SME CONFIDENCE TRACKER

Q2 2019

BIBBY FINANCIAL SERVICES

29%

OF SMES USE EXTERNAL FINANCE

↑6%

SINCE Q1 2019

KEY FINDINGS: Q2 2019

50% believe it is likely the UK will experience a recession this year

37% reported increased sales in Q2 2019

42% expect sales to increase in Q3 2019

£81,000 the amount SMEs plan to invest in Q3 2019

10% invested in exports in Q2 2019, an increase of 3% from Q1 2019

FOREWORD

TOUGH Q2 LEADS TO **UNEVEN GROWTH**

Following a weak start to the year, UK SMEs have performed better in the second quarter, but this has been tempered with caution. The good news is that nearly two fifths (37%) have increased investment, reversing a five-quarter decline since Q1 2018.

Despite this, SMEs remain cautious for the year ahead as sales expectations for Q3 remain flat at 42 per cent. This is in line with levels seen in the last two years and suggests a seasonal trend, but time will tell if this is cause for wider concern.

Fear of a downturn remains a worry to many SMEs and exactly half (50%) believe the UK is likely to enter recession this year. However, this is a slightly improved outlook to that in Q1 when 57 per cent said they felt that the UK would experience a recession in 2019.

This view is likely as a result of a combination of factors, including signals stemming from the trade war between the U.S. and China and the ongoing risk of Brexit.

The positive news is that a significant number of SMEs are carrying on with business as usual with a slight uptick in confidence. Additionally, despite Brexit woes, it seems that many businesses are still investing. According to the latest data, SMEs are planning to increase their capital expenditure from £64,600 to £81,000 and reverse declining spend since Q1 2018.

Evidence suggests that many SMEs were stockpiling goods in the run-up to the March Brexit deadline. The fact is that the new October deadline has left many SMEs in limbo. This is very likely a continuation of the theme I remarked upon in the first quarter - that Brexit remains a dead weight on what could otherwise be a robust economy. This is further evidenced by what SMEs have been telling us this quarter. While many businesses continue to invest, over half (54%) have not done so due to the uncertain economic environment within the UK, and the same number due to uncertainty arising from the UK's exit from the EU. The fact is, stockpiling can only last so long before its impact on cashflow becomes unsustainable.

As a result, nearly half (44%) have told us they are struggling with cashflow. Usually, a rise in the number of businesses investing would benefit the economy. But with SMEs facing increasing competition (15%), rising materials costs (17%) and the broader economy stalling, they appear to be sourcing finance to cope with these challenging conditions rather than investing for a brighter future.

Overall, there has been an uneven level of growth in the SME sector since the EU referendum and I would suggest that the primary cause of this has been a lack of stability both at home and abroad. UK SMEs are a diverse group working across many different sectors, but the common thread is that their growth depends on feeling confident enough to invest and expand. I'm in no doubt that they could perform even better if the political environment stabilised and the flow of goods, services and people were guaranteed to move easily to and from the UK's shores.

EDWARD WINTERTON

UK Chief Executive,
Bibby Financial Services
July 2019

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Edward Winterton

SME **CONFIDENCE** INDEX

CONFIDENCE INDEX CHANGE

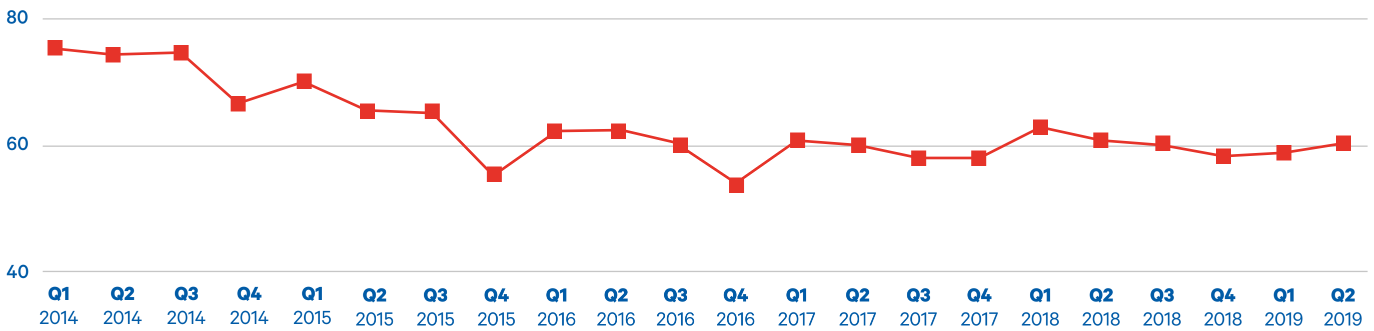
59.1 Q1 2019 ↗ **60.3** Q2 2019

The SME Confidence Index is compiled by equally weighting SME sales performance over the past three months with anticipated sales performance for the three months ahead.

The Index for Q2 2019 showed an increase in confidence from Q1 2019, rising by 1.2 points to 60.3 from 59.1. This increase in confidence is marginal and therefore suggests there has been little to spark renewed optimism in UK SMEs, other than the delayed impact of Brexit.

The data also reveals confidence is weakest amongst micro businesses with a turnover below £250k. Interestingly, and perhaps reflecting the optimism of starting a new business, younger SMEs are more likely to be confident than those that have been trading for some time.

CONFIDENCE INDEX



THE BUSINESS **FUNDING** LANDSCAPE

SHARON WILTSHIRE
UK Commercial Director,
Bibby Financial Services

Sharon Wiltshire

Ten years ago, the UK was in the tail end of recession because, in part, companies of all shapes and sizes couldn't get the funding they needed to grow. Since then unprecedented intervention from The Bank of England has created an era of easy credit. Most of this credit has flowed into financial services and unfortunately less has flowed into the hands of UK SMEs.

The fact is that the level of bank lending to SMEs remains lower than before the financial crisis[1]. This quarter one in ten (10%) of SMEs said that Banks were more willing to lend to them whilst a fifth (21%) said Banks are less willing to lend to them, a third (32%) said willingness had remained the same.

Open Banking is one initiative the Government created to try to address this, but research by YouGov shows that data sharing, which the scheme relies on, is not very popular. Last year just six per cent of UK adults said they would be comfortable sharing their financial data with organisations other than their main bank[2].

Our own research this quarter provides insight into the complex picture of SME funding. There has been a six per cent jump in SMEs using external finance since Q1 2019. The bad news is that four in ten (40%) of those who needed external finance have turned to credit cards.

Using unsecured borrowing can mean SMEs pay a higher financial or even personal cost to access this additional capital. Whilst a credit card or an increase in an overdraft may provide a temporary boost to businesses, it does not offer the same benefits that secured forms of borrowing do.

Earlier this year, BFS provided Liverpool based specialist print finisher Thomas Loughlin with an invoice finance facility to free up additional working capital that was previously tied up with overseas customers in Ireland and the USA. This type of funding grows in line with an SME's sales ledger rather than providing a single spike in cash flow.

This funding is one form of borrowing that is vital for fuelling sustainable investment. Until this quarter, SMEs had been reducing their spend since Q4 2017 when 80 per cent were investing in their businesses. As a result, the data from this quarter shows that levels of SMEs investing is increasing, as 69 per cent prepare to invest in Q3.

The long-term sustainability of this future investment will depend on whether SMEs build their investment plans on a secure footing or borrow from unsecured sources. The task for the industry is to support them as best we can.

[1] UK Finance research from evidence given to The House of Commons inquiry into SME Finance
[2] YouGov Three quarters of Britons haven't heard of open banking, August 2018

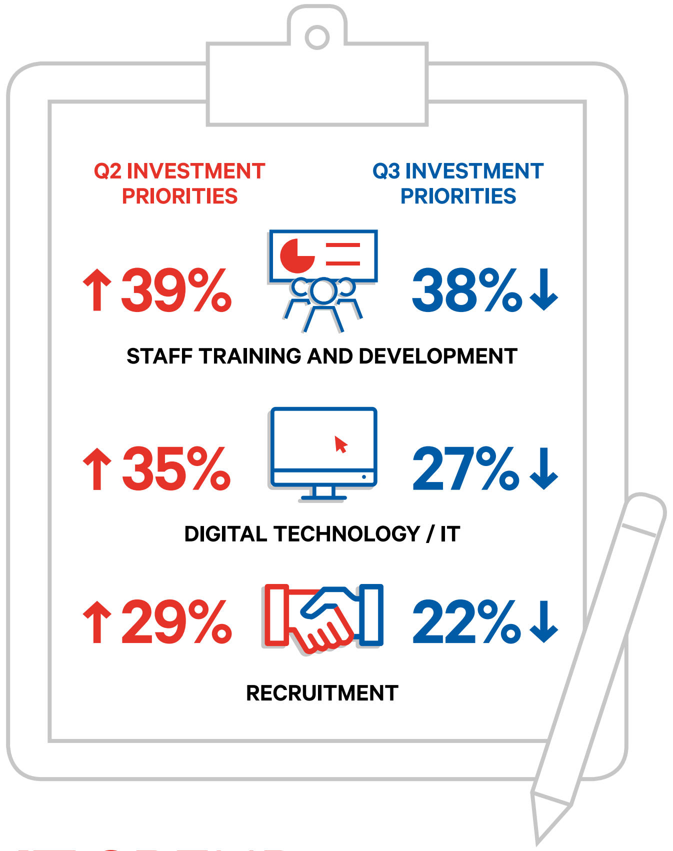
"RECEIVING CUSTOMER PAYMENT ON TIME AND MAINTAINING AN EFFICIENT LEVEL OF WORKING CAPITAL IS CRUCIAL TO OUR DAY-TO-DAY OPERATIONS, AND THE INVOICE FINANCE FACILITY IS ALLOWING US TO GET ON WITH BUSINESS RATHER THAN CHASING EXPORT DEBTORS."

TONY ASPEY, Managing Director, Thomas Loughlin

SKILLS AND **DIGITALISATION** AT THE TOP OF THE SHOPPING LIST

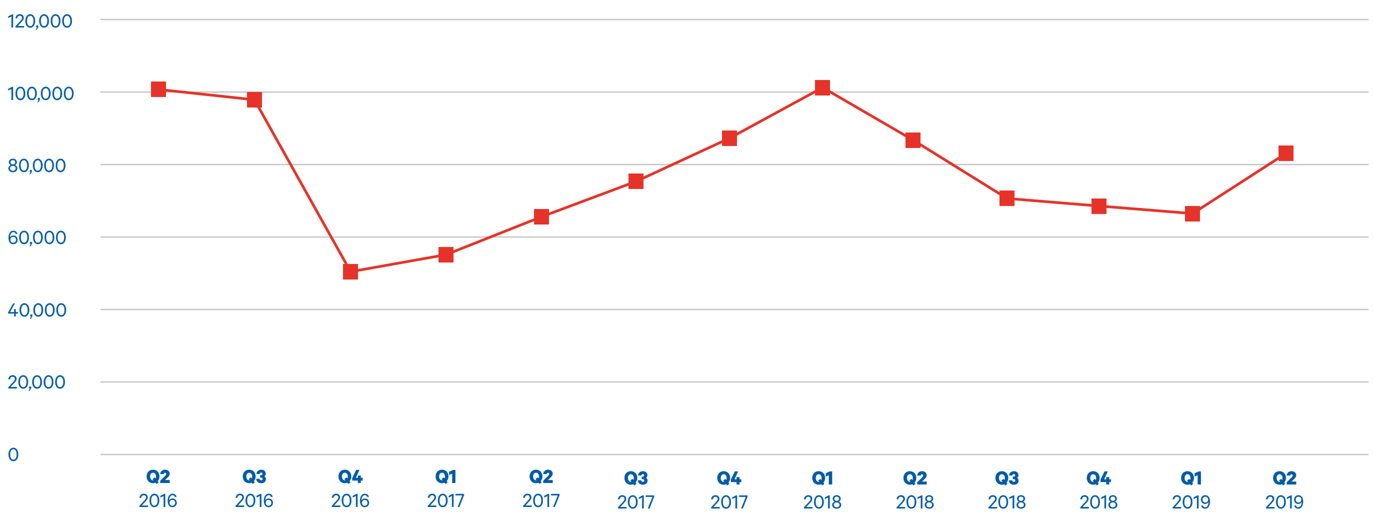
SMEs are choosing to prioritise their skills and digital competencies. The data reveals that spend in Q2 and planned spend in Q3 is being allocated into longer term business plans designed to maintain staff development and IT equipment. SMEs may be responding to ongoing recruitment difficulties caused by historically high employment levels[3], a factor witnessed in previous quarters.

In Q2, just under a quarter (24%) citied the primary reason for investing was to reduce operating costs / increase efficiencies. In Q2 2016, when the EU referendum occurred, only eight per cent of UK SMEs were investing for this reason, suggesting that maintaining operational efficiencies has become a higher priority for SMEs since Brexit.



PLANNED **INVESTMENT** SPEND

Planned average investment spend increased from £64,600 to £81,000. The number of SMEs that are investing in their businesses has also remained high, increasing by one percentage point to 72 per cent. This planned spend reverses five quarters of declining spend witnessed since Q1 2018.



[3] According to the ONS, the UK unemployment rate was estimated at 3.8 per cent; it has not been lower since October to December 1974.

THE **BARRIERS** TO INVESTMENT

SMEs are being prevented from investing by several factors, the top cited reasons being:

AT A GLANCE

BREXIT AND THE RISK OF **RECESSION**

Half (50%) of SMEs believe a recession is likely which is seven percentage points less than in Q1 (57%). Larger businesses (£5m+ turnover) are the most concerned with nearly three fifths (57%) believing a recession is likely this year. Opinion is being driven in part by the perceived risk to business of a no deal Brexit which hasn't abated since Brexit was delayed in the first quarter of the year.

SMEs are not alone in feeling this way as corporate businesses in the UK also share similar concerns. Deloitte's latest quarterly survey of chief financial officers found that 83 per cent[4] expect the long-term business environment to deteriorate as a result of Brexit - the highest level since the EU referendum in 2016.

By sector, SMEs working in the transport sector are the highest proportion that feel a recession is very likely (17%) followed by manufacturing (16%) and construction (14%).

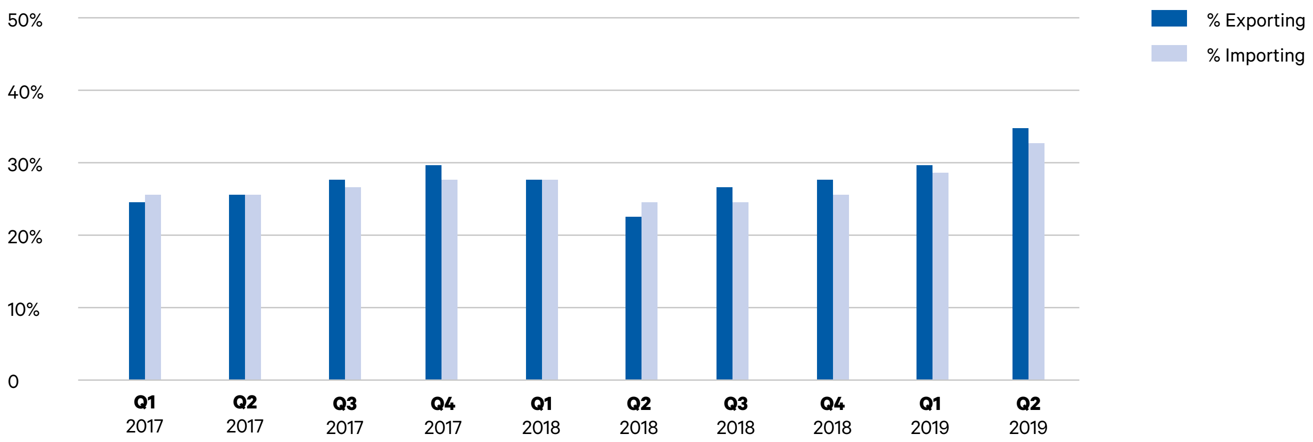
On a regional basis more than one in five (21%) in East Anglia believe a recession is very likely this year followed by 17 per cent in London, 15 per cent in the North West and West Midlands, respectively.

[4] Deloitte CFO Survey Q2 2019

SPOTLIGHT ON **INTERNATIONAL TRADE**

Export activity has seen a slight uptick in the second quarter as the data reveals that over a third (34%) exported whilst almost a third (32%) imported goods from abroad. These figures mark an increase in spend as they are a four-percentage point increase on Q1 2019.

Those trading overseas are more likely to be larger SMEs with a turnover of over £1m, and SMEs operating in the manufacturing and wholesale sectors.



EXPORT **INVESTMENT** IN Q2

One in ten (10%) SMEs invested in exporting this quarter, an increase of three percentage points from Q1 2019. The last time this many SMEs invested in their exports was in Q1 2018. However, the number of SMEs investing in exports remains five percentage points off the historic high seen in Q3 2016 (15%), this suggests that businesses are not taking full advantage of the opportunities exporting could bring.

JIM DAVIS
Managing Director,
Export Finance,
Bibby Financial Services

Jim Davis

"Exports are a growth area for SMEs, particularly for businesses that have adapted their business models to suit this approach. In the second quarter we saw the Secretary of State for International Trade, Dr Liam Fox make a welcome move to help UK firms increase their export volume. The Small Deals Initiative, which will see UKEF guarantee the loans of potential overseas buyers of British goods, will go some way to help restore SME confidence. As global uncertainty remains high, SMEs must rethink how they can develop new business, focus on profitability and find operational efficiencies.

"Many exporters we speak with are looking to cut costs and grow profits. This includes looking more closely at opportunities in the countries where they already operate, as well as expanding into new markets. We've worked with thousands of exporters and the one common thread amongst those that have been successful is leveraging the support available, both from the private and public sector."

CHALLENGES TO **IMPORTING** STILL **UNDERESTIMATED** AND **MISUNDERSTOOD**

Importing remains a core area of business operations for SMEs with over half (51%) of wholesalers, (44%) manufacturers and (36%) of transport SMEs relying on imports in Q2 2019.

The UK regions most reliant on imports are the traditional industry strongholds of Yorkshire (39%), the East Midlands (36%) and North East (34%) where there are still significant manufacturing and heavy industry operations which require significant material input for production.

"Businesses that rely on imports could be most challenged by a no deal Brexit. Even for those that have taken precautionary measures, such as registering for Transitional Simplified Procedures (TSP), the consequences could be detrimental. Whatever happens with Brexit, importers can't risk seeing critical components trapped in the supply chain, as this will leave them unable to clear goods and contend with falling stock levels. It leaves British companies ill-equipped to meet demand, thus preventing them from reaching their full potential. Add on foreign exchange volatility, and importers are presented with the challenge of stocking up when they are least able to do so."

GARY GRIFFITHS
Managing Director, Trade Finance, Bibby Financial Services

Gary Griffiths

THE SME **CASHFLOW** POSITION

Over two fifths (44%) suffer from some form of cashflow problem, a similar figure to last quarter (45%).

Larger businesses and those in the transport and wholesale sectors are more likely to avoid cashflow issues. This is possibly due to the nature of these businesses which have adapted to cope with cashflow problems as they are more prone to them.

THE **KEY BUSINESS CHALLENGES** IN Q2 2019

Almost one in five (17%) SMEs said that rising costs are their biggest challenge this quarter. This is followed by increased competition from other firms (15%) and lack of domestic demand (13%).

These challenges perhaps reflect the wider experience of uncertainty currently impacting the UK economy.

At sector level, there are several insights from the data which show the most pressing concerns unique to each field. For example, a fifth (22%) of SMEs in the construction sector are faced with difficulties caused by late paying customers - a common issue tied to the power imbalance inherent in the subcontractor and main contractor relationship.

A fifth (20%) of manufacturing SMEs are struggling with rising costs. This is likely to be caused by the increasing cost of raw materials due to the weaker buying power of the pound, compared to overseas suppliers' currencies.

THE TOP THREE **CHALLENGES** BY SECTOR

CONSTRUCTION	**22%** Late payment from customers	**19%** Lack of skilled staff	**16%** Lack of domestic demand
MANUFACTURING	**20%** Rising costs	**13%** Lack of skilled staff	**12%** Lack of domestic demand
SERVICES	**14%** Increased competition from other firms	**13%** Rising costs	**13%** Lack of domestic demand / Lack of skilled staff
TRANSPORT	**22%** Increased competition from other firms	**18%** Rising costs	**12%** Red tape / regulations
WHOLESALE	**18%** Increased competition from other firms	**18%** Rising costs	**15%** Lack of domestic demand

REGIONAL SPOTLIGHT: IS YORKSHIRE THE UK'S MOST RESILIENT REGION?

DEBORAH JOHNSON
Commercial Director North,
Bibby Financial Services

Deborah Johnson

Despite SMEs having a steady rather than spectacular performance last quarter, our data this quarter shows that Yorkshire is making the most of a difficult business environment.

The region's SMEs are displaying significantly greater optimism compared to other regions across the UK. Our SME Confidence Index displayed a reading of 64.1, almost 4 points above the national average. This builds on a strong performance in Q1, where it was also the best performing region, demonstrating a sustained willingness to get on with business amid continued adversity.

This upbeat attitude is translating into investment levels that dwarf those of regional counterparts. The average SME is planning to put over £167,000 into its operations during Q3, more than double the national average. The motives behind this investment also present a cause for optimism. Almost half (47%) will be investing in the training and development of their staff, which will help to alleviate concerns over a skills mismatch amongst the region's workforce.

Over a fifth (22%) of SMEs said a lack of skilled staff is currently the biggest challenge to their business, well above the 12 per cent average. This willingness to put faith in existing resources is an illustration of how the region's businesses are determined to carve out their own success. Coupled with similarly strong investments in digital technology and new machinery, Yorkshire SMEs are acting confidently to future-proof their businesses.

Not only are they demonstrating high levels of confidence and investment, Yorkshire's SMEs are looking to exploit avenues for growth beyond UK shores. Two-fifths (41%) of SMEs in the region now export, up from 38 per cent in Q1, while just a third (34%) do so nationwide.

At BFS, we are seeing this positive attitude in Yorkshire first-hand. In the past quarter, we partnered with several ambitious businesses in the region. For example, Tuber Produce, an East-Yorkshire based fresh food wholesaler is boosting its trading capabilities with the support of a bespoke trading facility. Despite only being established in late 2017, the business is now using its expertly assembled supply chain as foundation for expansion into the US, whilst also targeting a record in domestic annual turnover.

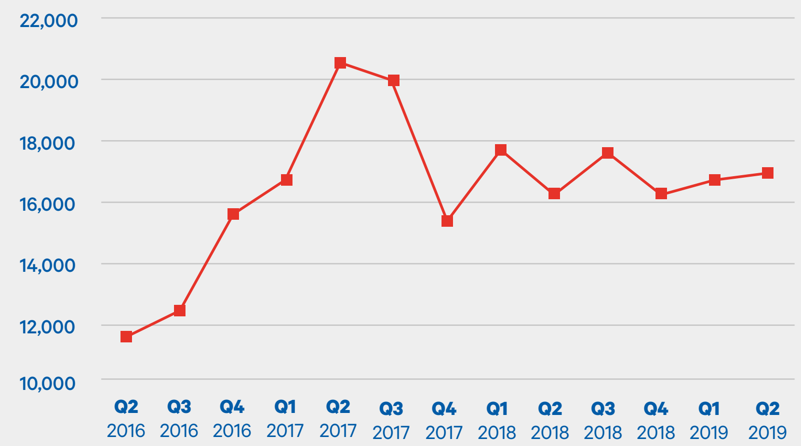
Whilst Yorkshire has long since diversified from its industrial roots to represent a modern, robust economy, we see it has not lost any of its renowned grit. Despite Brexit continuing to cloud important business decisions, focusing on moving forward is key for SMEs nationwide seeking to emulate Yorkshire's success.

SPOTLIGHT ON **BAD DEBT**

Over a third of SMEs (34%) suffered from a bad debt in the past 12 months, an increase of 3 percentage points from 2019 Q1 (A bad debt is a money which cannot be recovered by an SME for work which has been undertaken).

The average amount written off as bad debt in 2019 Q2 was £17,000, a similar amount to Q1 2019.

Over the last three quarters the amount of bad debt has been increasing marginally.



WHAT IS THE SME CONFIDENCE TRACKER?

The SME Confidence Tracker surveys over 1,000 of the UK's small and medium sized businesses on a quarterly basis. The Tracker charts the confidence of owners and senior decision-makers of businesses in manufacturing, construction, wholesale, transport and services sectors. Field work for Q2 2019 took place between 21st May and 27th June 2019 and respondent businesses had average annual turnover of £2m.

ABOUT BIBBY FINANCIAL SERVICES

Bibby Financial Services is a leading independent financial services partner to more than 7,500 UK SMEs.

Our total funding capability exceeds £1bn and through our network of 18 regional offices we handle annual client turnover of £6.4bn.

Formed in 1982, we are a member of UK Finance, supporting the growth of businesses in over 300 industry sectors.

In 2011, 2012, 2014, 2015, 2016, 2017, 2018 and 2019 the company was awarded a place in The Sunday Times 100 Best Companies to Work For, ranking 42nd in the most recent poll.

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

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