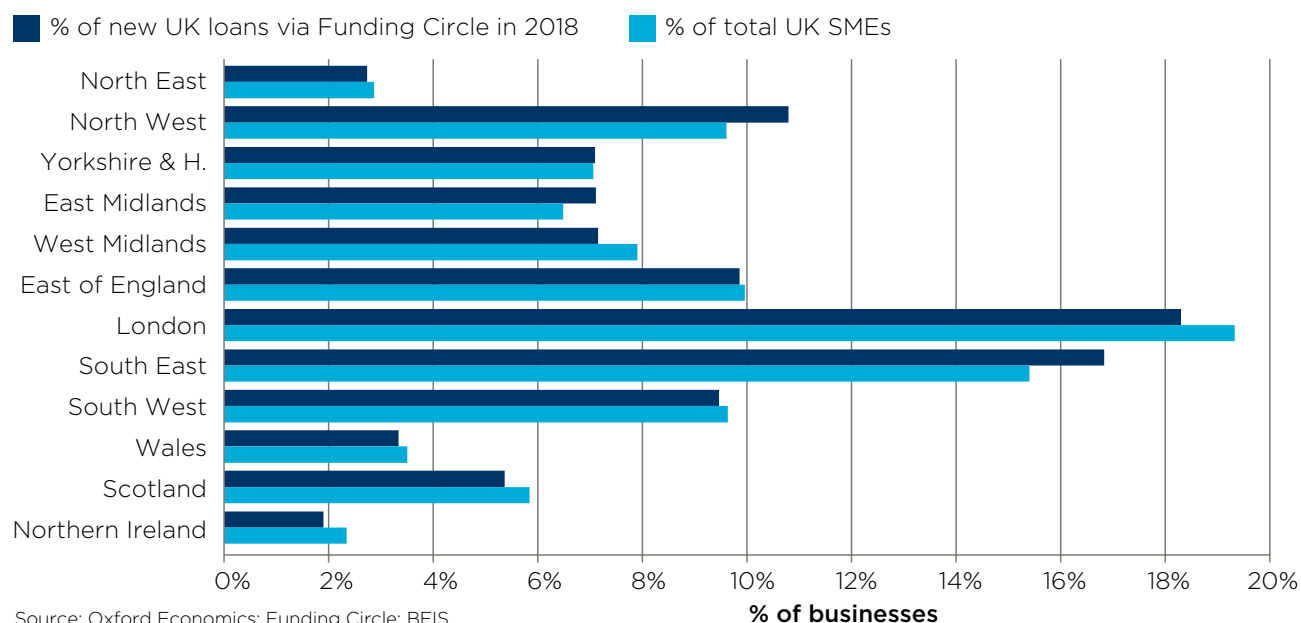


Source: Funding Circle

reports this region has seen the biggest reduction in bank branches since 2015 – some 425, or 13 percent of all branch closures in that period.<sup>14</sup>

**“Funding Circle facilitates lending to businesses in all parts of the UK. During 2018, nearly 21,000 new business loans were arranged through the platform.”**

**Fig. 8: Regional distribution of new loans granted via Funding Circle, versus total SME distribution**



Source: Oxford Economics; Funding Circle; BEIS

<sup>14</sup> Which?, Bank branch closures: is your local bank closing? Jan 2019.

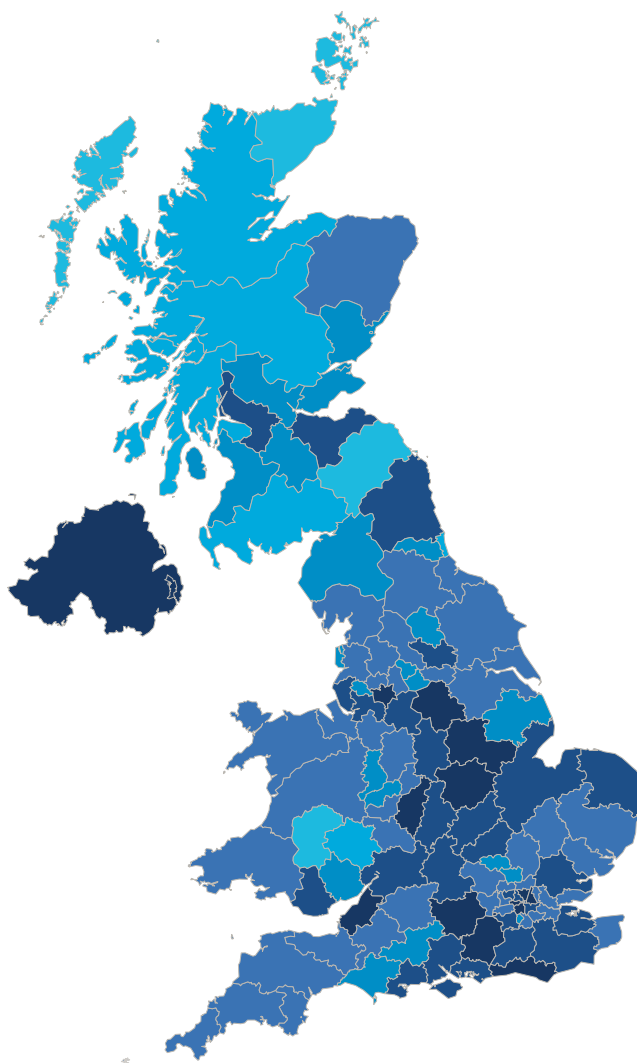
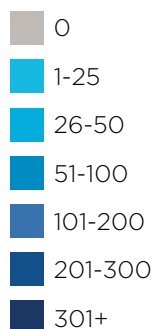
Finance was granted to firms located in every one of the UK's 121 postal areas, from the far south-west of England, to the north of Scotland. Fig. 9 shows how this translates into loans by local authority area, with SMEs in nearly all such areas accessing finance through Funding Circle.

**Between 2007 and 2017, the number of bank branches fell by 37 percent across the UK.<sup>15</sup>**

While these closures affected both metropolitan and rural areas, their impact has typically been more negative in rural areas, due to the lack of locally-available alternatives. According to *Which?*, the 10 local authority areas experiencing the most bank closures between 2015 and 2018 included the rural areas of Cornwall, Highland, and Wiltshire. In 2018, Funding Circle facilitated 181, 47, and 98 loans respectively to enterprises in these areas.

**Fig. 9: New Funding Circle business loans in 2018, by postal areas**

Number of loans



Source: Funding Circle; Oxford Economics

**“Lending through Funding Circle reached businesses in the postal areas of England’s 20 most deprived neighbourhoods in 2018. A similar picture is seen in the rest of the UK.”**

**Lending through Funding Circle in 2018 reached businesses in the same postal areas as England’s 20 most deprived neighbourhoods.<sup>16</sup>**

These include neighbourhoods in and around seaside towns such as Clacton, Blackpool, Lowestoft, and Great Yarmouth, and in “de-industrialised” localities such

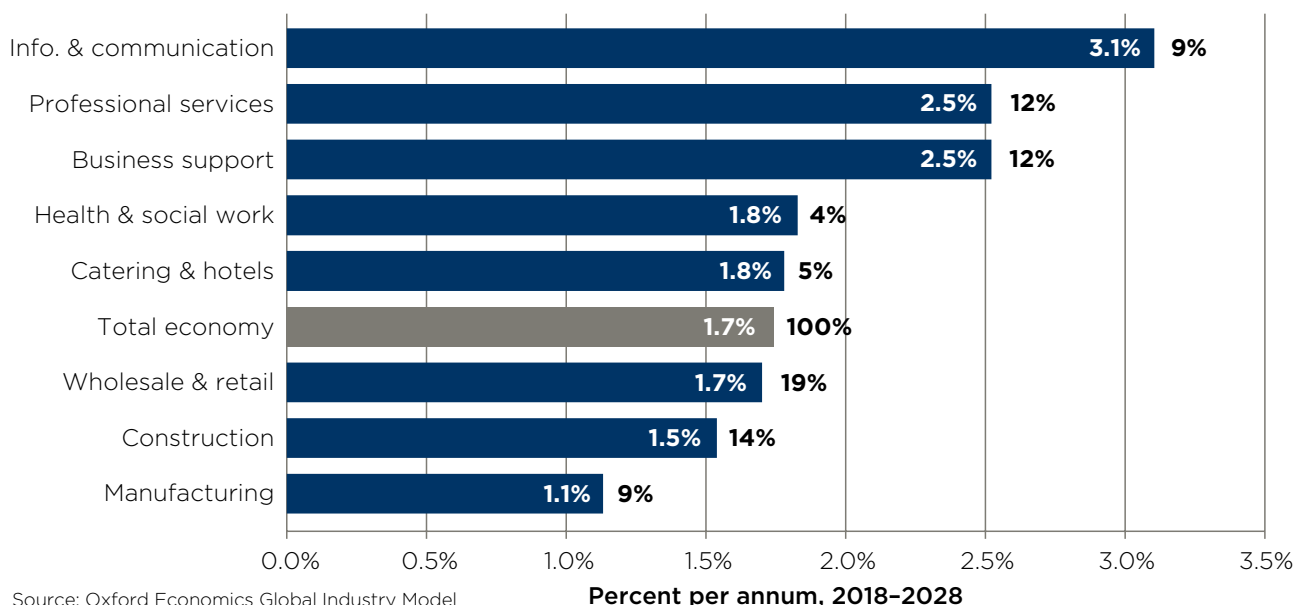
as Hull, Grimsby, Burnley, and Mansfield. A similar picture is seen in Scotland, Wales, and Northern Ireland, with loans being granted to businesses in Paisley, Glasgow, Rhyl, Wrexham, Belfast, and Derry City, among other areas of particular economic disadvantage.<sup>17</sup>

<sup>15</sup> House of Commons Library, Briefing Paper: Bank Branch Closures, 2018,

<sup>16</sup> Based on Department for Communities and Local Government, English Areas of Deprivation 2015.

<sup>17</sup> Scottish Government, Scottish Index of Multiple Deprivation 2016; Welsh Government, Welsh Index of Multiple Deprivation 2014; Northern Ireland Statistics and Research Agency, Northern Ireland Multiple Deprivation Measure 2017.

**Fig. 10: Projected real annual GDP growth in key customer industries, and their shares of loans under Funding Circle management at end 2018**



Source: Oxford Economics Global Industry Model

**While Funding Circle's lending profile is representative of the UK SME sector in very broad terms, there is some bias towards industries with better-than-average growth prospects, including the six percent of SMEs that are in the digital sector and those that have embraced the rapid adoption of digital technology.** As illustrated in Fig. 10, three of these key customer sectors—professional services, business support services, and information & communication—are expected to grow at a significantly faster pace than the wider UK economy over the next decade. Between them, SMEs in these three sectors currently employ 4.3 million people—26 percent of all SME workers, and 16 percent of the entire UK private sector workforce.

### 2.3 WHAT IS FUNDING CIRCLE'S FULL ECONOMIC IMPACT IN THE UK?

**Based on our survey of UK SMEs with loans under Funding Circle management at the end of 2018, we calculate that lending through the platform directly supported £2.2 billion of UK GDP, and 39,200 jobs.**

Scaling up from the sample, we find that Funding Circle clients generated a combined annual revenue of £41.5 billion—of which 7.8 percent can be allocated to the platform's activities.<sup>18</sup> Of this loan-related revenue, the firms' employment and capital costs plus net profits accounted for some £2.2 billion. This represents the "direct" contribution to the UK's gross domestic product (GDP—the key measure of the nation's economic activity), as

a result of the loans through Funding Circle. We calculate that 39,200 jobs and £600 million in UK tax revenues were also directly supported by these loans.<sup>19</sup>

**But the contribution to the national economy does not end there.** Two further channels can be considered: the "indirect impact", which captures the support for activity in Funding Circle's clients' UK supply chains as a result of their purchases of inputs; and the "induced impact", which reflects the support provided to the wider economy by the wage-funded expenditure of all these firms' staff.

<sup>18</sup> Business clients with outstanding loans as of 31 December 2018. Scaling up from the survey sample to the overall total is undertaken on an industry-by-industry basis. The share attributable to Funding Circle is calculated as the share of the Funding Circle loan in total liabilities on an industry by industry basis.

<sup>19</sup> These tax revenues comprise corporation tax, business rates, taxes on business purchases (such as fuel duty), employers' and employees' national insurance contributions, and employees' income tax. Survey respondents were not asked for tax information in this year's survey and these results are derived from the direct GVA and employment estimates, taking into account the industry-by-industry distribution of income and jobs, official data on tax-to-income and tax-to-spending ratios, and features of the UK tax system in 2018-19.

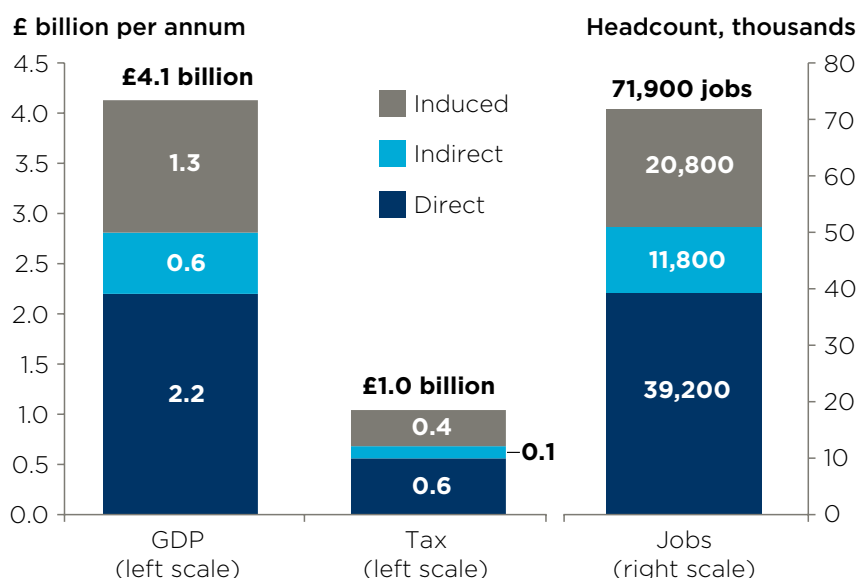


We estimate that £1 billion spent by SMEs on purchases from other firms was supported by the loans under Funding Circle management at the end of 2018. Of this amount, some 80 percent was received by UK-based suppliers, which in turn supported £610 million of GDP in UK-based supply chains—the indirect impact of the loans. Based on the industry-by-industry distribution of that GDP, we estimate that it supported a further 11,800 UK jobs, and an additional £120 million in tax revenues.

In addition, spending by Funding Circle clients' employees and by workers in their supply chains is estimated to stimulate an extra £1.3 billion of UK GDP—the induced impact of the loans.<sup>20</sup> This is associated with a further employment impact of 20,800 jobs, and a tax contribution of £360 million.<sup>21</sup>

**Combining all three channels, we calculate that the loans under Funding Circle management at the end of 2018 supported a total contribution to UK GDP of £4.1 billion** (see Fig. 11).<sup>22</sup> This is similar to the total value of goods and services produced annually in each of the local authority areas of Norwich, Stratford-upon-Avon, Bath, and North-East Somerset.

**Fig. 11: Total economic impact of Funding Circle in the UK, 2018**



Source: Oxford Economics. Note: totals may not sum due to rounding.

**We find that 71,900 jobs were supported by these loans, and that the associated tax revenues were worth £1 billion.**

The overall employment impact is about the same as the number of people employed in Cheltenham, while the tax revenues would be sufficient to fund 31,500 full-time nurses for a year.

**Funding Circle's contribution to UK GDP in 2018 is more than 74 percent larger than a year earlier, when it was calculated to have contributed £2.4 billion**

(see Fig. 12). Over the same period, the value of UK loans managed by Funding Circle grew by 55 percent. The additional growth in its year-on-year GDP contribution is driven by an improved revenue performance by its businesses. This could reflect

a change in the mix of clients by type and size of business, a shift in the lending profile towards more capital efficient firms, or (most likely) some combination of the two. In part, this may reflect an increase in repeat business, as firms use their loans to become more productive.

The increase in the total GDP contribution in turn supported further increases in the total employment and total tax impacts enabled by Funding Circle.

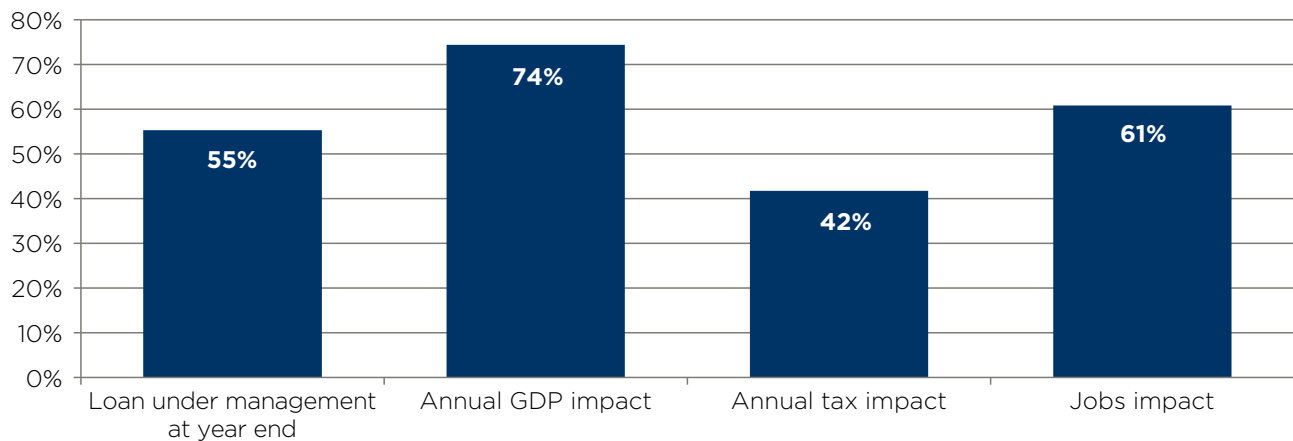
<sup>20</sup> In the UK, loans under management do not include loans to property developers, following Funding Circle's decision in 2017 to no longer facilitate this type of finance.

<sup>21</sup> The induced tax contribution includes all taxes, such as VAT and excise duties, levied on the consumer spending of the workers, as well as taxes levied on businesses, and on workers' income, in the induced channel.

<sup>22</sup> This amount only reflects the contribution of finance outstanding at that particular point in time, and ignores any ongoing impact related to Funding Circle loans granted in the past but repaid in the interim.

**Fig. 12: Annual growth in loans through Funding Circle, and the economic activity they support, between 2017 and 2018**

Percentage growth



Source: Oxford Economics

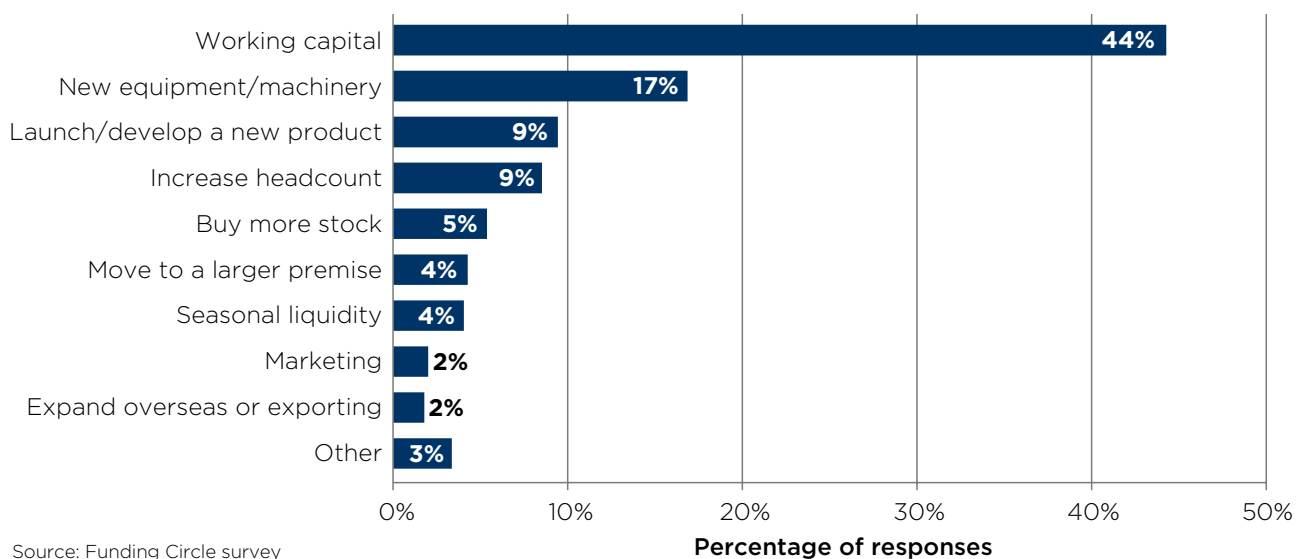
## 2.4 WHY DO SMALL BUSINESSES USE FUNDING CIRCLE?

**According to our survey of Funding Circle's UK clients, many of the SMEs want the finance to provide them with working capital.**<sup>23</sup> This motivation

was cited by 44 percent of

respondents, with purchase of new equipment (17 percent), a new product launch or development, and workforce expansion (both nine percent) seen as the next most important reasons (Fig. 13).

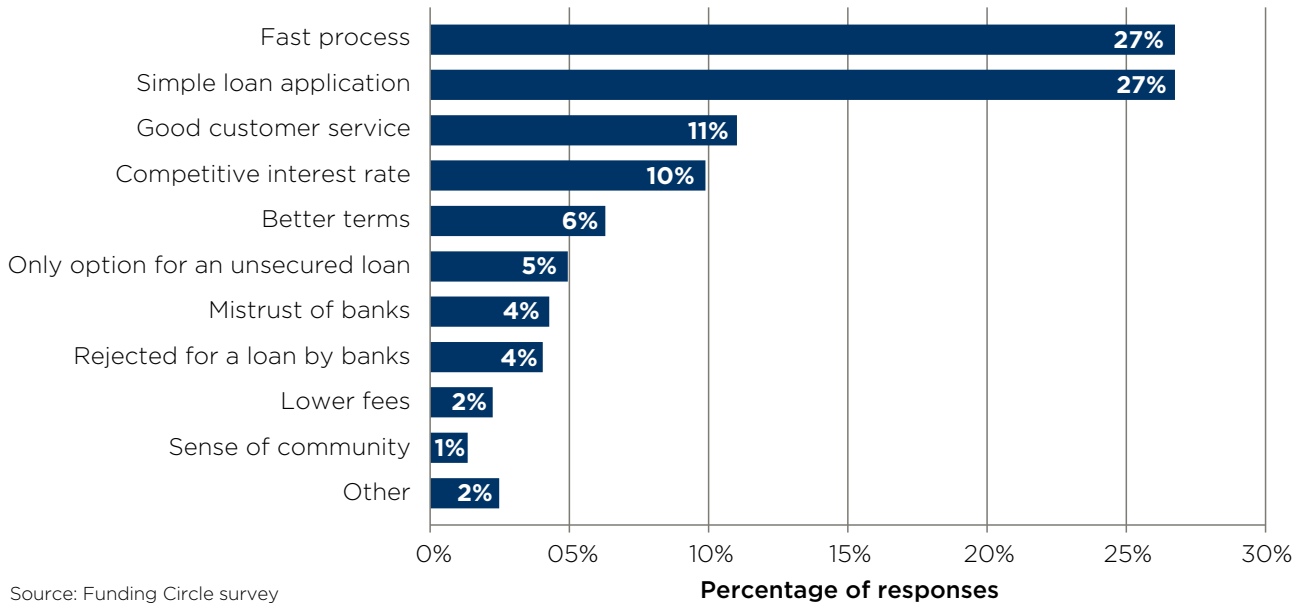
**Fig. 13: Main reason for seeking finance for the business**



Source: Funding Circle survey

<sup>23</sup> To identify why small UK firms choose to borrow through Funding Circle, a survey of its customers was carried out in January and February 2019.

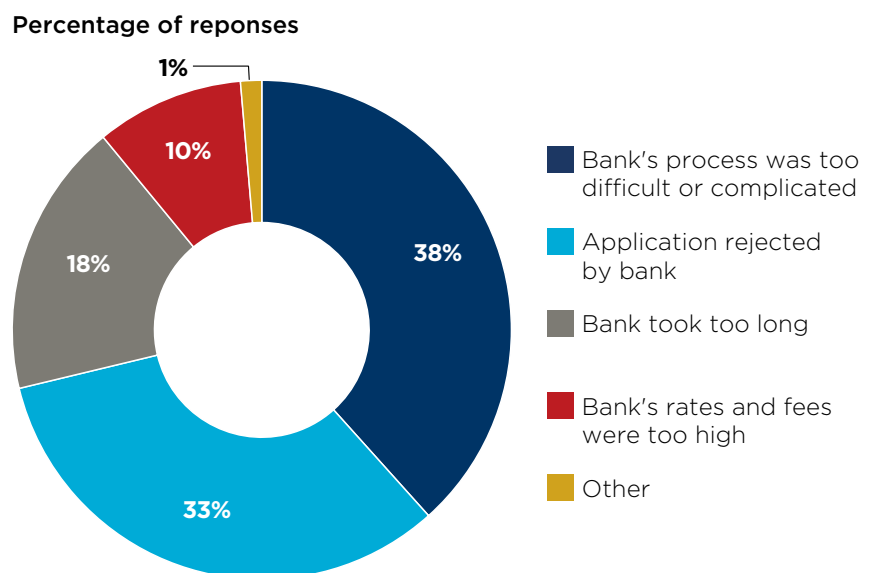
**Fig. 14: Main reason for borrowing from Funding Circle**



**Small firms in the UK continue to be attracted by the speed and ease of Funding Circle's loan application process.** Of the whole sample of 445 firms, 27 percent said the most important reason for borrowing from Funding Circle was the *fast* process, while an identical share were most attracted by the *simple* nature of the loan application process (Fig. 14).

Funding Circle's clients are deterred from borrowing from the banks by their negative experiences or perceptions. Some 38 percent did not complete the application process as they thought it too difficult or complicated (see Fig. 15). A further 18 percent perceived it would take too long, while 10 percent were deterred by the high interest rates and fees.

**Fig. 15: Reasons for not completing a bank loan application**





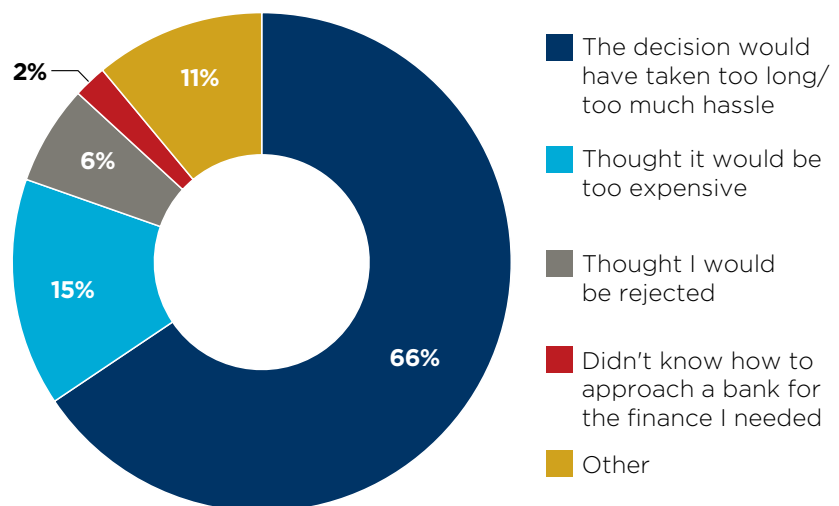
**The majority of surveyed clients had not approached a bank before applying to Funding Circle.** Of these respondents, 66 percent believed that a bank's decision would have taken too long or caused too much hassle (see Fig. 16). Others cited the potential expense (15 percent), and an expectation that their application would be rejected (six percent).

**A significant proportion of firms surveyed thought they were unlikely to obtain finance in the absence of Funding Circle, leading to negative consequences.**

While just over half stated they would have been likely or very likely to obtain the finance they required had Funding Circle not existed, a fairly significant 17 percent of the entire sample felt they were unlikely or very unlikely to have obtained finance in Funding Circle's absence.

**Fig. 16: Reasons for not approaching a bank first**

Percentage of responses



Source: Funding Circle survey



# CASE STUDY: KATE LESTER INTERIORS

A business major from the University of Southern California, Kate Lester launched her luxury interior design firm back in 2010—"from my guest room, with \$500; no capital, no investors. I'm a firm believer that businesses should start slowly and grow slowly; don't bite off more than you can chew."

So initially, growth of Kate Lester Interiors came largely by word of mouth. "One fabulous client told another fabulous client, and it sort of expanded ..."

But this slow-and-steady approach changed when a "perfect new space" suddenly became available on the Pacific Coast Highway, allowing Kate to open her first storefront.

"My bookkeeper said to me, 'Getting financing isn't a bad thing. You're going to pay it back; you just need a little help right now to build out the space, hire some people, and do a little marketing.'"

At first, Kate approached her bank for funding "because we already had so much in-and-out cash flow with them". They turned her down. On the very same day, however, she received a promotional mailer from Funding Circle and decided to apply.

Kate ended up securing her loan just 11 days after applying with Funding Circle. "Time is something that's super-valuable to me," she says, "so if we can get our financing done efficiently, I don't have any issue with paying a premium for that. For me to go to a bank, and maybe get one or two points difference in the interest rate, wasn't worth all the back and forth it would have required."

Similarly, she contrasts the "eight hours I spent on the phone with my bank, just trying to get someone to talk to me" with her experience with Funding Circle. "Jackie was our one contact person at Funding Circle, and she knew everything about our loan and where it was in the process. We didn't have to talk to 10 different people—so that was a huge benefit for me."

Five months after securing the loan in March 2017, Kate opened her new retail space on the Pacific Coast Highway. Since then business has boomed, and she is now focusing on the next phase of her long-term plan: building her team and brand, while helping each client create spaces that are "luxurious, livable, and unique".







## 3. UNITED STATES

### 3.1 SMALL BUSINESSES' ACCESS TO FINANCE

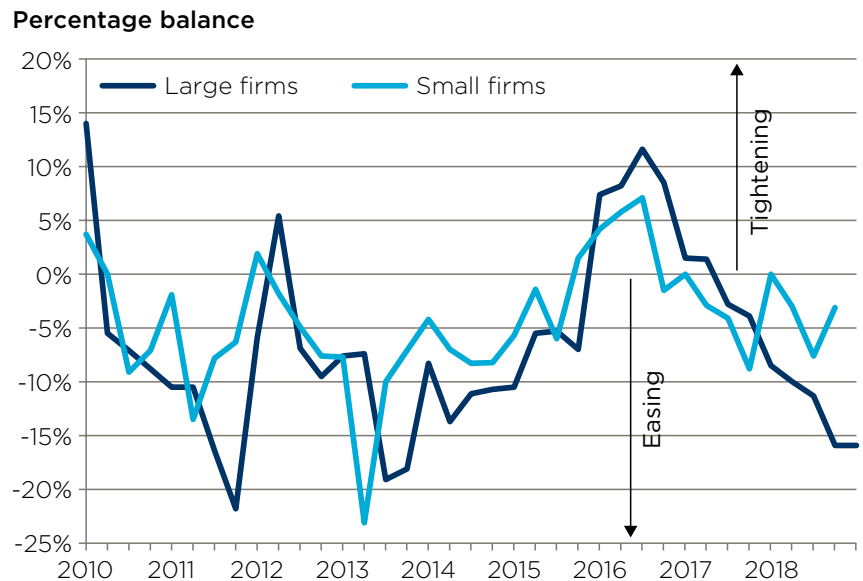
**During 2018, the US economy achieved its second-longest continual expansion on record, having experienced unbroken growth since June 2009.** Over the year, the US economy grew by 2.9 percent, supported by strong growth in consumer spending and resilient business activity.

“While bank lending to commercial and industrial customers is increasing in the US, small businesses are being left out.”

**And yet, while bank lending to commercial and industrial (C&I) customers is increasing, small businesses are being left out.** According to the Federal Reserve's latest Senior Loan Officer Survey, more banks relaxed their standards for C&I loans to large and middle-market firms than to small firms in 2018. On average a net balance of 13.3 percent of respondents reported easing their credit standards on loans to large and medium firms in 2018, while the equivalent figure was just 3.1 percent for loans to small firms.

“An average net balance of 24.7 percent of banks eased their interest rate spreads to medium and large firms in 2018, compared with just 13.9 percent for small firms.”

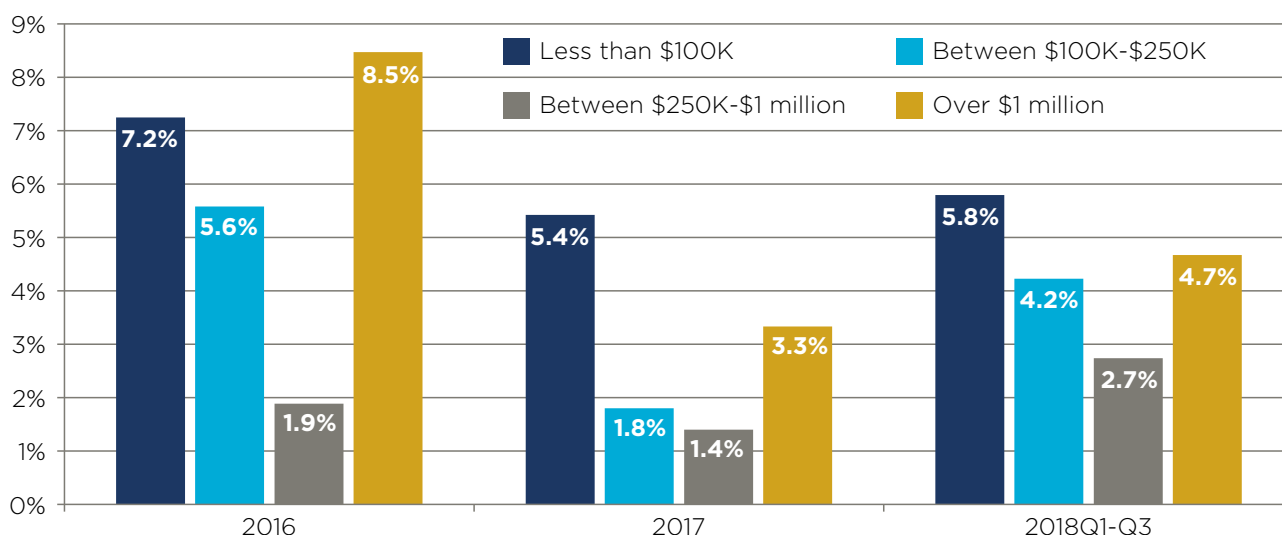
**Fig. 17: Senior Loan Officer Survey on how banks' credit standards for approving applications have changed over the past three months**



**The Senior Loan Officer Survey also suggests the banks were disadvantaging their small corporate customers in how they changed the terms and conditions on loans in 2018.**

An average net balance of 24.7 percent of banks eased the interest rate spreads they charged on loans to medium and large firms, compared with just 13.9 percent for small firms. Similarly, a larger net balance of banks eased the collateral requirements and covenants for medium and large firms than they did for small firms in 2018.

Looking specifically at the value of bank lending to small C&I customers, the pattern of demand for, and supply of, bank loans for different-sized companies is quite complicated. But the most rapid growth in each of the last three years has occurred in the total value of credit under \$100,000 (including business credit cards) and loans over \$1 million (Fig. 18).

**Fig. 18: Annual growth in the value of bank lending to C&I customers in the US, split by loan size**

Source: FDIC

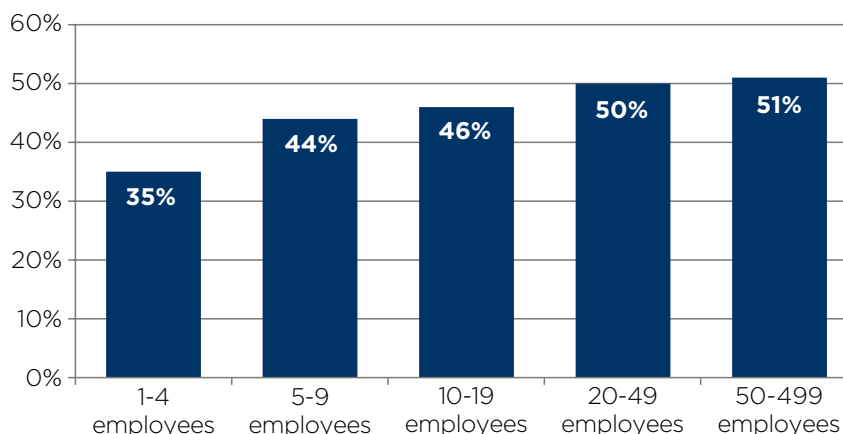
**The size of loan that a firm applies for is heavily correlated with its size.**

According to the latest Small Business Credit Survey (SBCS), some 69 percent of the loans applied for by firms with one-to-four employees, and 57 percent of those by firms with five-to-nine employees, are under \$100,000.<sup>24</sup> In addition, 43 percent of loans applied for by firms with 50-499 employees are over \$1 million. Following our earlier analysis, this suggests the US's smallest firms, and also some medium-sized firms, have been particularly successful in increasing the value of the loans they obtained between 2016 and 2018 Q3.

**The latest Small Business Credit Survey suggests there is a strong appetite for external finance among SMEs.**

This continues to reflect their desire to expand (a 2018 survey by the National Federation of Independent Business found that 60 percent of small firms had made a capital expenditure in the previous six months).

Larger SMEs are more likely to seek external finance: according to the SBCS, the proportion of small businesses applying for external finance over the past 12 months ranged from 35 percent of firms with one-to-four employees, up to 51 percent of firms with between 50 and 499 employees (Fig. 19).

**Fig. 19: Share of SMEs that applied for financing in previous 12 months**

Source: Small Business Credit Survey 2017

<sup>24</sup> The SBCS is the most comprehensive survey of its kind in the US, carried out nationally by the 12 Federal Reserve banks. It collates information on small business financing needs, decisions, and outcomes. For the purposes of this survey, 'small businesses' include all firms with fewer than 500 employees.

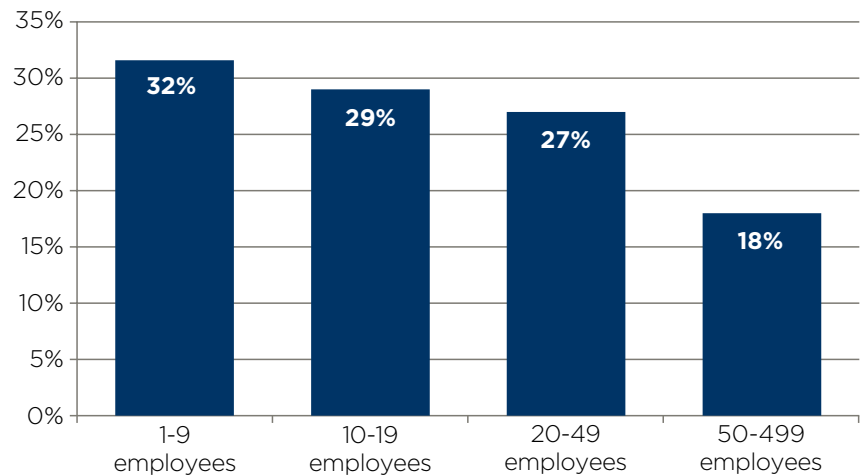
**However, small US businesses continue to report difficulty in accessing credit, with the smallest firms facing the most severe difficulties.**

Some 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 SMEs with over 50 employees.

**These difficulties echo the share of small businesses that have their credit applications rejected, or obtain only a proportion of the external finance they seek.** The SBCS shows that smaller firms are much more likely to have their applications rejected—just as they are more likely to receive only part of the loan they requested (see Fig. 21). In part, this reflects the difficulties lenders have in judging smaller businesses' credit risk, due to a combination of the lack of publicly available information,

**Fig. 20: Firms reporting credit availability as 'a challenge', by firm employee size-band**

Percentage share of firms



Source: Small Business Credit Survey

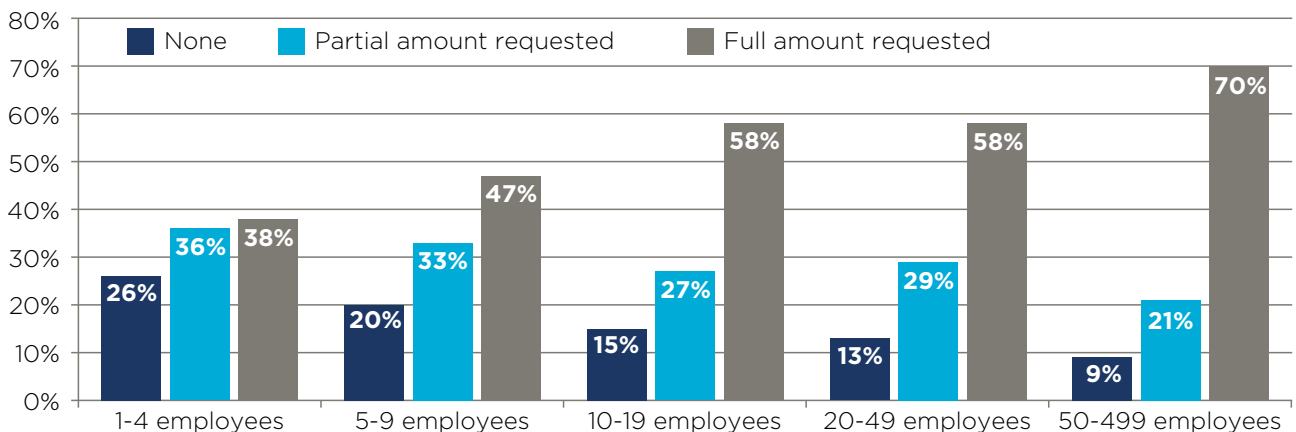
insufficient credit histories for younger firms, and their lack of assets to offer as collateral.

When looking at outcomes based on loan size, SMEs applying for credit of between \$25,000 and \$250,000 face the most difficulties. Some 58 percent applying for such

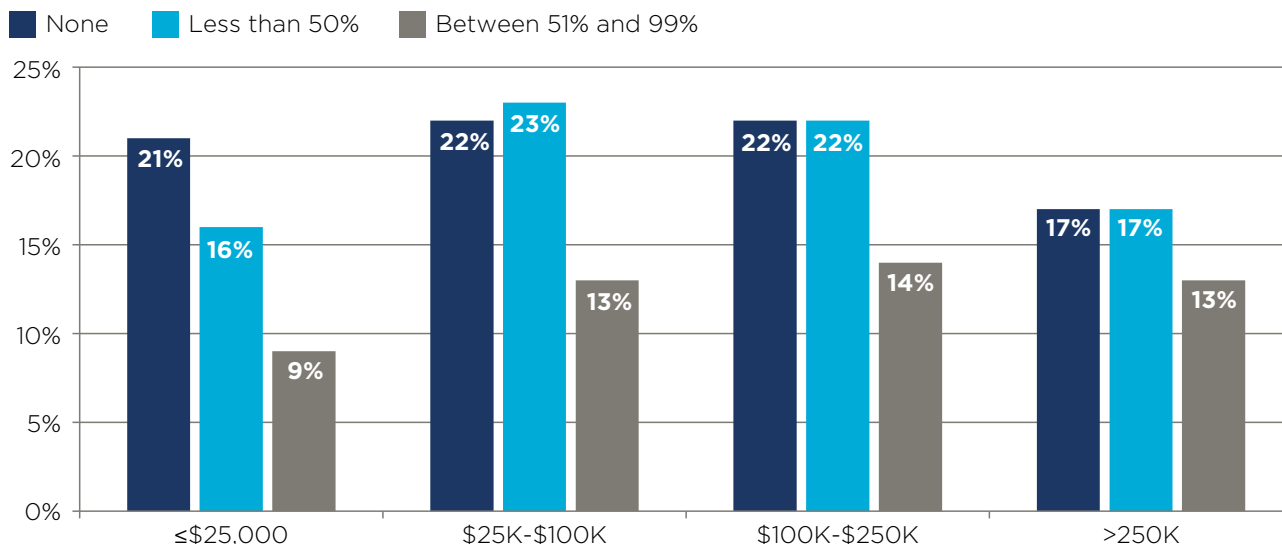
loans either got rejected or did not obtain all the finance they sought (see Fig. 22). In all, 22 percent of loans of this size were rejected, the highest of all rejection rates. The “funding gaps” for loans of less than \$25,000 and over \$250,000 were broadly similar, at 46 and 47 percent, respectively.

**Fig. 21: Outcome of small businesses' finance applications, by firm employee size-band, 2017**

Percent of total



Source: Small Business Credit Survey

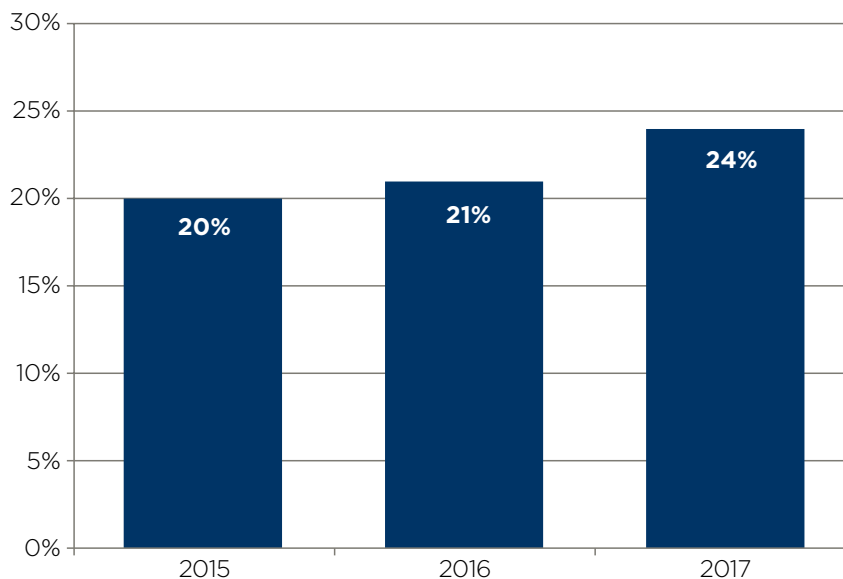
**Fig. 22: Percentage of applications that were not fully successful, by size of loan sought, 2017**

Source: Small Business Credit Survey

**To meet their funding needs, small businesses are increasingly searching for new sources of finance.** The proportion applying to online lenders increased from 20 percent in 2015, to 24 percent in 2017 (see Fig. 23), with applicants attracted by the speed of credit decisions, improved funding chances and lack of collateral requirements. This type of finance is particularly popular with smaller businesses: some 27 percent of firms with one-to-nine employees sought finance from an online lender in 2017, compared with 18, 17, and 11 percent of firms with 10-19, 20-49, and 50-499 employees, respectively.

**Fig. 23: Proportion of SMEs who applied to online lenders**

Percent of all loan, line of credit and cash advancement applicants



Source: Small Business Credit Survey

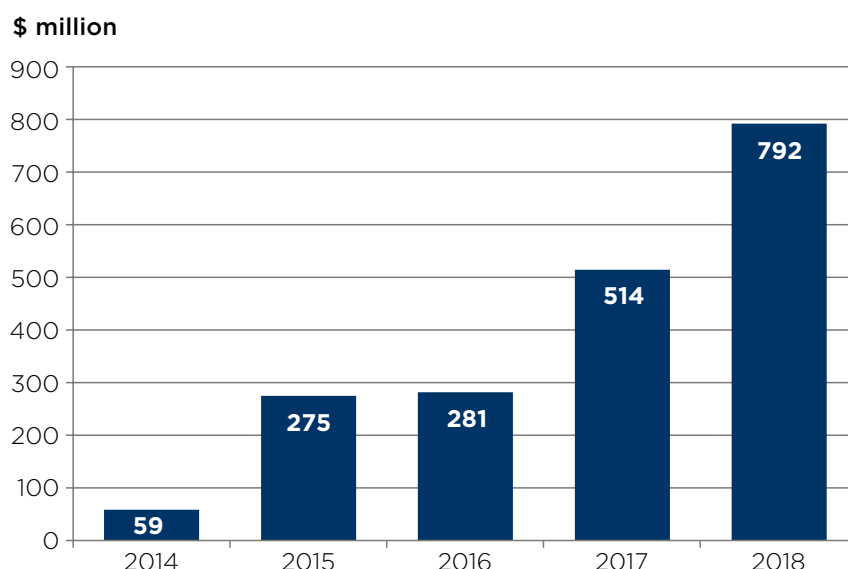


### 3.2 FUNDING CIRCLE'S US LENDING PROFILE

**Over the course of 2018, Funding Circle originated \$792 million in new loans to US companies.** This sum represents an increase of 54 percent on its 2017 total, and caps off a four-year period when new loan issuance grew at a compounded rate of 92 percent per year. The average value of a current loan held by a Funding Circle customer at the end of 2018 was \$136,300, while 45 percent of all loans outstanding were for between \$100,000 and \$500,000.

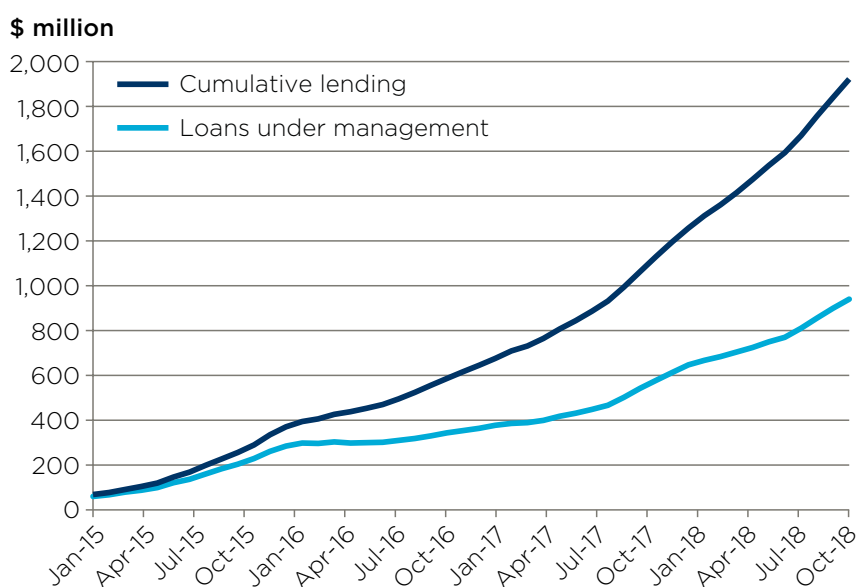
**The value of loans under Funding Circle management continued to grow strongly in 2018,** reaching \$940 million by the end of the year—63 percent higher than at the end of 2017 (see Fig. 25).<sup>25</sup> Funding Circle's consistently strong growth in the US since its launch in October 2013 saw cumulative lending through the platform reach \$1.9 billion by the end of 2018.

**Fig. 24: Value of new loans issued through Funding Circle**

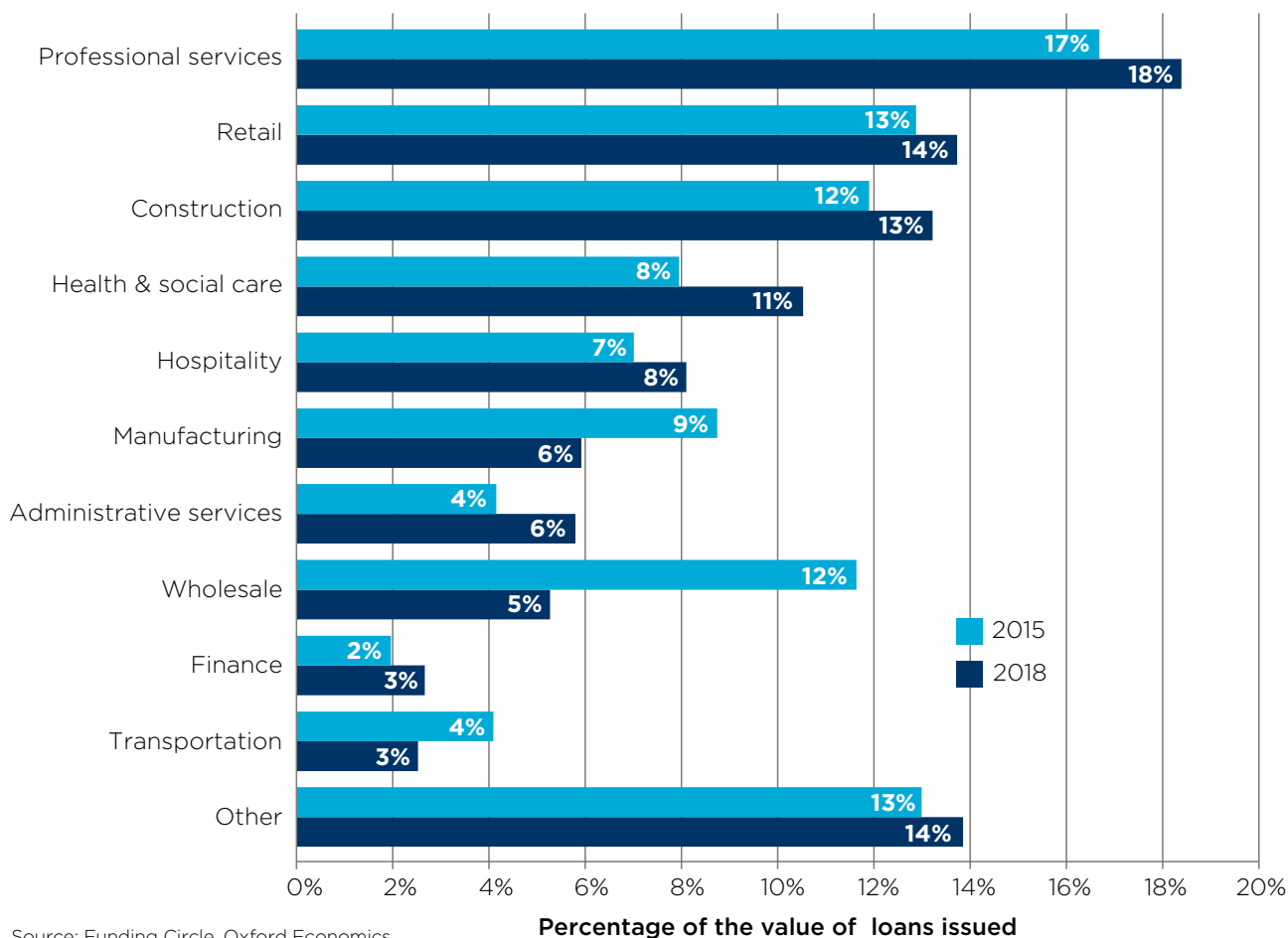


Source: Funding Circle, Oxford Economics

**Fig. 25: 'Stock' measures of lending to US SMEs through Funding Circle**



Source: Funding Circle

**Fig. 26: New loans issued in the US by Funding Circle, 2015 and 2018**

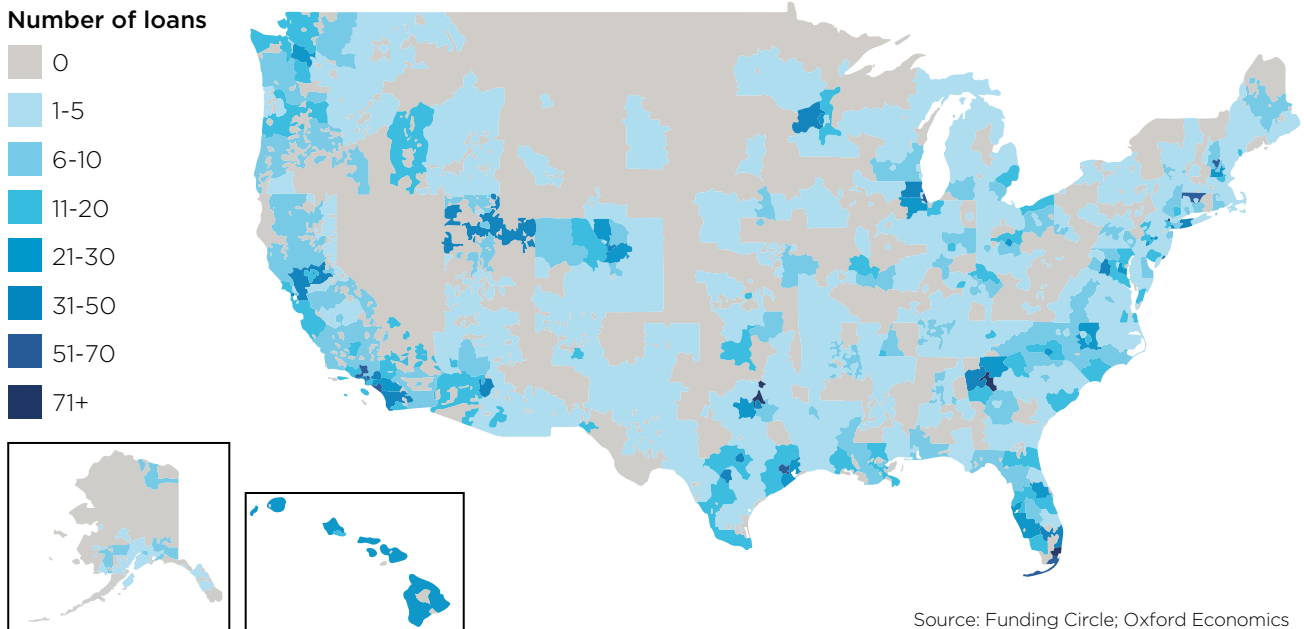
**Loans facilitated through Funding Circle provide credit to businesses across the US economy.**

A breakdown of the loan recipients reveals their industrial structure has remained broadly stable over time (see Fig. 26). In both 2015 and 2018, the US sector receiving the largest share of its funding via Funding Circle was professional services.<sup>26</sup> In 2018, large shares also flowed to retailers, as well as firms in construction, healthcare, and hospitality (i.e. hotels, restaurants, and caterers).

**The small businesses that borrowed through Funding Circle in 2018 are spread across the US**—as is shown in our analysis of the distribution of loans by ZIP code areas (see Fig. 27). Especially concentrated areas for Funding Circle loans include Los Angeles, Atlanta, and Miami.

<sup>26</sup> The 'professional services' category encompasses activities such as technical consulting, design, engineering, software, legal, accounting, marketing/advertising, and other similar business services.

**Fig. 27: Loans issued through Funding Circle in 2018, by ZIP code area**



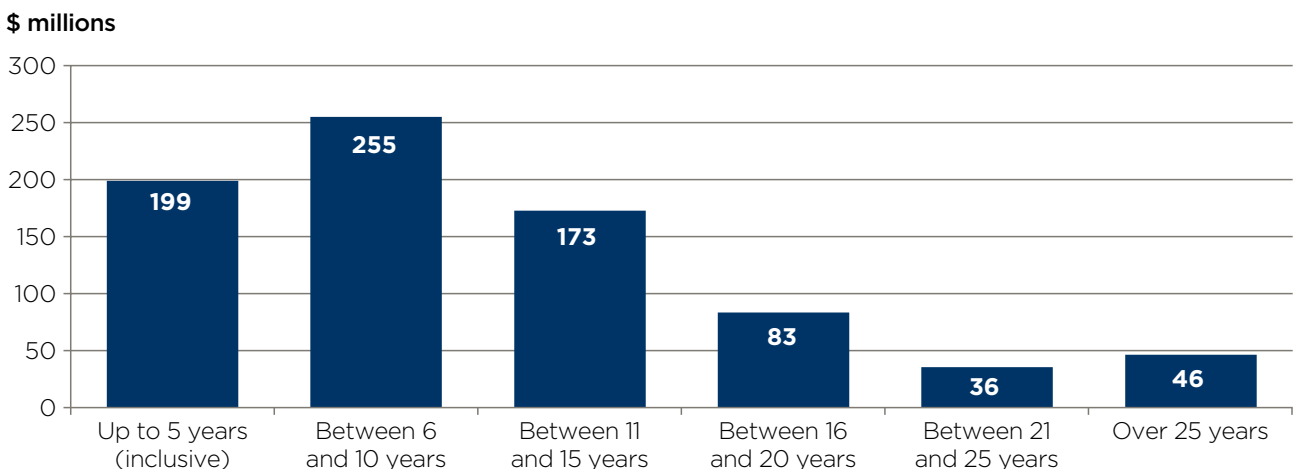
**Funding Circle enables loans for firms at an important stage of their growth.**

Some 25 percent of the total value of loans issued in 2018 went to firms between two and five years old, with a further 32 percent issued to firms aged six-to-10 (see Fig. 28). These

firms are in the earlier stages of the financial growth cycle, and are of a size that is more likely to experience difficulty accessing credit in the US. Funding Circle enables them to access the finance they need to support their expansion plans and fund their working capital.

The remaining 43 percent of the total loan value in 2018 was issued to more mature firms. Being more established still does not exclude them from the constraints on traditional forms of funding that so many small US firms face.

**Fig. 28: Age of SMEs receiving a loan through Funding Circle, 2018**



Source: Funding Circle

### 3.3 WHAT IS FUNDING CIRCLE'S FULL ECONOMIC IMPACT IN THE US?

Using our survey results, we calculate that US lending through Funding Circle *directly* supported a \$1.1 billion contribution to GDP, and 20,500 jobs. Small businesses in the US held a total value of \$939 million in loans under Funding Circle management at the end of 2018. We calculate that these small businesses made a direct, “gross value added” contribution to US GDP of \$9.1 billion in 2018.<sup>27</sup>

On average, Funding Circle loans accounted for 12 percent of these small businesses’ liabilities. We therefore estimate that lending through Funding Circle supported a direct contribution of \$1.1 billion. In producing this level of economic output, these small businesses directly supported 20,500 jobs, and paid \$450 million in annual tax revenues.

But these loans also generate a large amount of activity in the wider economy. We calculate that loans under Funding Circle management at the end of 2018 supported an indirect (supply chain) contribution to GDP of \$620 million, 6,000 jobs, and \$220 million in annual tax revenues. In addition, the wage payments by Funding Circle’s small business customers and in their supply chain supported a \$1.0 billion contribution to GDP, 11,500 jobs, and \$430 million in tax revenues.

**Summing all three channels of impact, we see that lending through Funding Circle made a sizeable impact on the US economy in 2018.**

Through the direct, indirect, and induced channels, this lending enabled a gross value added contribution to GDP of \$2.8 billion, and supported 38,000 jobs (see Fig. 29). Additionally, some \$1.1 billion in tax revenues were supported—enough to fund the salaries of around 26,000 paramedics across the US.

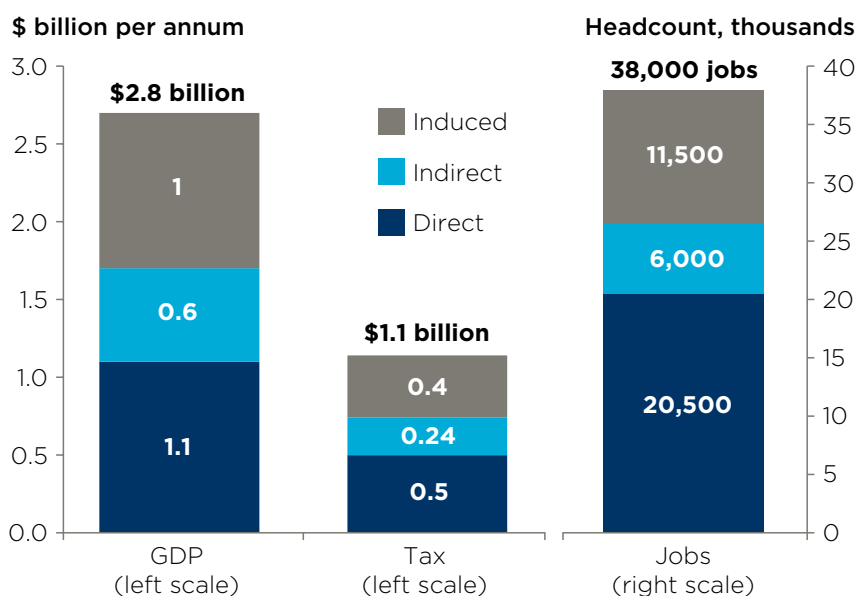
**Our calculations show that the economic impact of lending through Funding Circle increased significantly in 2018.**

The outstanding value of loans held by small businesses through the platform rose from

\$641 million at the end of 2017 to \$939 million a year later—and in turn, there was a notable rise in the economic activity supported by this funding.

We find that the gross value added contribution to GDP went up 33 percent year on year, while the employment supported rose by 37 percent.<sup>28</sup> The total value of taxes paid by small businesses as a result of this economic activity was 36 percent higher in 2018 than the previous year.

**Fig. 29: Funding Circle’s total contribution to the US economy, 2018**



Source: Oxford Economics

<sup>27</sup> Gross value added is a widely used measure of economic activity which subtracts expenditure on inputs from output to ascertain the ‘value-added’ by a given firm or industry. This includes expenditure on employment and capital, and profits.

<sup>28</sup> The percent change comparisons between 2017 and 2018 use monetary values in real terms.



### 3.4 WHY DO SMALL BUSINESSES USE FUNDING CIRCLE?

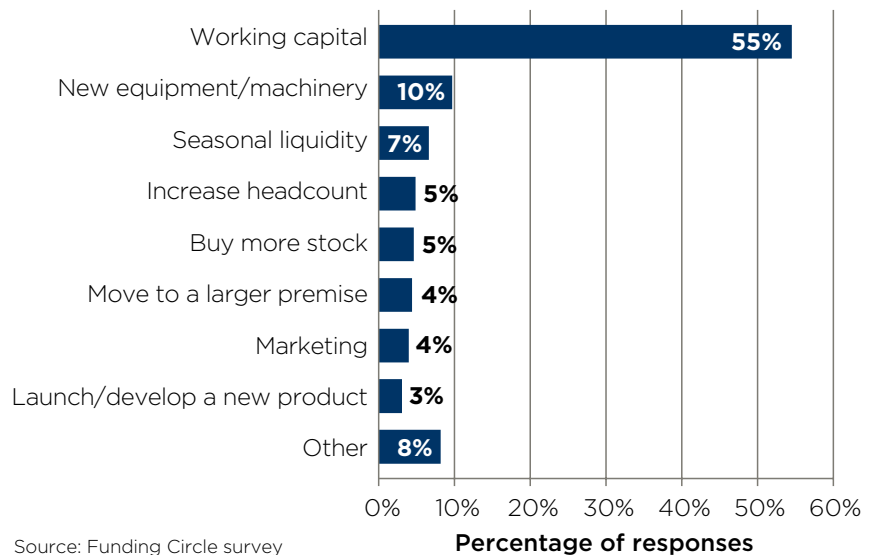
#### Small businesses in the US use loans through Funding Circle for working capital.

Some 55 percent of the platform's clients we surveyed said the main reason they sought finance through Funding Circle was to fund the day-to-day operations of their businesses, such as paying staff wages or purchasing inventory (see Fig. 30). A further 10 percent of customers required the funding to invest in new equipment or machinery for their business.

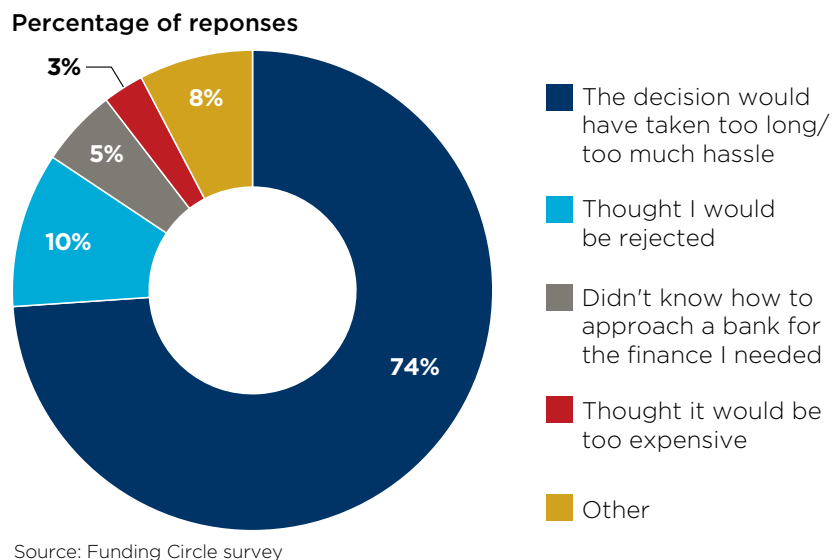
Such a finding is not out of step with the rest of the market. The Federal Reserve's Small Business Credit Survey suggests that small firms in particular seek funding primarily to support their working capital. In that survey, some 54 percent of small firms with revenue under \$100,000 said that funding operating expenses was a main reason for them applying for finance, compared with 42 percent of firms with revenue between \$100,000 and \$1 million.<sup>29</sup> Larger firms were less likely to seek funding for working capital, and instead were much more likely to seek funds to expand their business, or to pursue new opportunities.

**Small businesses are approaching Funding Circle as their first choice for sourcing finance.** Some 72 percent of US customers did not approach a bank for a loan before seeking

**Fig. 30: Main reason for seeking finance**

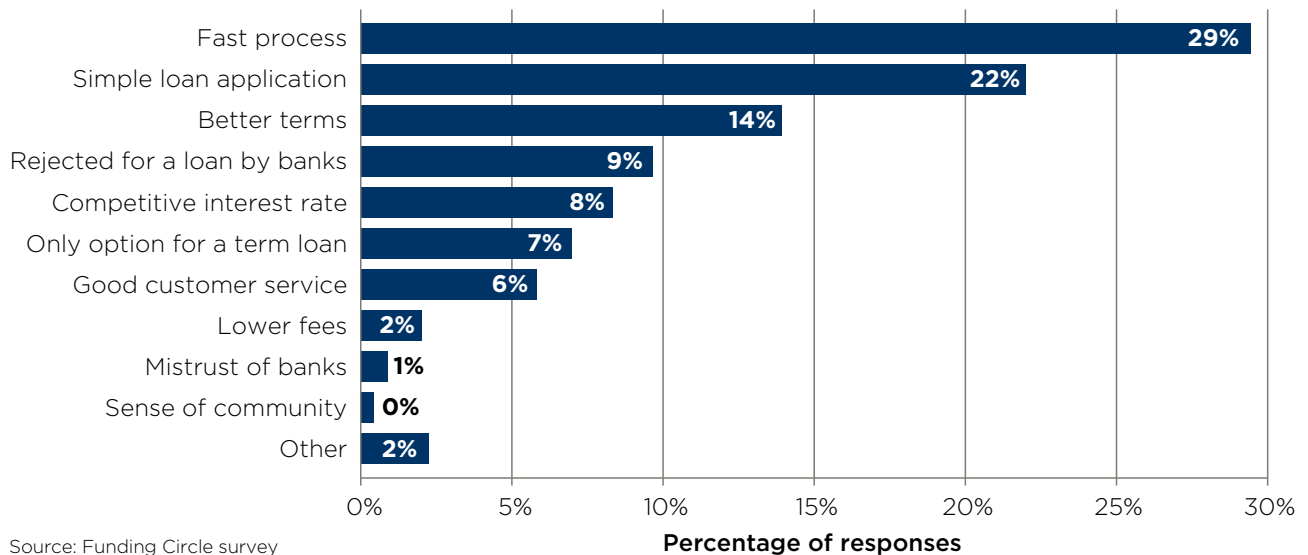


**Fig. 31: Reasons for not attempting to obtain a bank loan before applying for funding through Funding Circle**



finance through Funding Circle. Of these businesses, 74 percent said they felt the bank would have taken too long to make a decision (see Fig. 31). A further 10 percent were discouraged

from applying to a bank as they thought their funding application would have been rejected, while five percent said they did not know how to approach a bank for funding.

**Fig. 32: Main reason for borrowing through Funding Circle**

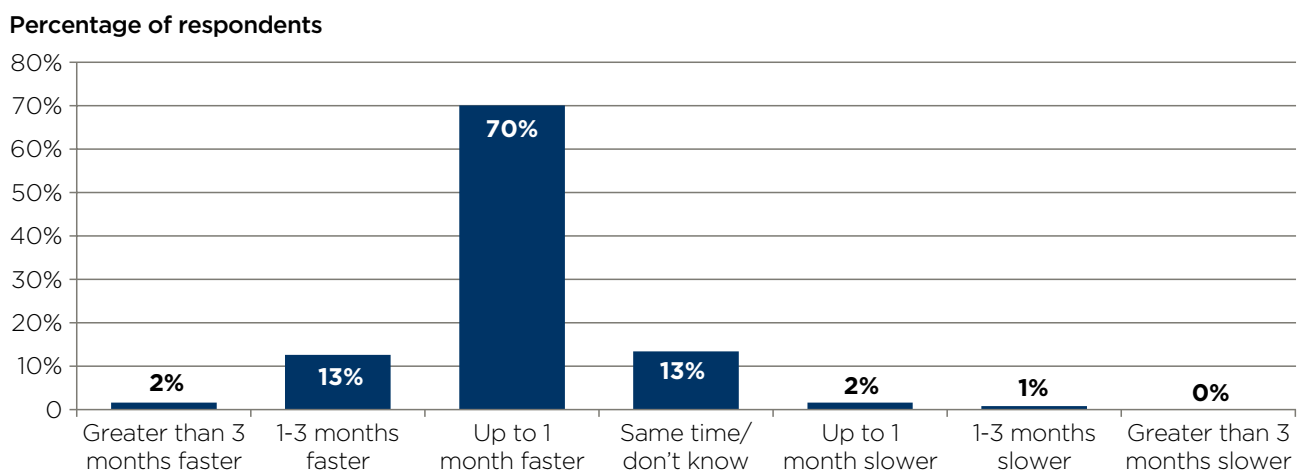
**Customers are attracted to Funding Circle by the fast borrowing process, and the ease of the application.** Some 29 percent of Funding Circle customers in the US said their main reason for borrowing through the platform was the *speed* of the process (see Fig. 32). A further 22 percent

of customers chose Funding Circle primarily because of the *simplicity* of the loan application, while 14 percent said they felt they could get better terms over any alternative.

**Funding Circle customers typically regard the loan process as much faster than**

**alternative sources of finance.**

Indeed, the survey suggests that some 70 percent of customers perceive the processing time for a loan through Funding Circle to be up to one month faster than the alternatives, while a further 14 percent believe the Funding Circle process is more than one month faster (see Fig. 33).

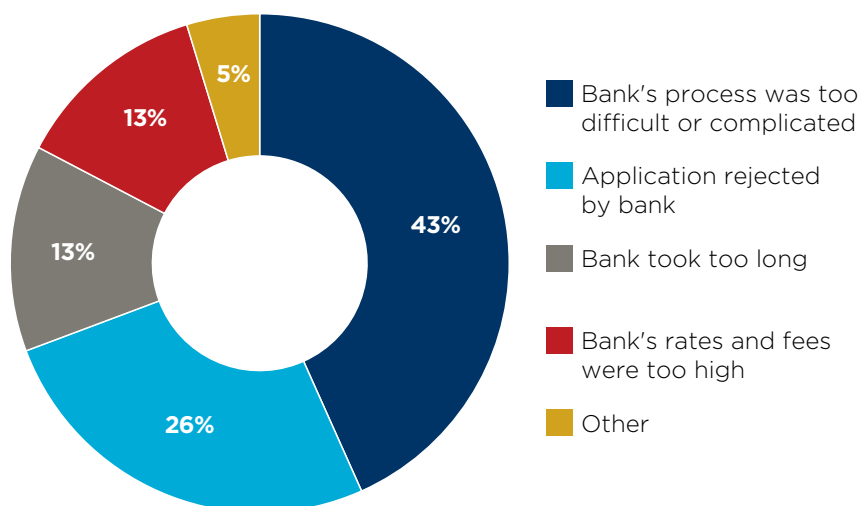
**Fig. 33: How much time it took to borrow through Funding Circle, compared to other sources of finance**

The survey also reveals that small businesses have issues with the time and effort required to complete a bank loan application. On average, Funding Circle customers that had previously applied for a bank loan reported taking eight hours to complete that application.<sup>30</sup> The time involved in applying for a bank loan can represent a significant drain on small businesses' resources, potentially pulling owners and key staff members away from other revenue generating activities.

Beyond the intensive application process, bank loan applicants also incur the cost of waiting for the bank's decision, which may result in further missed opportunities. Of the Funding Circle customers that had applied for bank loans, some 33 percent reported having to wait between one and three weeks for the bank's decision, while a further 30 percent said they had to wait at least one month.

**Fig. 34: Reasons for not completing a bank loan application**

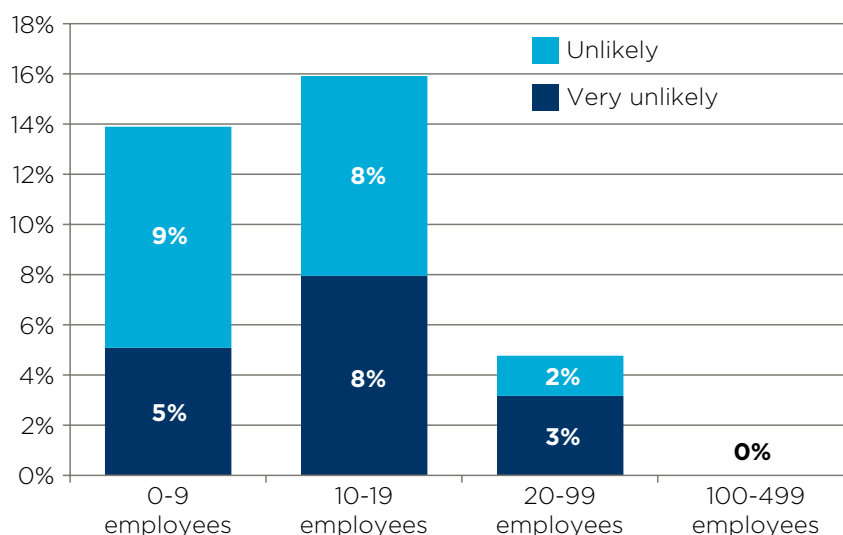
Percentage of responses



Source: Funding Circle survey

**Fig. 35: Likelihood of obtaining finances in Funding Circle's absence, by firm's number of employees**

Percentage of respondents



Source: Funding Circle survey

<sup>30</sup> The average was calculated by taking the mid-point of each survey response (e.g 1-2 hours is measured as 1.5 hours). A figure of 10.5 days was used for the 'more than a week' response.

**Nearly half of Funding Circle's US customers who had initially applied for a bank loan did not complete the bank's application process.**

Of these, some 43 percent said this was because they found the bank's process too difficult or complicated (see Fig. 34). A further 13 percent of customers said they did not complete their application because the bank took too long.

**Funding Circle provides access to finance that many small businesses would otherwise have difficulty obtaining.**

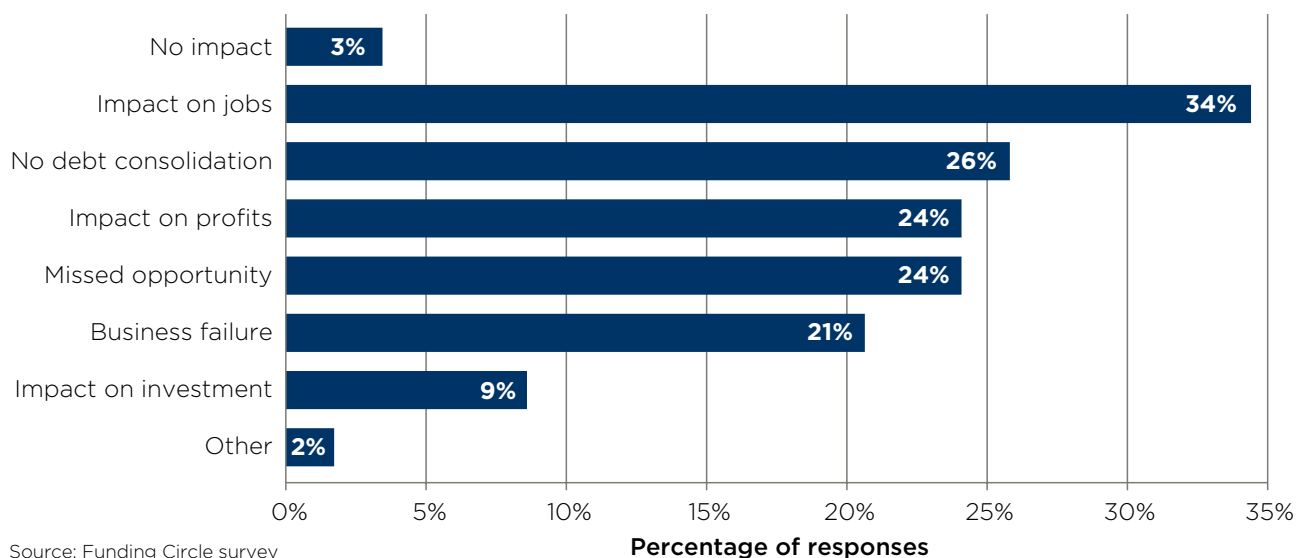
This includes important funding for businesses in the earlier stages of their financial growth cycle,

for whom it is more difficult to obtain finance. Some 14 percent of Funding Circle customers with fewer than 10 employees felt it was either "very unlikely" or "unlikely" that they could obtain finances without Funding Circle (see Fig. 35). The equivalent figure for small businesses with 10-19 employees was 16 percent.

When considering Funding Circle's US business customers of all ages, the survey reveals that without this source of finance, 34 percent felt they would experience an impact on their employment levels, and 24 percent would encounter some impact on their profits (see Fig. 36).

Furthermore, 21 percent felt there would be a risk of their business failing altogether without the finance obtained through Funding Circle. This threat of business closure particularly affects smaller businesses: some 75 percent of the firms answering in this way had fewer than 10 employees, and the remaining 25 percent had 10-to-19 employees.

**Fig. 36: Perceived impact of not receiving finance via Funding Circle<sup>31</sup>**



<sup>31</sup> Customers could choose multiple responses.







# CASE STUDY: LAW OFFICES OF WILLIE D. POWELLS III

Willie D. Powells is a man on a mission. “Anybody that gets hurt, we want to help them out,” he says of the law firm he runs from the top floor of a 20-story Houston skyscraper.

Having worked tirelessly to build a solid client base over more than a decade, securing significant settlements along the way, in recent years he had been looking for ways to grow his business more rapidly.

“I want to do bigger and better things,” he says. “There’s eight million people in Houston alone—and a lot of that eight million don’t even know I exist.”

So it was fortuitous that Funding Circle sent him a letter in the spring of 2017. “Maybe it was the Lord, but I didn’t throw that envelope away. I opened it up and it said: ‘What would \$500,000 do for your business?’ Which was exactly what I’d been thinking to myself—I’d been growing, but a bit of support can help you grow a little better.”

Despite feeling some trepidation, Willie took the plunge and applied for a loan through Funding Circle: “Applying for the loan was a very simple, streamlined process—that’s one of the things that stands out,” he says. “If you go to a bank they want a lot more from you.

“After I’d submitted everything, I was told it would take a week or so to get back to me—and that’s what happened. The amount I asked for is the exact amount I was awarded. I’m really blessed to have opened the envelope and overcome my concerns. The relationship worked out.”

With the infusion of funds, Willie hopes to double or even triple the size of his client base by investing in more marketing, including TV commercials. He also plans to “beef up my personnel a little ... With the funding, I’m now able to work with the best of the best, to build my empire like some of my mentors have done.”

His long-term goal? To see his business thrive, possibly including opening some additional offices. “Longevity is one of the best credibility-builders out there,” he says. “Each year my business gets a little bit better, simply because I’ve been out there doing it for so long. People are starting to understand that I’m a lawyer who has helped a lot of people.”



## 4. GERMANY

### 4.1 SMALL BUSINESSES' ACCESS TO FINANCE

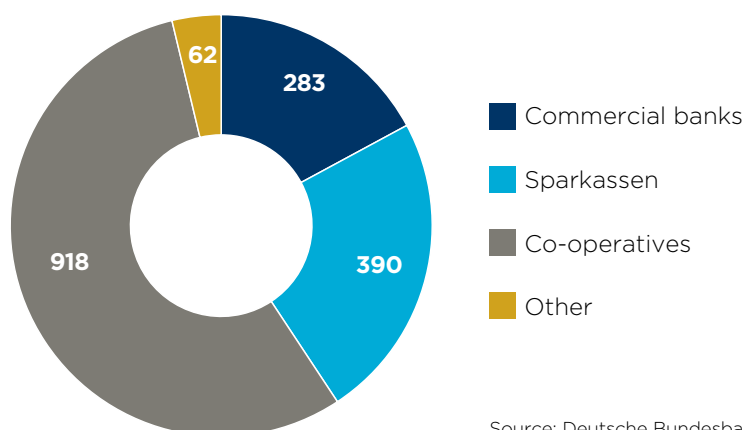
While Germany is regularly championed for its *Mittelstand* businesses and their ability to raise finance, for its micro-businesses access to finance is much harder and the issues more similar to countries such as the UK. The stringent terms and conditions and high administrative costs imposed by banks constrain these firms' ability to expand.

**“For the smallest German firms, access to finance continues to be an issue, due to the stringent terms and high administrative costs imposed by banks.”**

The German banking system is, however, different from its Dutch and British counterparts. It has a less-concentrated, regional lending structure, with a wide range of institutions reflecting the diversity of banking needs in the economy. Sparkassen and co-operative banks, which make up over 75 percent of German banking institutions, focus on household and SME lending (see Fig. 37). The state-backed development bank, KfW, also plays a key role, providing seed financing for start-ups and loans for larger companies.<sup>32</sup>

The availability of credit for SMEs from banks is perceived to be less of a problem in Germany than elsewhere in the European Union. Evidence from the ECB's Survey on the Access to Finance of

**Fig. 37: Number of banks in Germany in 2017, by type**

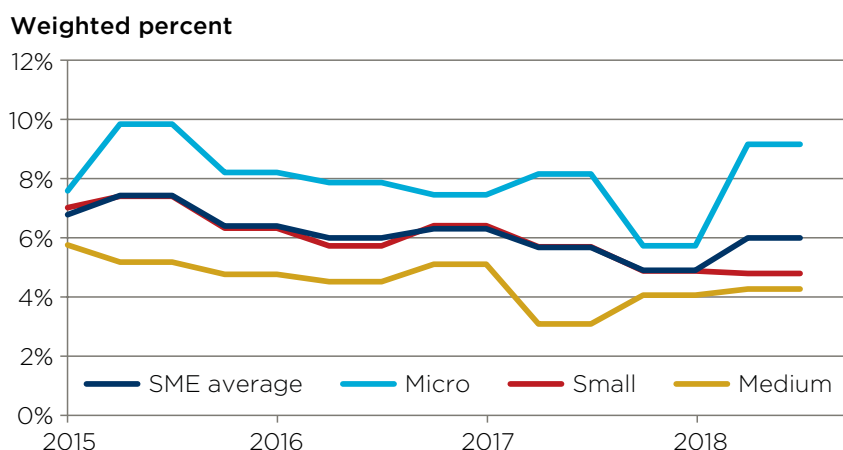


Enterprises (SAFE) supports this sentiment: in 2018, less than six percent of German SMEs reported that access to finance was a major issue, a figure identical to that reported by large German firms.<sup>33</sup>

SMEs, however, are a disparate group, ranging from firms with 249 employees to entrepreneurs operating alone. Breaking down SMEs into their

constituent groups (micro, small, and medium-sized firms) suggests that micro-firms (1-9 employees) have greater difficulty accessing finance than their peers. The latest SAFE survey suggests that nine percent of micro enterprises viewed access to finance as their most pressing problem, broadly twice the proportion for both small and medium-sized firms (see Fig. 38).

**Fig. 38: Trend in businesses reporting access to finance as their most pressing concern, 2015 H1 to 2018 H1**



<sup>32</sup> Sparkassen and KfW are perceived to benefit from lower refinancing costs, as they are believed by many market participants to benefit from an implicit government guarantee reflecting their ownership.

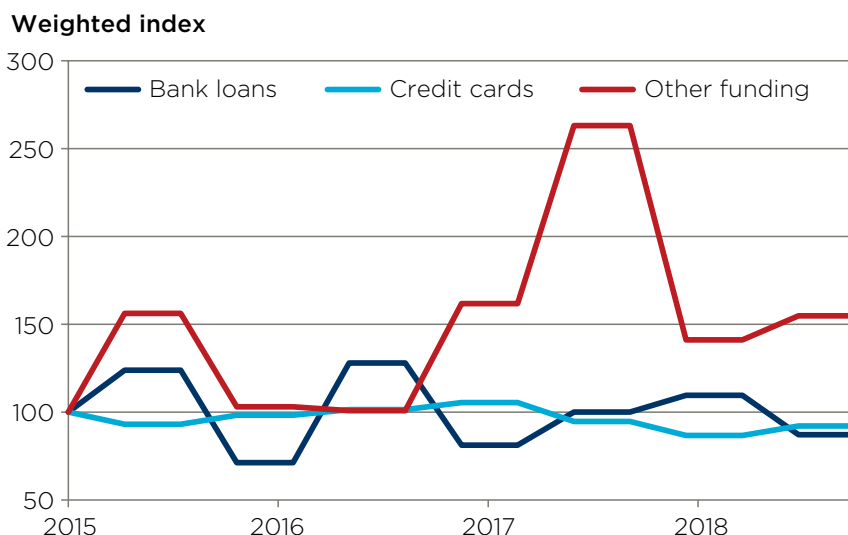
<sup>33</sup> In the ECB's SAFE, 'micro' enterprises have 1-9 employees, 'small' enterprises have 10-49 employees, 'medium-sized' enterprises have 50-249 employees, and large enterprises have 250 or more employees. The term 'small and medium-sized enterprises' (SMEs) covers micro, small, and medium-sized enterprises.

**The inability to satisfy all their financing needs may limit the development of these businesses.** Small (10–49 employees) and micro-businesses play a core role in the German economy: in 2016, 96 percent of all German firms were in these two categories, supporting 40 percent of total employment.<sup>34</sup> These businesses are some of the fastest-growing in Germany. Since the 2008 financial crisis, their nominal revenue growth has averaged four percent per annum, compared to three percent for large businesses. Micro-businesses are also extremely dynamic. Since 2008, their average productivity growth has been surpassed only by Germany's largest firms (those with at least 250 employees, or turnover greater than €50 million).

However, a lack of finance can inhibit the continued growth of these firms—if, for example, they are unable to make the large investments in capital equipment that would enable them to expand their capacity.

**Perceptions of traditional financing options seem to be influencing the types of external finance that firms use.** The SAFE survey indicates that use of “other” forms of finance has grown considerably among micro-businesses, from one percent in 2015 to almost two percent in 2018, as the uptake of traditional forms of finance has fallen over the same period (see Fig. 39).<sup>35</sup>

**Fig. 39: Growth in external financing use by micro-businesses, by type of finance, 2015 Q1 to 2018 Q3**



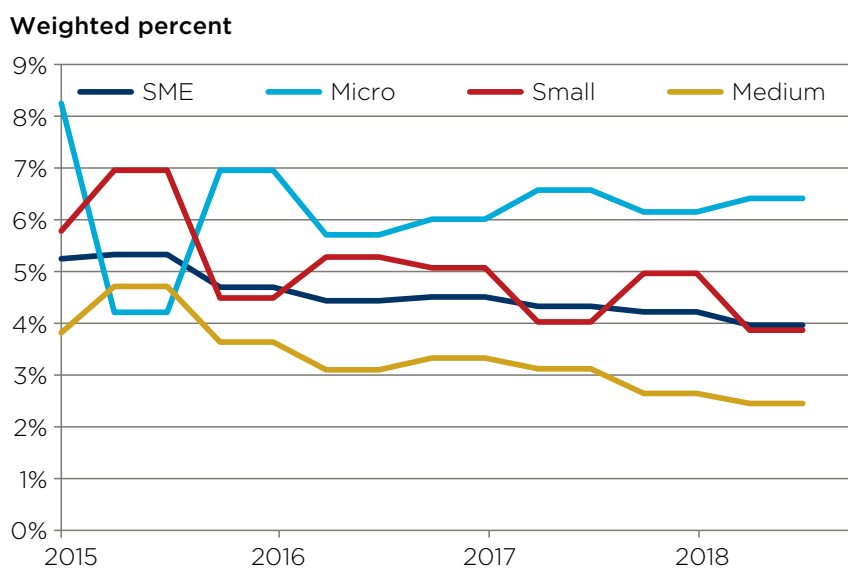
Source: ECB SAFE

**Elevated interest rates may also be influencing the nascent switch to other forms of finance among micro-firms.**

While small and medium-sized German businesses have

reported easing of interest rates over recent years, charges for micro-businesses have remained comparatively elevated across all types of funding (see Fig. 40).

**Fig. 40: Interest rates charged to SMEs, 2015 Q1 to 2018 Q3<sup>36</sup>**



Source: ECB SAFE

<sup>34</sup> Federal Statistics Office Germany (figures for 2008–2016)

<sup>35</sup> Note ‘other finance’ is defined as in footnote 40.

<sup>36</sup> Weighted percentage



# 12%

Proportion of German micro-businesses that highlighted 'too much paperwork' as the most important factor limiting their ability to access external finance.

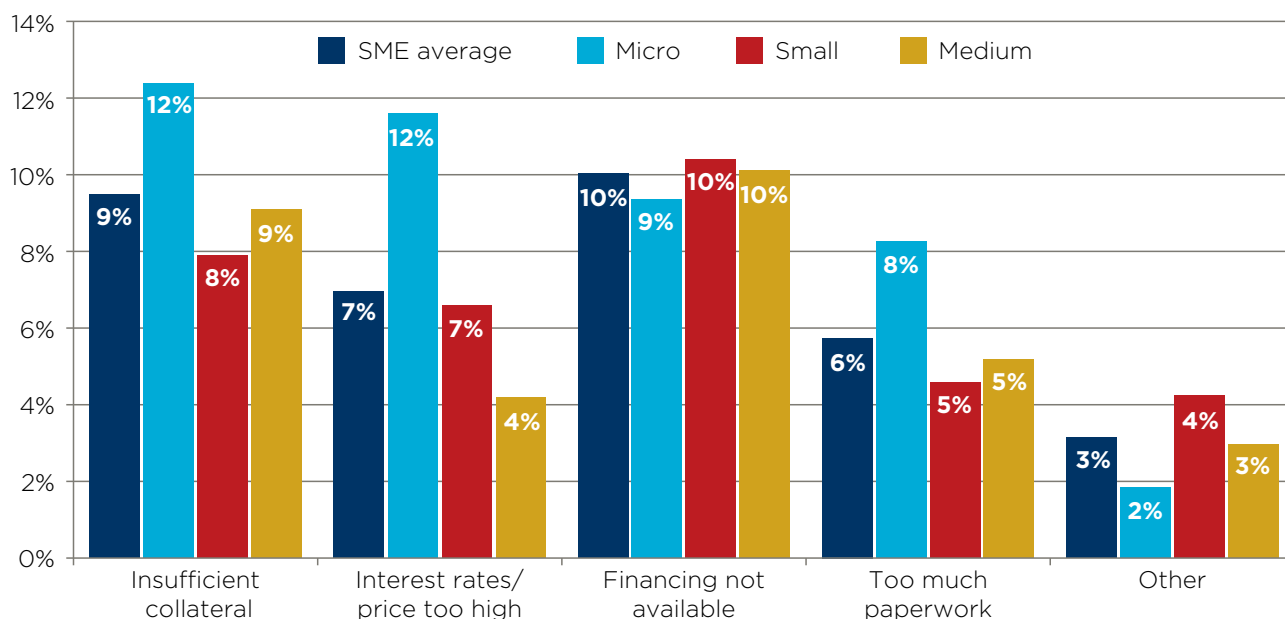
**The SAFE survey also suggests that micro-businesses feel onerous application procedures and substantial collateral requirements limit their access to external finance.**

Some 12 percent of the German micro-businesses interviewed reported "too much paperwork" as the most important factor limiting their ability to access external finance, compared with five and seven percent in Italy and France, respectively.<sup>37</sup> This is also a much higher proportion than for large German firms, whose greater labour resources mean completion of application forms is comparatively less burdensome.

The same percentage of German micro-businesses perceived "insufficient collateral" to be the most important factor in limiting their access to this finance—again, a greater proportion than for their small or medium-sized counterparts (see Fig. 41). Pledging tangible assets as collateral is generally a prerequisite for obtaining a bank loan. Smaller and younger firms tend to have few such assets, inhibiting their capacity to acquire the finance desired. Furthermore, for firms in new digital industries, a lack of physical assets could prove a permanent impediment to obtaining finance.

**Fig. 41: Firms' perceptions of the most important limiting factor to getting external finance, 2018 H1**

Weighted percentage



Source: ECB SAFE

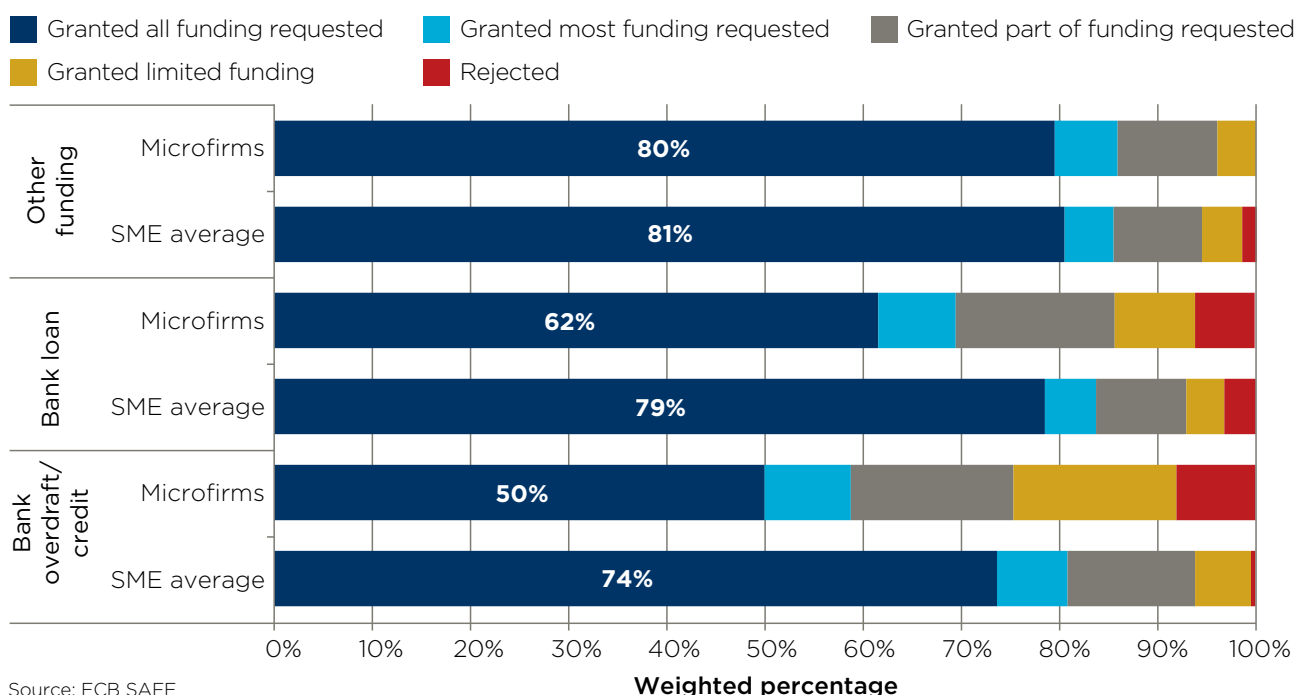
**Not only do micro-businesses face higher requirements, they are also less likely to obtain all their desired financing when applying through a bank.**

Almost 80 percent that applied for other, non-bank funding reported receiving all the credit they requested—a rate comparable to that for all SMEs. In contrast, when applying for traditional forms of finance, micro-businesses are considerably less likely than other SMEs to receive all the finance requested. According to the SAFE survey, while only 20 percent of micro-firms applying for non-bank funding were left with funding gaps, 38 percent were left with a shortfall when applying for bank loans, and 50 percent when applying for credit cards or bank overdrafts (see Fig. 42).

**Onerous applications and collateral requirements, plus a greater likelihood of rejection, may be influencing micro-firms' perceptions of the relevance of traditional bank lending.**

In 2018, only 39 percent considered bank loans relevant to their firm, compared to 48 percent of all SMEs, while less than 50 percent considered credit cards and bank overdrafts relevant (versus 54 percent).<sup>38</sup> Conversely, more micro-firms considered “other” forms of finance relevant to their business, compared with their larger counterparts.<sup>39</sup>

**Fig. 42: Outcome of SMEs' funding applications, 2018 H1<sup>40</sup>**



<sup>38</sup> Specifically, relevance refers to whether firms have used the form of finance in the past or are considering using them in the future.

<sup>39</sup> Other external financing refers to loans from a related company, shareholders or family and friends, leasing, factoring, grants, subordinated debt instruments, participating loans, peer-to-peer lending, crowdfunding, and issuance of equity and debt securities

<sup>40</sup> The results have been adjusted to exclude pending, don't know and refuse to answer options.

## 4.2 FUNDING CIRCLE'S GERMAN LENDING PROFILE

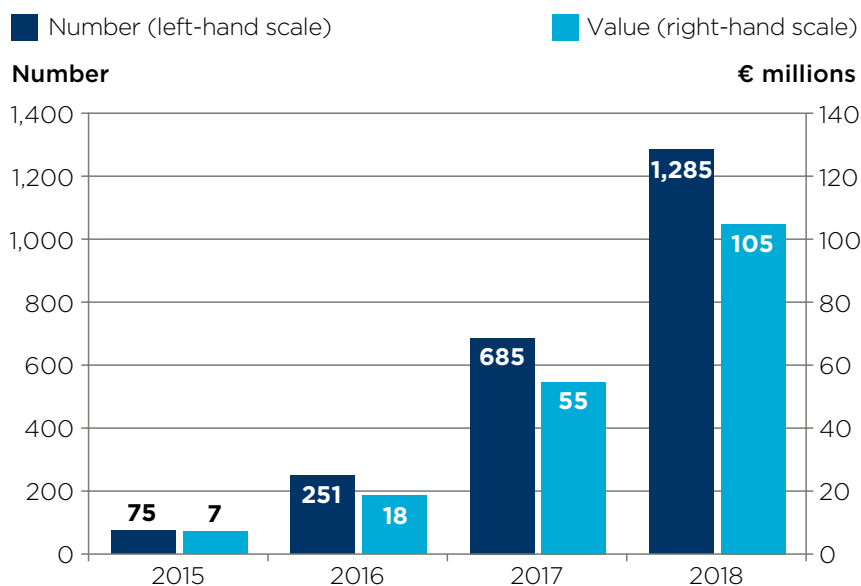
The rapid growth of Funding Circle's German operations continued unabated in 2018, with 1,285 new loans issued through the platform—over 85 percent more than in 2017.<sup>41</sup> The total value of new loans grew even faster, rising by 92 percent year on year (see Fig. 43).

**The size of loans facilitated by Funding Circle, ranging from €5,000 to €250,000, is particularly relevant to SMEs.**

Data from the ECB's SAFE survey indicates that some 86 percent of micro-businesses and 69 percent of small firms would require external finance of less than €250,000 to meet their growth targets for the next two years. In 2018, according to a revenue-based definition of business size, 77 percent of new loans issued through Funding Circle were to micro-businesses, and almost 22 percent were to small businesses (see Fig. 44).<sup>42</sup>

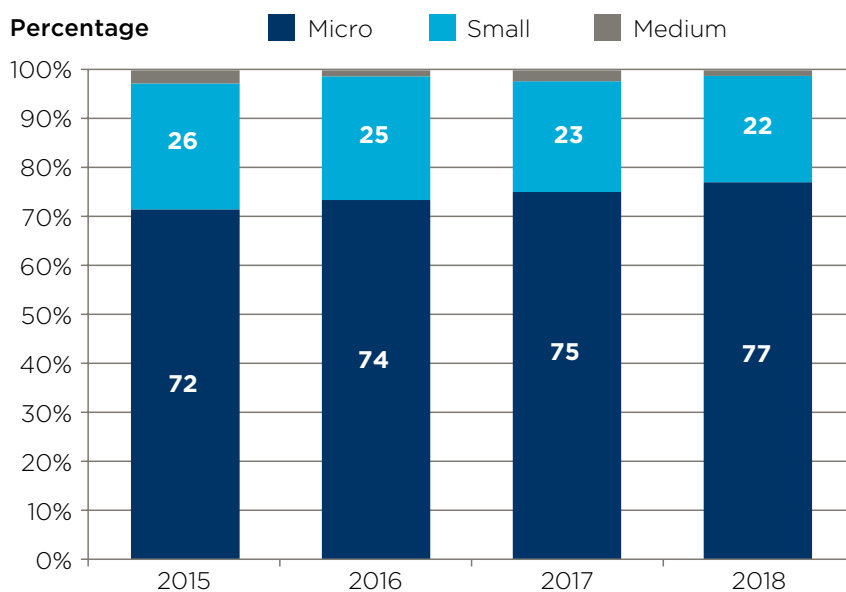
Loans to micro-firms are typically smaller than those to small or medium-sized businesses. However, since 2015, the proportion of lending through Funding Circle in Germany that goes to micro-businesses has grown—from 59 percent of total book value in 2015 to 67 percent in 2018, potentially reflecting the greater difficulties that micro-businesses face in accessing traditional forms of finance.

**Fig. 43: Number and value of loans issued through Funding Circle to German businesses**



Source: Funding Circle

**Fig. 44: Breakdown of loans issued to SMEs by firm size, 2015-2018<sup>43</sup>**



Source: Funding Circle

<sup>41</sup> Our loans under management calculations do not consider loans that were originated before Funding Circle acquired the business in Germany.

<sup>42</sup> For Funding Circle's entire loan book, business size is defined on a turnover basis rather than employment. Data from Funding Circle's loan book is categorised according to the ECB firm size definitions; micro less than €2 million, small less than €10 million, medium less than €50 million.

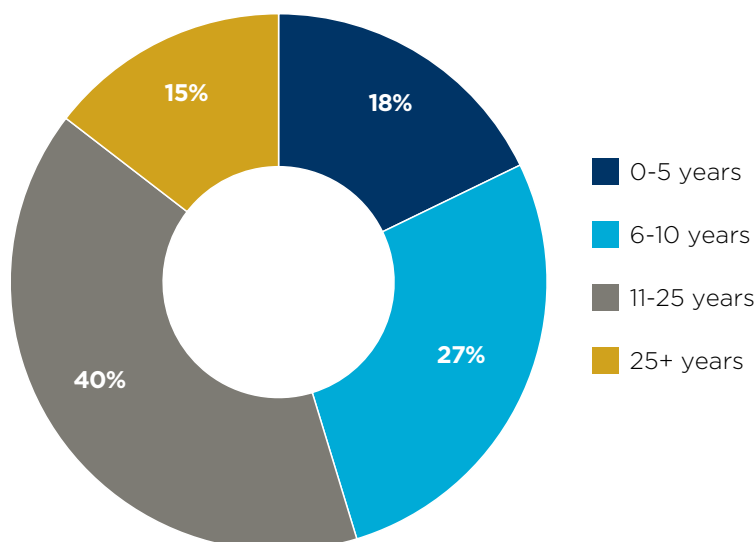
<sup>43</sup> Size categories are determined using firm revenues, not employees. In 2018, revenue figures were available for 1,181 of 1,285 loans issued, so percentages are based on this lower number.

A significant share of the new loans extended through Funding Circle in 2018 went to relatively young firms. Some 18 percent were aged five years or less, while another 27 percent were between six and 10 years old (see Fig. 45).

**Funding Circle's investors lend to businesses in almost all sectors of the German economy.**

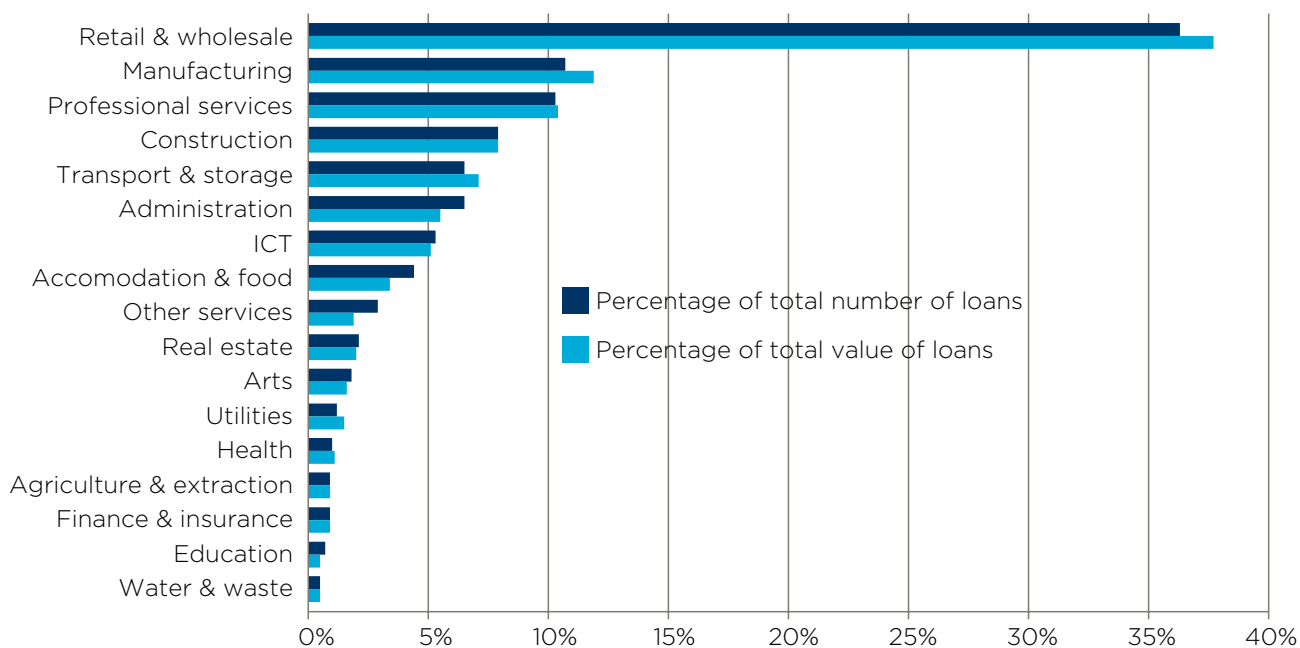
In 2018, 36 percent of new lending was to businesses in the retail & wholesale sector, and 10 percent to the professional services sector (see Fig. 46). In all, 55 percent of the new loans extended through the platform in 2018 went to companies in Germany's five fastest-growing sectors: ICT, health, retail & wholesale, construction, and transport & storage.<sup>44</sup>

**Fig. 45: Age of firms at point of Funding Circle loan origination, 2018**



Source: Funding Circle

**Fig. 46: Proportion of new loans and loan value through Funding Circle by sector, 2018**



Source: Funding Circle

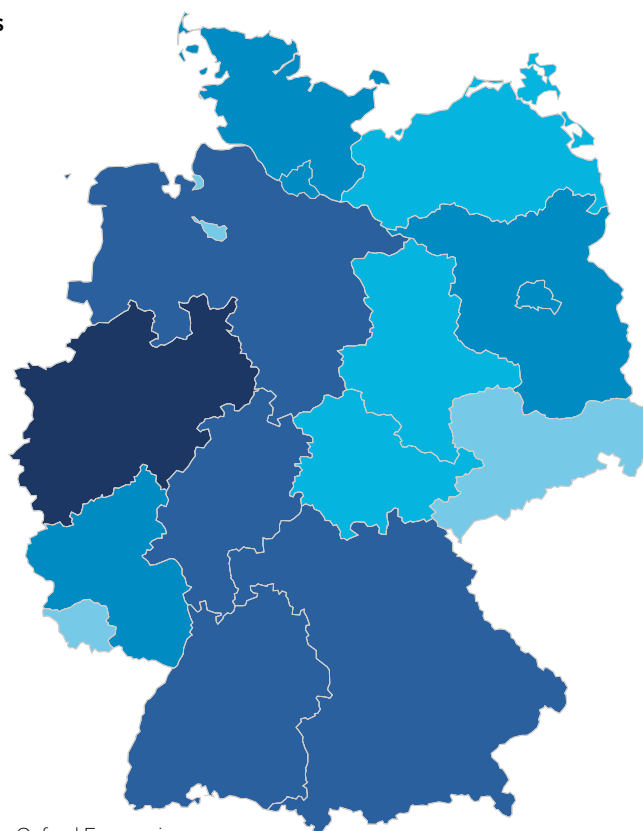
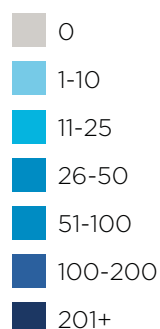
<sup>44</sup> Projected growth rates are calculated for the period 2018-2028 using Oxford Economics' Industry model.



As Fig. 47 illustrates, Funding Circle investors also lend to SMEs based all over the country. In 2018, the largest number of new loans went to Berlin-based businesses, with Hamburg a close second.

**Fig. 47: Locations of businesses taking out new loans through Funding Circle, 2018**

Number of loans



Source: Funding Circle; Oxford Economics

#### 4.3 WHAT IS FUNDING CIRCLE'S FULL ECONOMIC IMPACT IN GERMANY?

**We calculate that loans under Funding Circle management at the end of 2018 *directly* contributed €128 million to Germany's GDP, and supported 1,700 full-time jobs.** The direct gross value added contribution of all 1,700 German clients was found to be €3.7 billion—of which 6.2 percent, or €128 million, can be attributed to the Funding Circle platform. This contribution also supported 1,700 jobs, and stimulated €51 million of taxation for the German Exchequer.

**However, these firms trigger additional economic activity through their purchases of goods and services from domestic businesses, and through the wage-financed consumption spending of their employees.** As with our direct impact calculation, a proportion of the firms' wider economic impact is credited to lending provided through Funding Circle.

In 2018, businesses accessing finance through Funding Circle spent €1.1 billion in

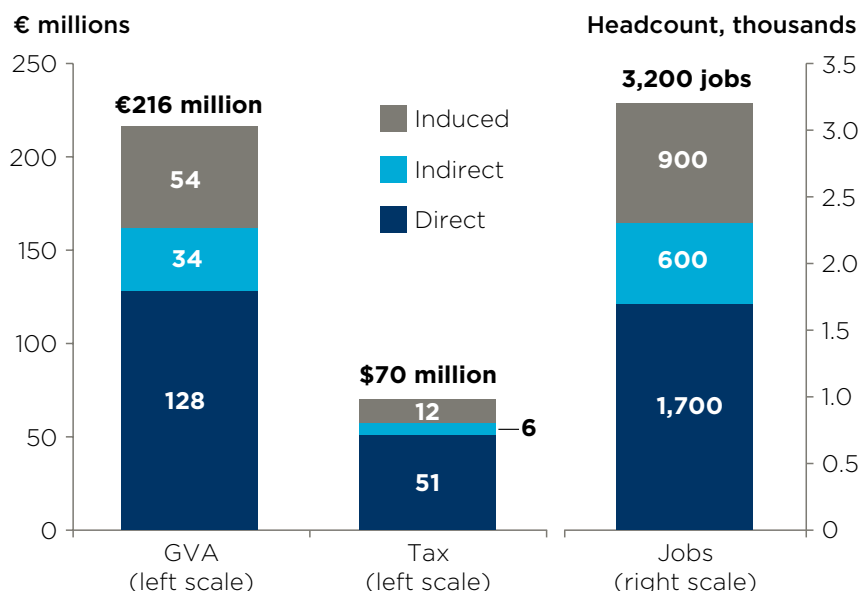
their supply chain, of which some €46 million can be apportioned to Funding Circle. This expenditure is estimated to have supported an indirect economic footprint of €34 million, 600 jobs, and more than €6 million in tax revenues. In addition, the payment of wages by Funding Circle's clients, and the firms in their supply chains, sustained a further €54 million induced contribution to GDP, nearly 900 jobs, and over €12 million in tax revenues.

Summing these three channels of impact, we find that

**Funding Circle supported a total contribution to German GDP of €216 million in 2018, and 3,200 jobs** (see Fig. 48). The €70 million of tax revenues it enabled could finance the salaries of over 1,000 experienced secondary school teachers.

**Funding Circle's economic impact has thus increased significantly since 2017.** The platform's contribution to Germany's GDP has more than doubled from €105 million in 2017 to €216 million in 2018, in real terms.<sup>45</sup> The employment it supports has grown by over 85 percent, from 1,700 to 3,200 jobs.

**Fig. 48: Total economic impact of Funding Circle in Germany, 2018<sup>45</sup>**



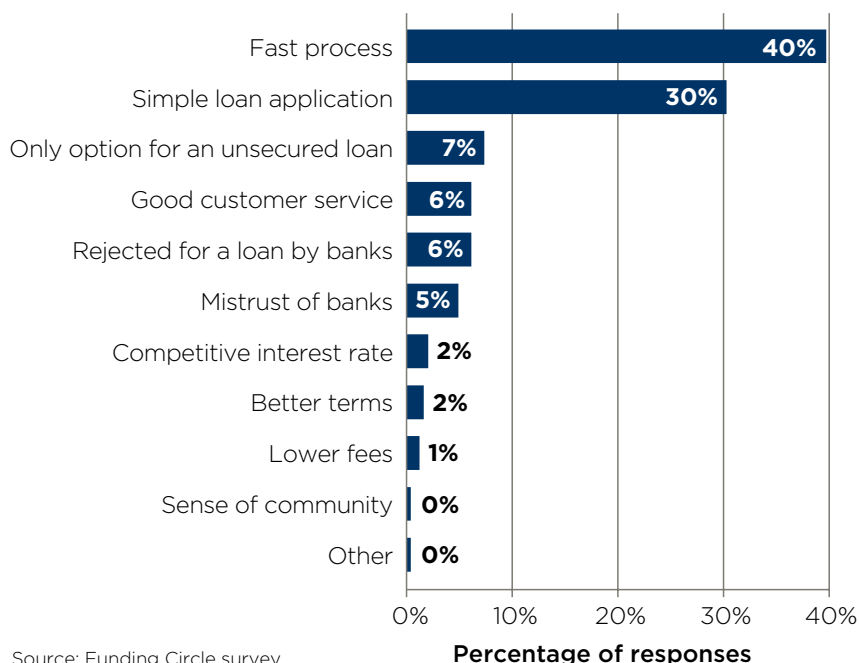
Source: Oxford Economics

#### 4.4 WHY DO SMALL BUSINESSES USE FUNDING CIRCLE?

**Customers continue to value the speed and ease of the application process.** The

majority of German Funding Circle clients surveyed (70 percent) reported that either the *swiftness* or *simplicity* of applying was their main reason for choosing the platform (see Fig. 49). A further seven percent reported that Funding Circle was their only mechanism for receiving an unsecured loan, up from six percent in 2017.

**Fig. 49: Reasons that businesses borrow with Funding Circle**



Source: Funding Circle survey

<sup>45</sup> Totals may not sum due to rounding.

<sup>46</sup> Figures for 2017 are expressed in 2018 prices for comparability

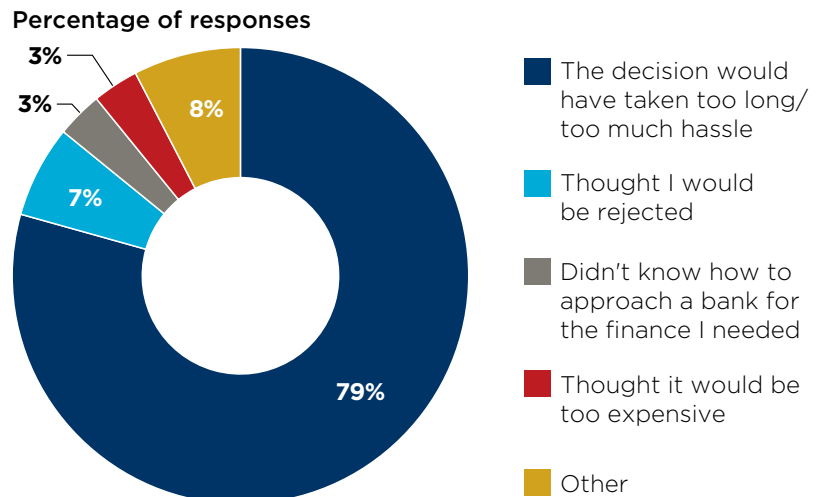
**The inconvenience of bank application processes remains a major deterrent to using bank financing.**

Some 75 percent of the firms said they chose to approach Funding Circle first over a traditional bank (a slight rise compared with 2017), with almost 80 percent citing long and inconvenient bank applications as the major deterrent (see Fig. 50).

Of the 25 percent of businesses that had applied to a bank before approaching Funding Circle, 60 percent reported suspending their applications due to the length and complexity of the process, a figure virtually unchanged from 2017.

The perception that bank processes are lengthier is confirmed by the small businesses' reported

**Fig. 50: Reasons for not approaching a bank first**

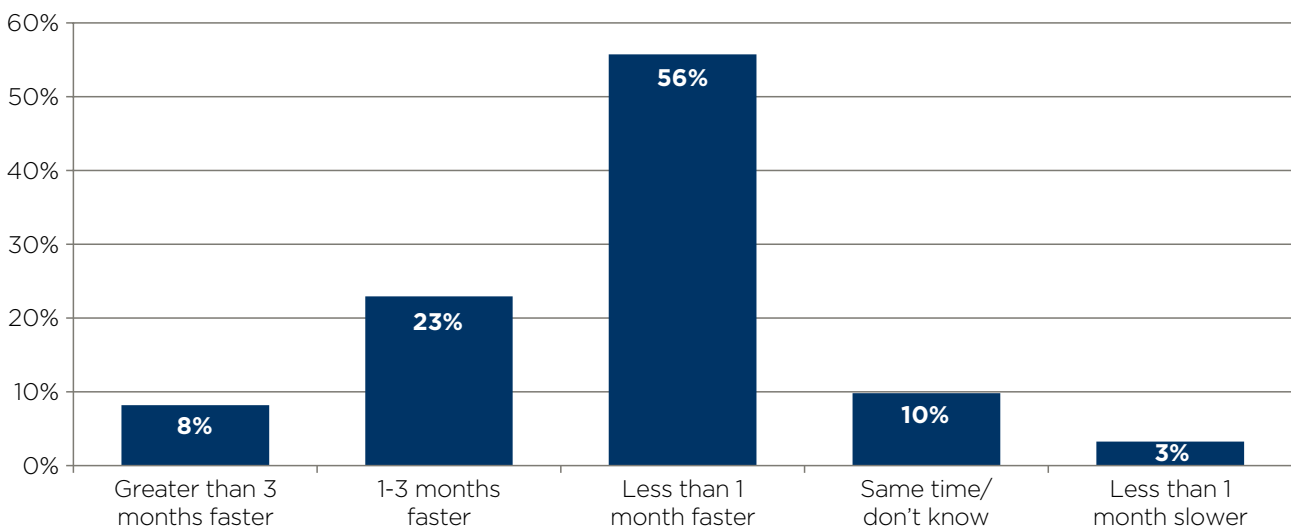


Source: Funding Circle survey

experiences. Some 87 percent of those that had first applied for a bank loan said they found Funding Circle to be faster, with over 30 percent reporting that its application process was more than one month quicker (Fig. 51).

**Fig. 51: Perception of Funding Circle process time compared with banks**

Percentage of respondents



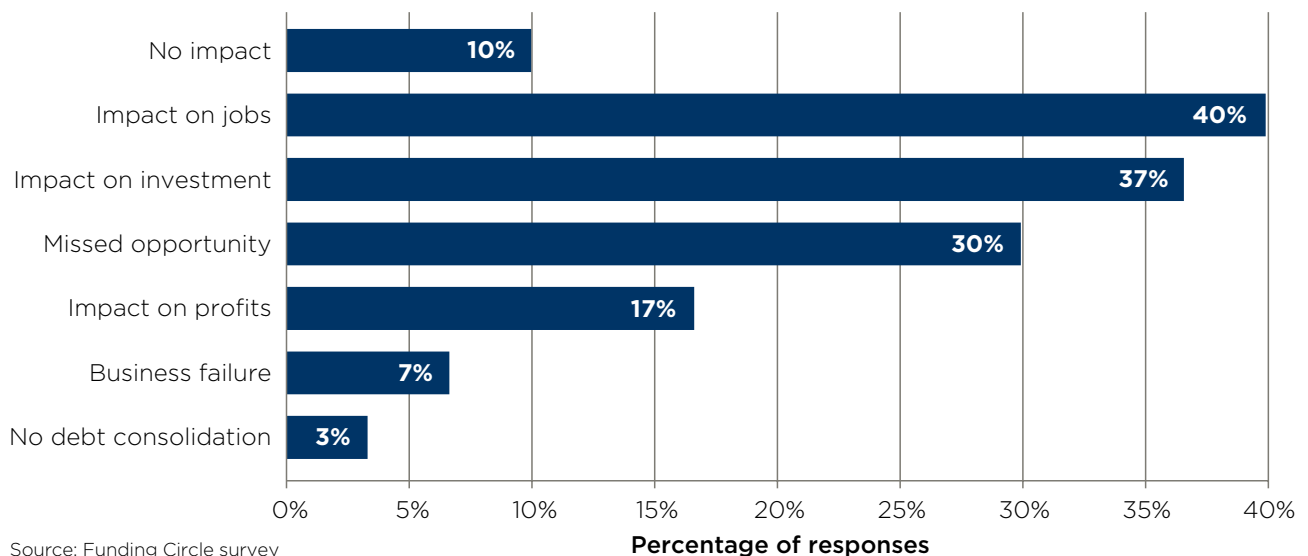
Source: Funding Circle survey

**Funding Circle customers also said that an inability to access finance would be detrimental to their business prospects.**

Those responding to this question were most concerned by the impact on jobs and investment of not receiving funding, and the potential for opportunities to be missed (see Fig. 52).

In the absence of Funding Circle, most small businesses would therefore have applied for other forms of finance. Their perception of the likelihood of obtaining other finance, however, varied considerably by firm size. Of the smallest firms (0-9 employees), 40 percent viewed it as unlikely or very unlikely that they would have been able to access this finance, compared to 30 percent for small firms (10-49 employees), and 20 percent for medium firms (50-249 employees).

**Fig. 52: Perception of impact of not receiving funding<sup>47</sup>**



<sup>47</sup> Survey respondents were able to pick multiple options from this list.



# CASE STUDY: MANNA FOOD

Konstantinos Chatziantoniadis has always been passionate about the Greek food he grew up eating. Along with his three brothers—and the assistance of Funding Circle—he has used that passion to build a thriving business in his adopted home city of Stuttgart.

When Konstantinos moved to southern Germany to study, his family moved too—but their Greek roots were never far from their thoughts. In 2012, they started a food import business, Agrofolio: “I’m a crazy Greek,” Konstantinos recalls. “I just went into the supermarkets and said I wanted to sell them some products.”

The business was immediately popular—to the extent that people would visit the Agrofolio warehouse to buy the Greek delicacies direct. This prompted the family to open their own Greek supermarket in Bad Cannstatt, one of the oldest districts of Stuttgart. Manna Food opened in November in 2014, offering an array of Greek culinary delights, as well as products from the Balkans, Russia, and Germany.

But growth and popularity create new challenges for small businesses, and last year they reached another crucial point in the story. Growth was being limited by the need to pay upfront for all the Greek products they import. “We needed a loan to expand our range

of goods, and also to provide us with more storage capacity,” Konstantinos explains. He was, however, unwilling to seek that funding from a traditional bank. “My past experiences told me everything takes much longer with bank credit. Also, the banks demand more security.”

Instead, he turned to Funding Circle. “I received a flyer, I called them, and everything happened very fast. I guess it was destiny to work with Funding Circle—some things just happen.”

The loan was secured at the beginning of 2018. Konstantinos says it only took a week to arrange, and that the impact on the business was almost immediate. “Given the opportunity to import more products, we very soon increased our turnover and profits. Last year we saw an increase of almost 20 percent over 2017, and 2019 will be even better.”

Konstantinos likes the fact that the Funding Circle model includes private individuals providing capital. “I think banks are conservative; they have certain rules, and everyone who works at a bank needs to comply with those rules. Whereas most people who invest in Funding Circle are business people, and they work for companies that are expanding themselves.”







## 5. THE NETHERLANDS

### 5.1 SMALL BUSINESSES' ACCESS TO FINANCE

**Bank lending to non-financial businesses continued to fall in the Netherlands in 2018.** Data from De Nederlandsche Bank (DNB) show that, while there were brief signs of growth in early 2018, the value of loans granted by Netherlands-based banks to non-financial firms in December 2018 was 2.1 percent lower than a year earlier.<sup>48</sup>

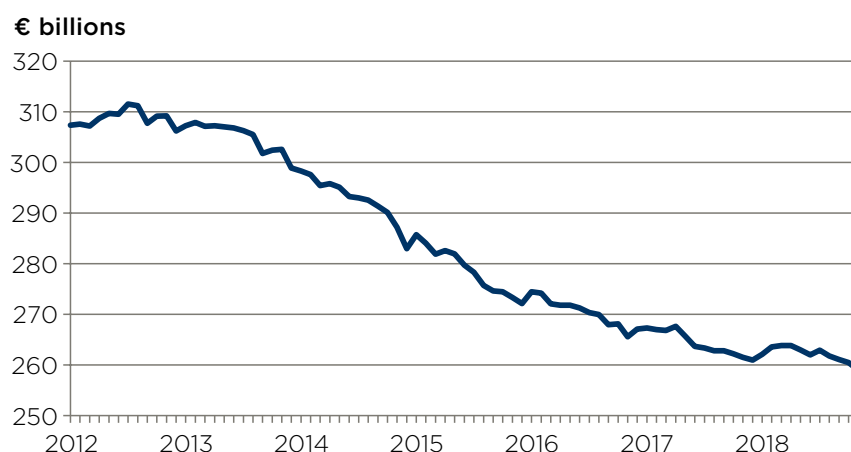
This follows a pattern of steady decline, with lending to non-financial institutions falling 18 percent in value between the recent peak in July 2012 and December 2018 (see Fig. 53). Last December's €255 billion of outstanding bank loans to non-financial businesses was, indeed, the lowest monthly value experienced in the Netherlands since the middle of the financial crisis.

# 18%

Decrease in the value of bank lending to non-financial institutions between July 2012 and December 2018.

*Last December's value was the lowest since the middle of the financial crisis.*

**Fig. 53: Outstanding bank loans to non-financial businesses, January 2012 to November 2018**

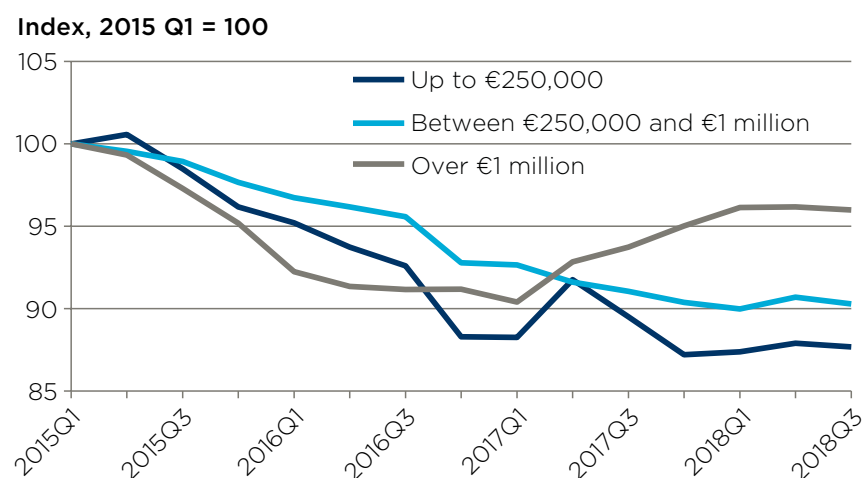


Source: DNB

**The situation is hardest for firms applying for smaller loans.** The value of outstanding loans under €250,000 issued to Dutch SMEs by the three major banks fell by 12 percent between 2015 Q1 and 2018 Q3 (see Fig. 54).<sup>49,50</sup> The value of loans between €250,000 and €1 million fell by 10 percent

over the same period, while the equivalent decline of larger loans, worth over €1 million, was just four percent. This is particularly concerning for SMEs with finance needs under €250,000, as they have suffered the most from the contraction of bank loans in recent years.

**Fig. 54: Outstanding bank loans to SMEs from the three major Dutch banks, by size of loan, 2015 Q1 to 2018 Q3**



Source: DNB

<sup>48</sup> De Nederlandsche Bank, *Key indicators monetary statistics* – January 2019.

<sup>49</sup> SMEs are defined here, and in any subsequent De Nederlandsche Bank data, as firms with turnover below EUR 50 million, while large enterprises are classed as those with turnover above this threshold.

<sup>50</sup> De Nederlandsche Bank, *Lending by Dutch large banks to the Dutch SME sector* – January 2019.



**Dutch banks have still not reversed the deterioration in terms offered to small and medium-sized firms, relative to larger firms, that was evident in the first half of the decade.** Prior to mid-2015, the ECB's Bank Lending Survey suggested the banks frequently increased their interest rate margins (the difference between the interest they charge customers and the rate they borrow at themselves) on loans to SMEs, while their margins on loans to large enterprises were falling (see Fig. 55). Since then, broad parity in these margins means that SMEs in the Netherlands are still no better off, relatively speaking.

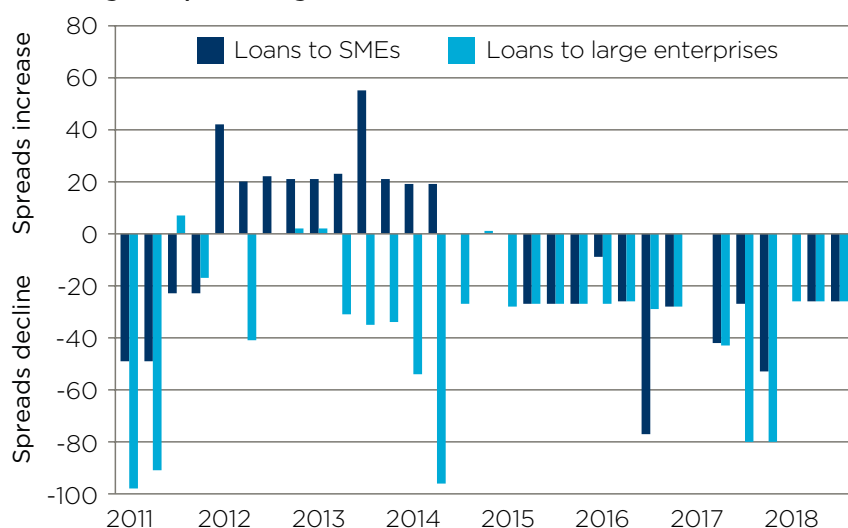
**An increasing number of Dutch SMEs report that bank loans are not relevant to them.**

According to the ECB's Survey on the Access to Finance of Enterprises (SAFE), in 2018 H1, 83 percent of the SMEs that regarded bank loans as "irrelevant" said this was because they did not need them as a source of finance. This is a marked increase on the 72 percent who said they did not need bank loans as a source of finance in the second half of 2015, suggesting there has been a movement away from traditional financing sources to alternative sources of funding, such as online lending platforms or crowdfunding, in this period.

The equivalent EU-wide average in 2018 H1 was 76 percent, **suggesting that Dutch SMEs have moved away**

**Fig. 55: Trend in banks' margins on average loans, Apr 2011-Oct 2018**

Net weighted percentages

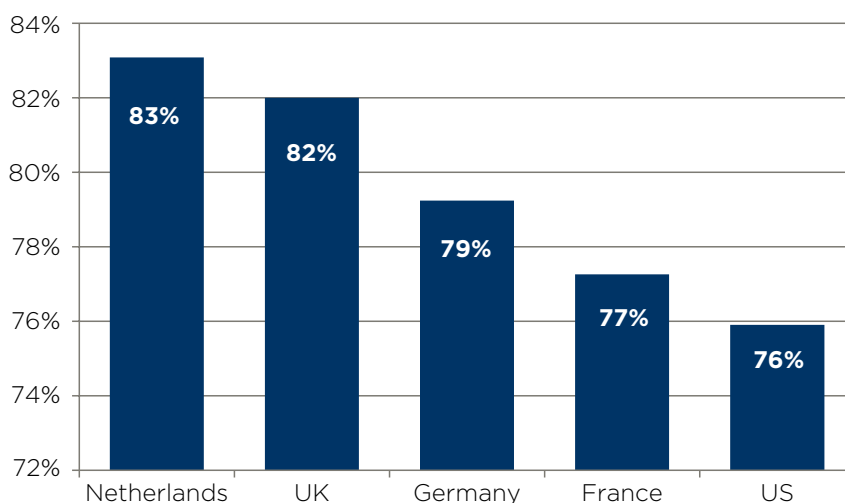


Source: DNB

**from traditional bank loans to a greater extent than their European counterparts** (see Fig. 56). The equivalent figures for the comparable economies of the UK and Germany were 82 percent and 79 percent, respectively.

**“Dutch SMEs appear to have moved away from traditional bank loans to a greater extent than their European counterparts.”**

**Fig. 56: Proportion of SMEs describing bank loans as irrelevant because they do not need them as source of finance, 2018 H1**



Source: ECB SAFE



**Against this backdrop of falling bank lending to small firms and a growing feeling that bank loans are not relevant to them, many Dutch SMEs are showing increased demand for other forms of external finance.**

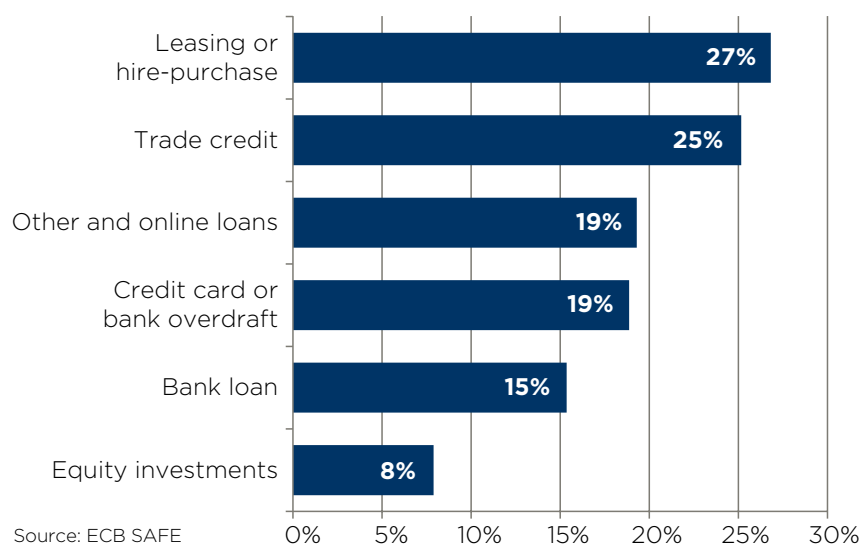
In 2018 H1, some 27 percent of those surveyed for SAFE reported a greater demand for leasing or hire-purchases, 25 percent for trade credit, and 19 percent for other types of loans, including online lending. All three ranked above the share of firms wanting more bank loans (see Fig. 57).

Similarly, evidence from the Dutch Financieringsmonitor report suggests that 36 percent of SMEs would seek funding from alternative sources in the future.<sup>51</sup>

**“For SMEs seeking credit, the rapid expansion of online lending platforms has been a significant benefit, reducing their dependence on bank finance in particular.”**

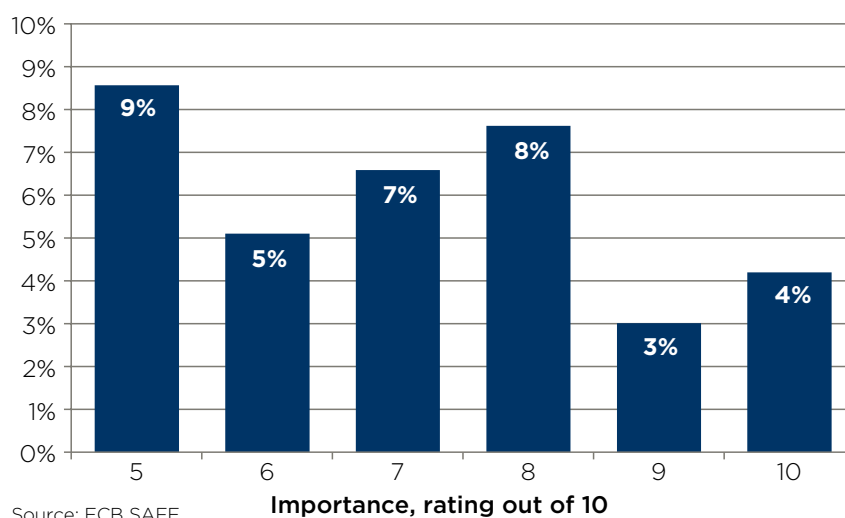
**This widely reported increase in demand for credit suggests access to finance is an important issue for many Dutch SMEs.** According to SAFE, 27 percent of Dutch SMEs rated the issue at least six out of 10 on a scale of importance, when considering the problems facing their businesses in the past six months. Of these, four percent felt that access to finance was an extremely important problem for them, rating it 10 out of 10 (see Fig. 58).

**Fig. 57: Firms reporting increased demand for external finance in the Netherlands, by type, 2018 H1**



For those SMEs seeking credit, the rapid expansion of online lending platforms has been a significant benefit—offering small firms greater choice, and the ability to reduce their dependence on bank finance in particular.

**Fig. 58: Importance of access to finance as an issue facing Dutch SMEs in the past six months, 2018 H1**



## 5.2 FUNDING CIRCLE'S NETHERLANDS LENDING PROFILE

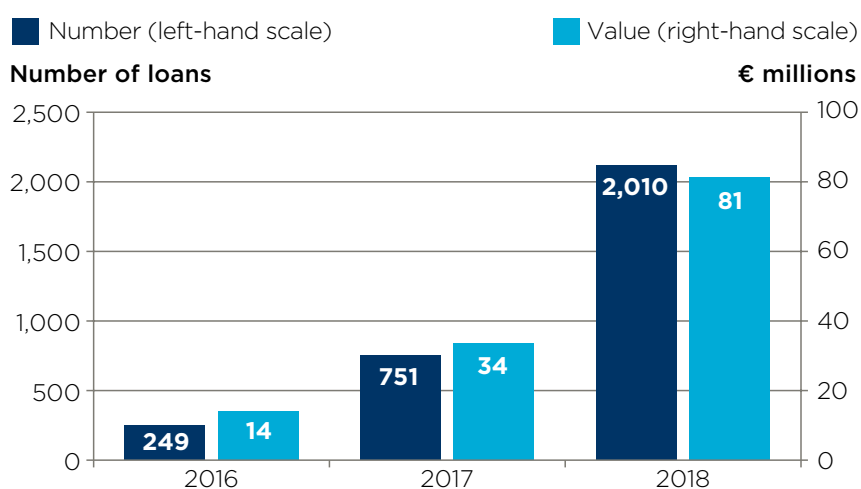
### Lending through Funding Circle in the Netherlands grew rapidly in 2018.

Some 2,120 new loans were issued, nearly three times the number issued in 2017 (see Fig. 59).<sup>52</sup> These new loans had a total value of €81 million, almost two-and-a-half times greater than the value of loans issued the previous year. The average value of a loan issued via Funding Circle in 2018 was €38,300.

### Loans through Funding Circle were issued to Dutch businesses across all types of industry in 2018.

Some 27 percent of the total loan value was extended to businesses operating in the wholesale & retail trade sector (see Fig. 60). The professional, scientific, & technical service

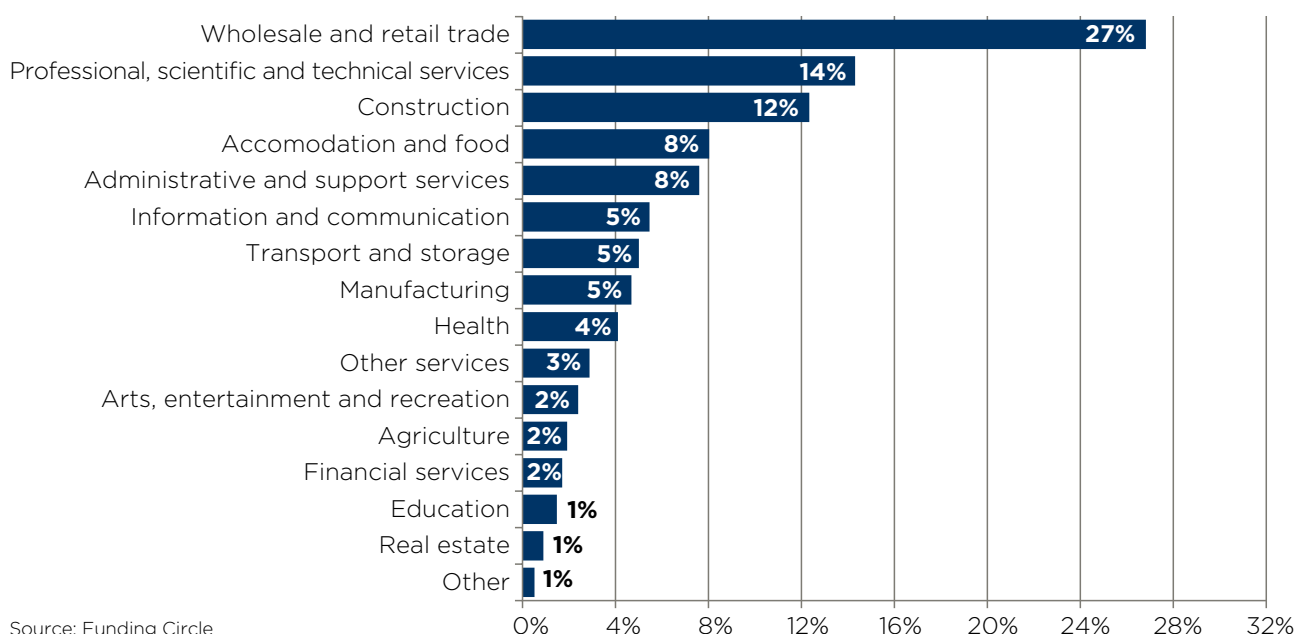
**Fig. 59: New Funding Circle business loans issued, by year**



Source: Funding Circle

sector received 14 percent of the total loan value, while a further 12 percent was issued to Dutch construction firms. The remaining funds were spread across a diverse range of other sectors.

**Fig. 60: Share of total value of new lending through Funding Circle in 2018, by sector<sup>53</sup>**



Source: Funding Circle

<sup>52</sup> Our loans under management calculations do not consider loans that were originated before Funding Circle acquired businesses in the Netherlands.

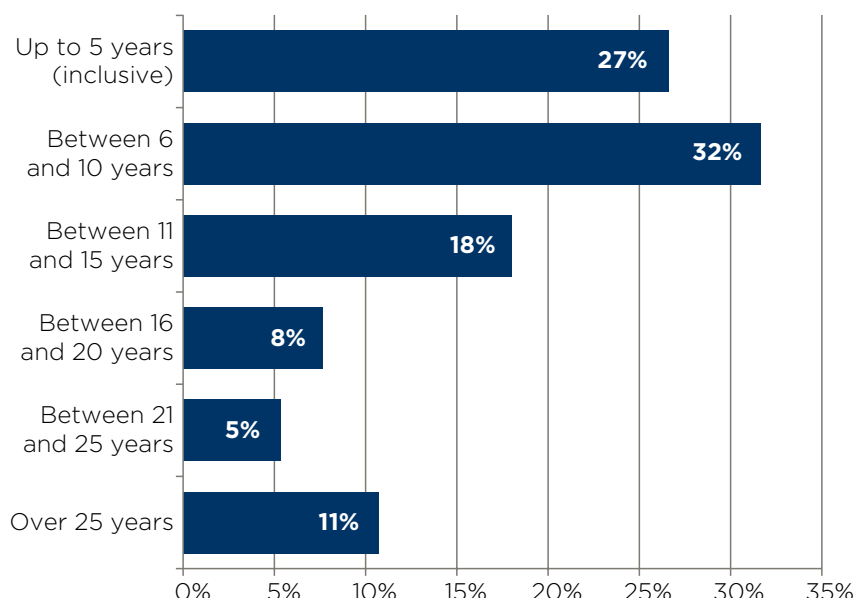
<sup>53</sup> 'Other' includes all other sectors that received at least some finances from Funding Circle: water supply & waste management; electricity & gas; and mining & quarrying.

**Funding Circle helps growing firms meet their financial needs.**

Some 27 percent of the value of new loans it facilitated in 2018 was given to businesses aged up to five years (see Fig. 61). These firms are at an important stage of the financial growth cycle; they are likely to have the fewest options for acquiring external finance, often having to rely on “insider” finance (via family or friends), or trade credit.

A further 32 percent of the total value of new loans was issued via Funding Circle to Dutch businesses aged between six and 10 years. Businesses aged 11 to 15 years received 18 percent of the total value in 2018.

**Fig. 61: Value of new lending through Funding Circle in 2018, by age of recipient**

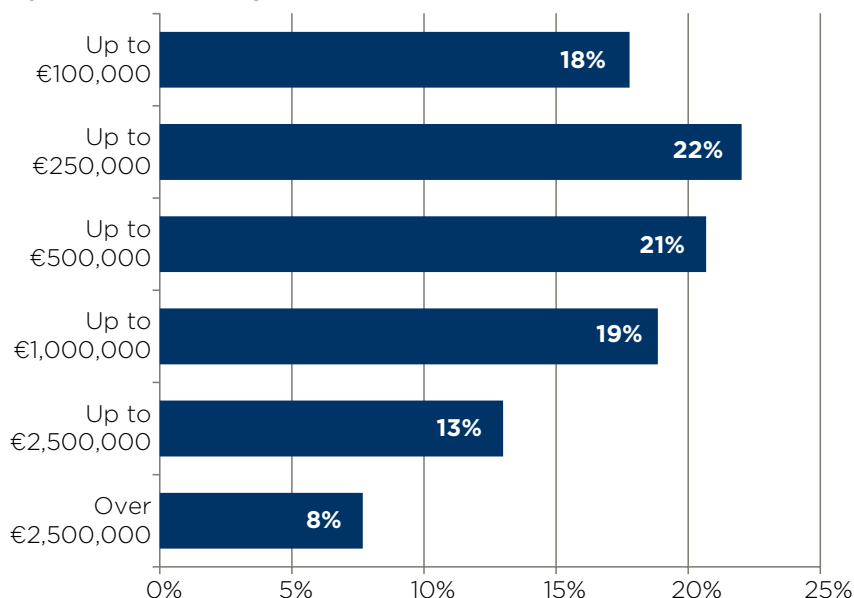


Source: Funding Circle

**The majority of new loans issued through Funding Circle in 2018 went to small Dutch businesses with revenues below €500,000.**

Some 18 percent of the total value of new loans was issued to firms with revenues below €100,000, while a further 22 percent was granted to businesses with revenues between €100,000 and €250,000 (see Fig. 62). Another 21 percent of the total value of new loans was extended to Dutch firms with revenues between €250,000 and €500,000.

**Fig. 62: Value of new lending through Funding Circle in 2018, by revenue of recipient<sup>54</sup>**



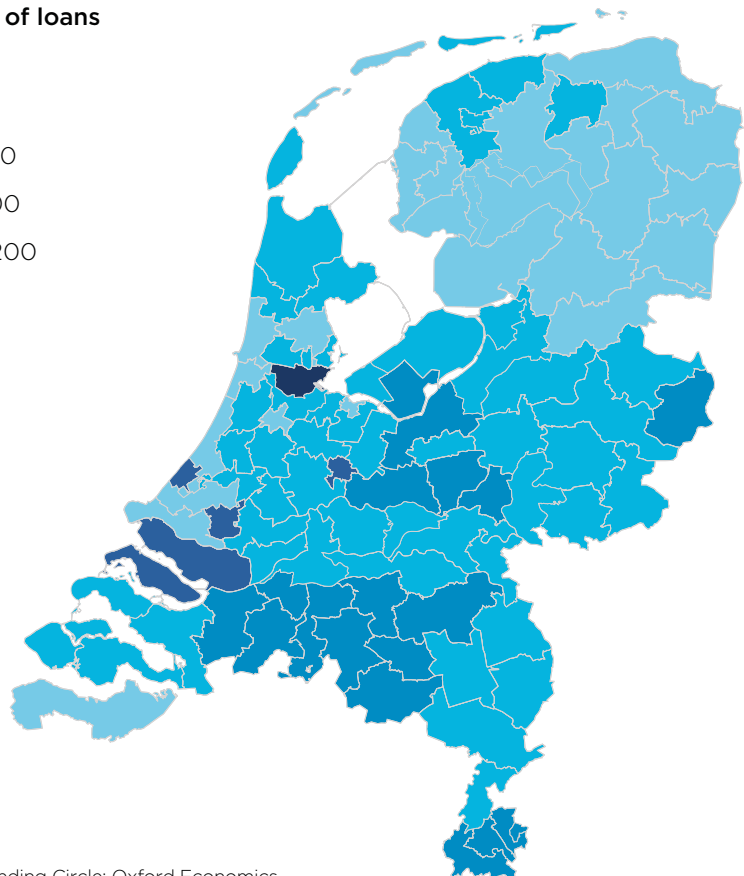
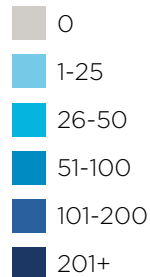
Source: Funding Circle

**Loans managed by Funding Circle were issued throughout all regions of the Netherlands in 2018** (see Fig. 63). Some 10 percent of the total number of new loans was issued to businesses in Amsterdam,

a further eight percent to firms in Rotterdam, followed by Utrecht (six percent) and The Hague (five percent).

**Fig. 63: Locations of businesses taking out new loans through Funding Circle, 2018**

Number of loans



Source: Funding Circle; Oxford Economics

### 5.3 WHAT IS FUNDING CIRCLE'S FULL ECONOMIC IMPACT IN THE NETHERLANDS?

**We estimate that lending through Funding Circle directly contributed €77 million to the Netherlands economy, and supported 1,400 jobs, in 2018.**

Funding Circle's customers at the end of 2018 are found to have made a direct gross value added contribution to the Netherlands' GDP of €1.1 billion. Using Funding Circle's share of these companies' total liabilities (eight percent), we estimate the direct

contribution generated by these loans was €77 million. Furthermore, these loans are estimated to have led to the direct employment of 1,400 people, and supported direct annual tax revenues of €29 million.

**But the economic impact of Funding Circle customers extends far beyond their direct contribution to the Dutch economy.** We also calculate that the indirect

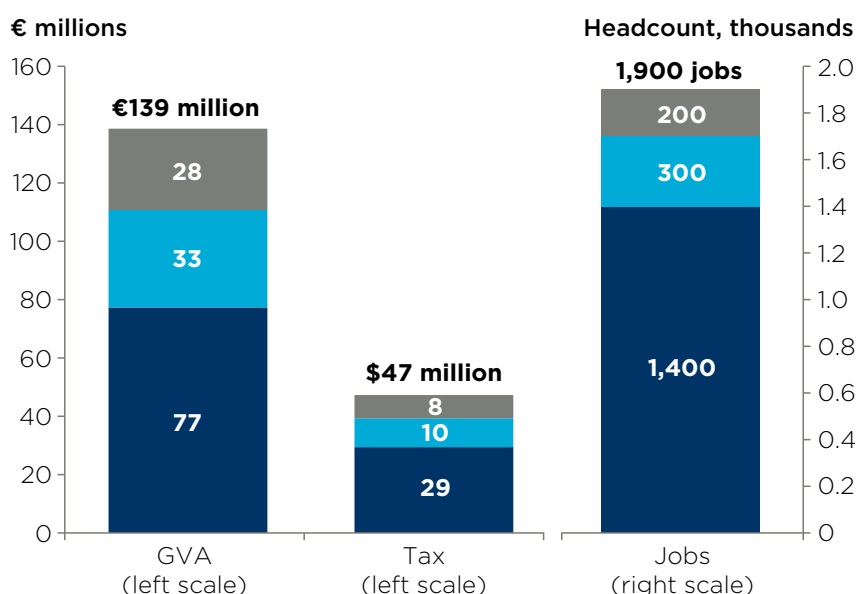
impact of lending through Funding Circle—via customers' spending in their domestic supply chains—supported a €33 million gross value added contribution to the Netherlands' GDP in 2018, and 300 jobs. And the induced impact of this lending enabled a further €28 million contribution to GDP, and 200 jobs. Together, the indirect and induced channels of impact supported €18 million in annual tax revenues.



**Combining all three impacts, we find that loans under Funding Circle management at the end of 2018 made a total contribution to the Netherlands' GDP of €139 million, and supported 1,900 jobs** (see Fig. 64). The economic activity facilitated by this lending also supported €47 million in annual tax revenues—enough to finance the starting salaries of 1,300 primary school teachers across the Netherlands.

**Funding Circle's contribution to the Dutch economy has therefore grown significantly in 2018.** While the value of outstanding loans held by its customers increased from €39 million at the end of 2017 to €95 million at the end of 2018, the economic activity supported by loans under Funding Circle management has also grown rapidly—with the total contribution to GDP increasing by some 109 percent over this period, and the number of jobs supported rising by 125 percent. The tax revenues supported by these loans were 132 percent higher than for the previous year.<sup>55</sup>

**Fig. 64: Total economic impact of Funding Circle in the Netherlands, 2018**

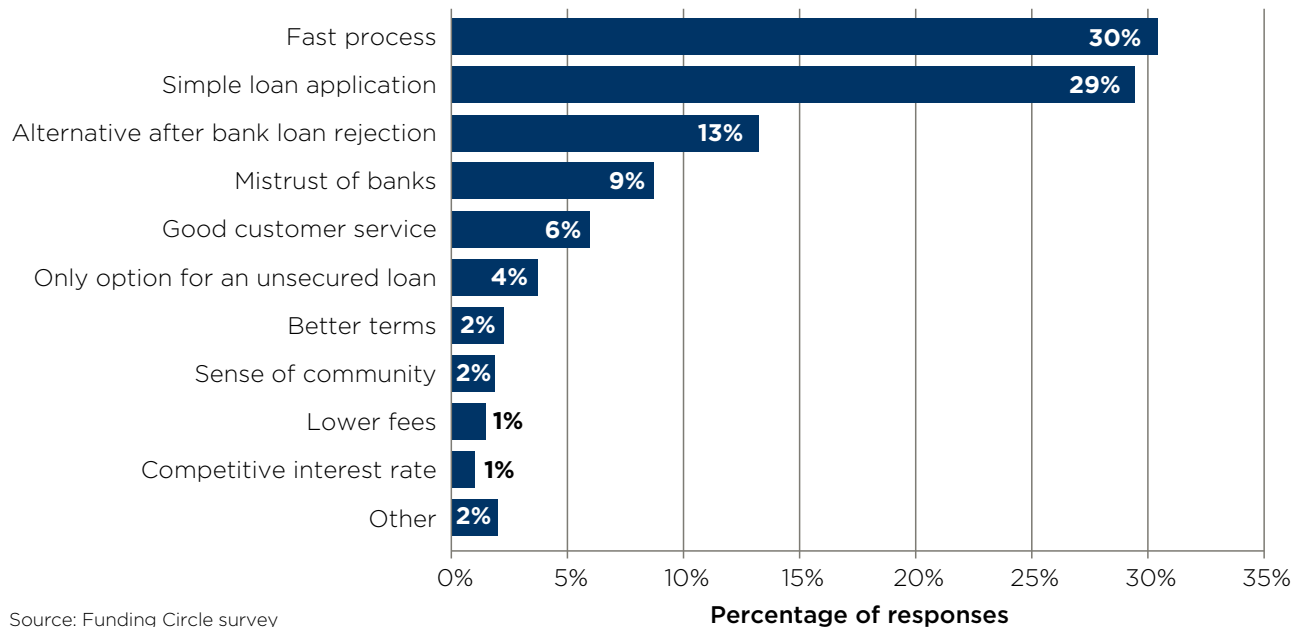


Source: Oxford Economics

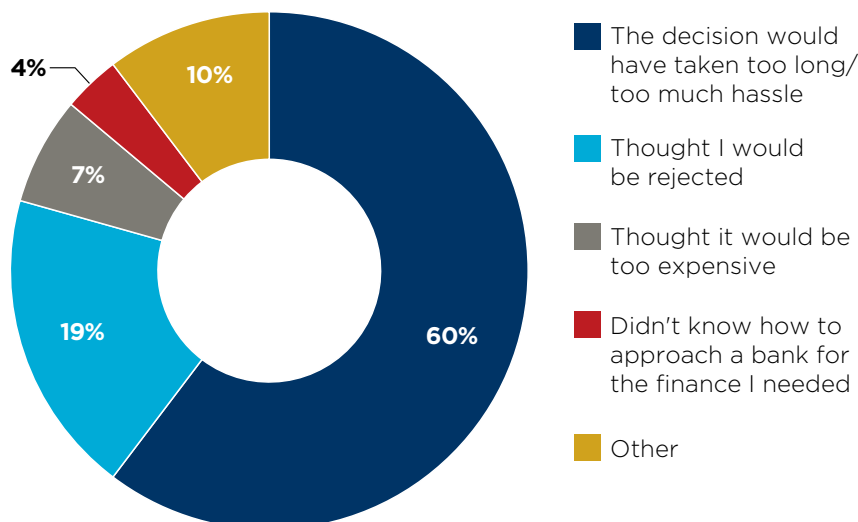
#### 5.4 WHY DO SMALL BUSINESSES USE FUNDING CIRCLE?

**Funding Circle customers are attracted by the fast and simple process for applying and borrowing.** Some 30 percent of the small businesses surveyed said the main reason for borrowing through Funding Circle was the *speed* of the process (see Fig. 65). A further 29 percent cited the *simplicity* of the online loan application as their main reason for using the platform. This highlights the benefits of Funding Circle's tech-enabled approach, which seeks to use digital solutions to improve the borrowing process and provide customers with a more efficient system, compared with traditional sources of finance.

**Customers choose to approach Funding Circle first over other sources of finance.** Some 63 percent of the small firms surveyed said they did not approach a bank before seeking finance through Funding Circle. Of these, 60 percent said they chose not to approach a bank first because the decision would have taken too long, or the process would have been too bothersome (see Fig. 66). A further 19 percent felt their application for a traditional bank loan would have been rejected.

**Fig. 65: Main reason for borrowing through Funding Circle****Fig. 66: Reasons for not attempting to obtain a bank loan before applying for funding through Funding Circle**

Percentage of responses

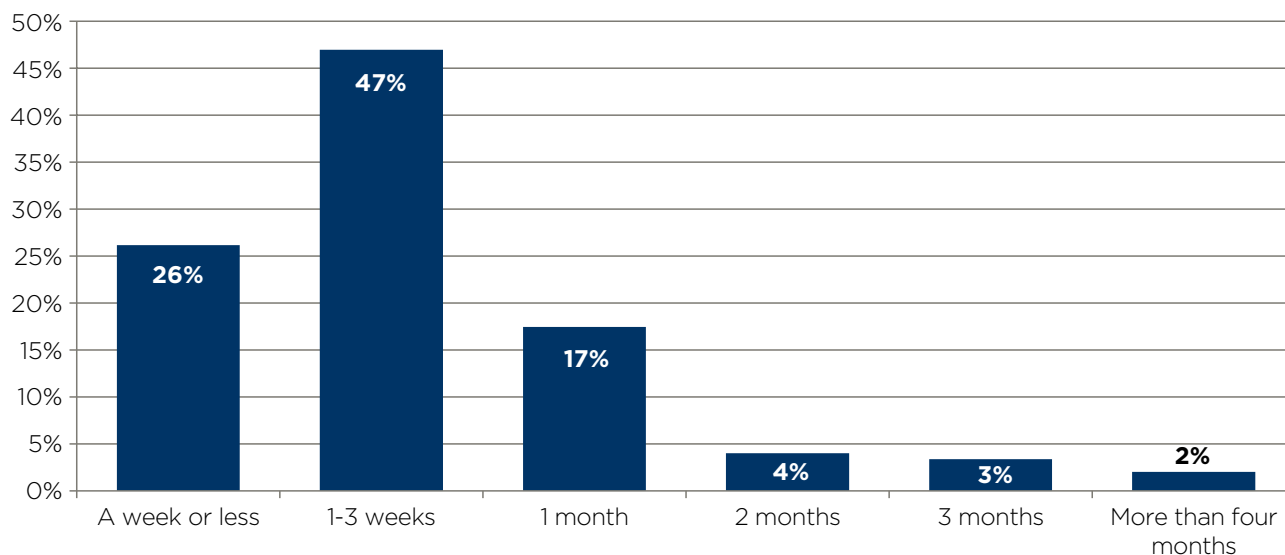


Source: Funding Circle survey

Of the other small businesses that *did* previously attempt to obtain bank loans, some 46 percent had their application rejected. A further 29 percent said they did not complete their application because the process was too complicated, while 17 percent reported not completing their application because the bank was taking too long.

**Fig. 67: How long to receive a decision from the bank?**

Percentage of respondents



Source: Funding Circle survey

**Small businesses have had negative experiences waiting for decisions from the banks.**

Some 47 percent of small businesses who had applied for bank loans reported having to wait between one and three weeks to receive a decision (see Fig. 67). A further 17 percent said they'd had to wait one month for the bank's decision, and nine percent reported having to wait two or more months. The time-cost of waiting for a decision on a bank loan can be a significant drain on small businesses' resources, especially when added to the cost and effort of applying.

**Customers found borrowing through Funding Circle faster than other providers of finance.**

Sixteen percent of the SMEs surveyed said it had been at least one month quicker than other sources of finance, and a further 68 percent reported it was up to one month faster—underlining how Funding Circle's tech-driven approach can be of benefit to small businesses.

**Borrowing through Funding Circle is especially important for smaller businesses, who say they would suffer without it.**

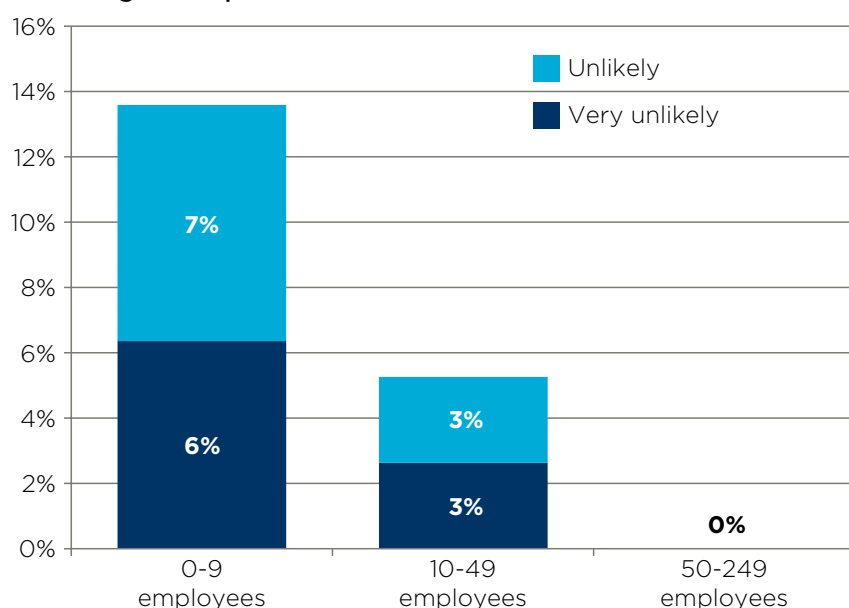
Micro-sized businesses with fewer than 10 employees that borrowed through Funding Circle were particularly concerned about the likelihood of obtaining finance in its absence—with some 14 percent reporting it would be either "very unlikely"

or "unlikely" (see Fig. 68). Five percent of businesses with between 10 and 49 employees were similarly concerned about not being able to access alternative funds.

In Funding Circle's absence, 40 percent of the Dutch small businesses surveyed said they would seek a bank loan, while 34 percent would approach another online lending platform. A further nine percent said they would seek funding from a family member or associate.

**Fig. 68: Likelihood of obtaining finances in Funding Circle's absence, by firms' number of employees<sup>56</sup>**

Percentage of respondents



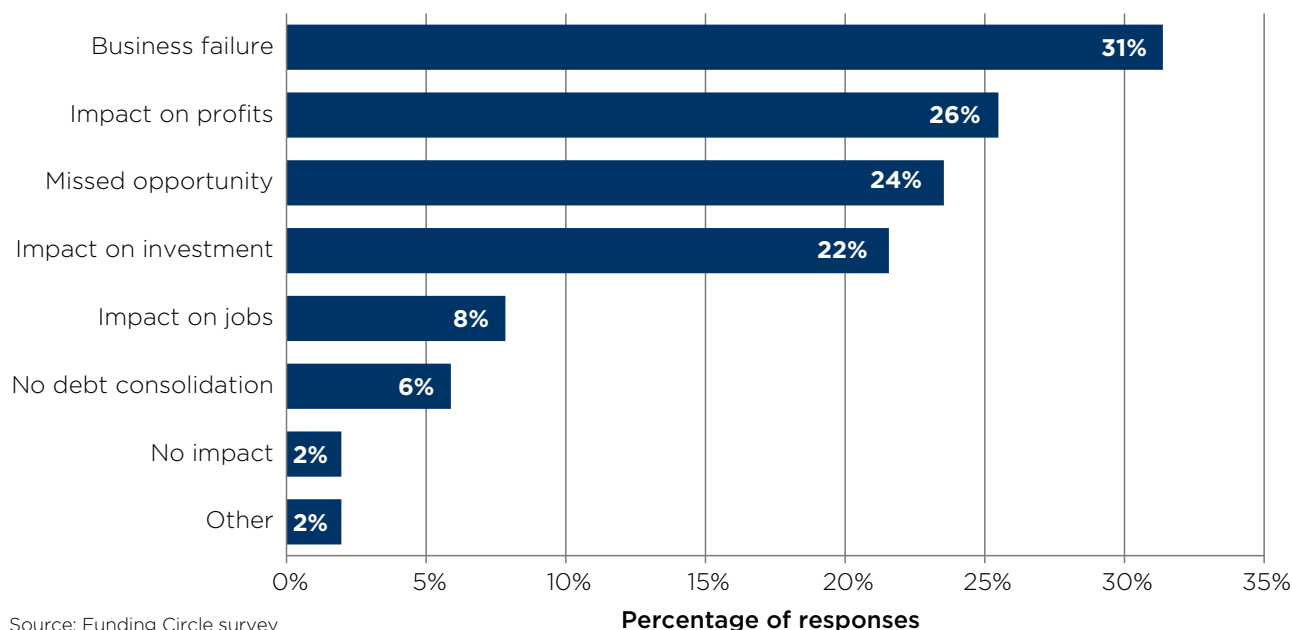
Source: Funding Circle survey

**Without their required financing, many small businesses said they would face closure.**

Some 31 percent of the SMEs surveyed felt their business would have failed without the funding they received (see Fig. 69). Of these businesses, 94 percent had fewer than 10 employees, while the remaining six percent were small-sized firms (10-49 employees).

A further 25 percent of SMEs said that not receiving the funding would have had an impact on their profits—leading to weaker, or zero, profit growth. Only two percent felt that there would have been no impact on their business, had they not received the funding.

**Fig. 69: What would have happened had the businesses not received their required financing?<sup>57</sup>**



Source: Funding Circle survey

<sup>56</sup> Figures may not sum due to rounding.

<sup>57</sup> Respondents could choose multiple responses. Two respondents selected both 'less revenue growth' and 'no revenue growth'; in each case, the latter response was accepted to avoid double-counting the impact.







The background of the entire page is a photograph of numerous plastic buckets of various sizes, stacked and filled with colorful cotton candy in shades of pink, blue, yellow, and white. The buckets are arranged in rows, creating a sense of depth and abundance. The lighting is bright, highlighting the soft texture of the cotton candy.

## CASE STUDY: TOYS UNLIMITED

"You could say I'm a born showman," says Edwin Vader, noting proudly that he is the seventh generation of his family to go into the funfair business. "We visit around 60 funfairs between March and November, with hardly ever a day off."

In recent years, with the help of a Funding Circle loan, Edwin has transformed his original business into a profitable global enterprise, Toys Unlimited. He saw the opportunity to increase his profits, if only he could make the plastic toys and stuffed animals that festoon his stalls more cheaply than his competitors. So he visited the legendary Canton Fair in Guangzhou, where a huge number of Chinese manufacturers showcase their products.

"From the outset," Edwin says, "my new wholesale business proved very popular. After just a few years, I realised I would need more money to fulfil all the demand—particularly as you have to pay for everything upfront in China."

"I decided to take my chance and contact Funding Circle. They are well known for supporting different types of businesses—especially small, modern firms. I am also in the fireworks business, and the whole package was, I think, interesting for potential investors coming through Funding Circle."

Edwin says the loan process was quick and easy: "I went through an intermediary, but as soon as the papers reached Funding Circle and were approved, it was very fast. The money was there in three or four days."

The impact of the loan was equally quick, he says. It unlocked a double bind that small import businesses such as Edwin's often encounter: it enabled him to order much more stock from his Chinese suppliers, and also more containers in which to store this merchandise when it reached the Netherlands. "As a result of the loan, my import business is growing very fast," he says. "In just three years, the turnover has multiplied four times."

## 6. CONCLUSION

This report has analysed the shifting financial services landscape for SMEs in the UK, US, Germany, and the Netherlands. While each country exhibits specific characteristics, there are some clear trends that apply across the four countries.

# 55%

**Year-on-year increase in the total value of loans under Funding Circle management at end 2018.**

*The combined value of these loans was £3.1 billion.*

**Firstly, we continue to observe a pattern of small firms finding it harder to access business financing than their larger peers.**

Typically, they also receive harsher terms on the loans that are granted. In part, this is because small businesses continue to be relatively unimportant to banks, with lending to SMEs making up a small proportion of banks' overall balance sheets.

**This stagnation in bank lending to SMEs is, however, in stark contrast to the rapid expansion in SME activity across the four countries.**

The vast majority of firms in industrialised countries are SMEs—and their numbers are growing. The total number of UK-based SMEs was five percent higher in 2018 than three years earlier, for example.

**Therefore, many SMEs are increasingly reliant on other forms of external finance to increase their working capital and undertake investment.**

The rapid expansion of online lending platforms is part of this trend, which has been supported by technological shifts that have transformed the way consumers access their money and choose financial products. 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”.

**Lending through Funding Circle has grown particularly rapidly in 2018.**

Across its four markets, 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. In Germany, over 85 percent more loans were issued in 2018 than a year earlier, for a total value that was 92 percent higher. In the Netherlands, the value of new loans in 2018 was almost two-and-a-half times the value of loans issued the previous year.

**In total, the loans under Funding Circle's management at the end of 2018 supported an annual contribution to global GDP of £6.5 billion.**

This equates to a year-on-year increase of 56 percent in real terms. We estimate that across the four countries, these loans enabled 115,000 jobs (up 54 percent), and generated £2.0 billion in business and labour taxes (up 39 percent in real terms).





Houston law firm president Willie D. Powells III.



# APPENDIX 1

## ESTIMATING THE ECONOMIC IMPACTS

In January and February 2019, a proportion of Funding Circle's small business customers in each of its four markets were asked to complete a survey about their loans and business. To enable Oxford Economics to carry out the economic impact study for this report, survey respondents were asked about their company's latest annual revenue, purchases from other firms, share of imports in those purchases, and employment levels. Some 1,544 firms completed the survey, of which 245 were in Germany, 401 in the Netherlands, 445 in the UK, and 453 in the US.

### Direct impacts

The direct "gross value added" contribution to GDP of these respondents was taken to be the difference between their 2018 revenues and the value of their purchases from other firms that year. Their direct employment was taken straight from the survey answers.

The "Funding Circle share" of those values then had to be calculated. Each company that responded to the survey was matched with its record in Funding Circle's entire loan book, as adjusted to capture only loans under management and not in default at the end of 2018. This enabled the value of the company's outstanding loan, and industrial sector, to be identified.

The industrial sector was used to split each firm's value added between employment costs and the "gross operating surplus" (i.e. capital costs plus net profits—equivalent to earnings before tax, interest, and depreciation in company accounts). This required

sector-by-sector data from the national accounts, adjusted to be more specific to smaller firms by taking into account relevant ratios from national statistical agencies' data.

The gross operating surplus was then used to estimate the size of each company's balance sheet (i.e. its net value plus all outstanding liabilities), using a balance-sheet-to-gross-earnings multiple of three. This ratio was chosen as being within the various ranges recommended by experts in the field—although it is towards the lower end of the scale, to reflect the small size of the firms involved. The ratio of each firm's Funding Circle loan to its estimated balance sheet size was then used to scale down from total direct value and jobs, to the share supported by Funding Circle's financing.

The gross value added and employment impacts for the sample of firms surveyed were then scaled up, to arrive at impacts for the entire Funding Circle loan book. Revenues, purchases from other firms, and business taxes paid were also scaled up in the same way. Direct tax contributions of all kinds were worked out from direct gross value added, using various tax-to-income and tax-to-spending ratios derived from national accounts and tax authority data.

### Indirect and induced impacts

Next, the indirect and induced impacts were calculated. The pattern of firms by industrial sector, both in the survey and across the entire loan book, was reasonably similar to that of the

wider business sector, excepting the relative absence of mining and energy firms. The pattern of economy-wide procurement found in the official "input-output table", by type of product purchased and domestic-versus-imported supplier split, was therefore adjusted to exclude non-business entities, and mining and energy firms, and applied to our estimate of Funding Circle borrowers' total purchases from other firms. The share of imports in that total was checked against the share indicated by the survey results, and found to be very similar.

The pattern of procurement from domestic suppliers, excluding imports, was then fed into Oxford Economics' economic impact models, which are based on the entire pattern of transactions between industrial sectors (as found in an input-output table). The direct employment costs of Funding Circle's borrowers were also fed in. The indirect and induced gross value added, employment, and tax impacts were then calculated within the model, which also incorporates the latest gross value added-to-jobs, tax-to-income, and tax-to-spending ratios, on a refined industry-by-industry basis.

The results show the economic contribution supported by lending through Funding Circle per annum, based on all loans under its management at the end of 2018. They are not cumulative, so do not show the economic impact of Funding Circle since its creation.

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## April 2019

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