



Rethinking business finance

Funding options and
opportunities for SMEs



Introduction

This report looks at the funding landscape for small and medium-sized enterprises (SMEs). It examines the way business finance is evolving, the funding avenues that are available today, and how SMEs can secure the capital they need to grow.

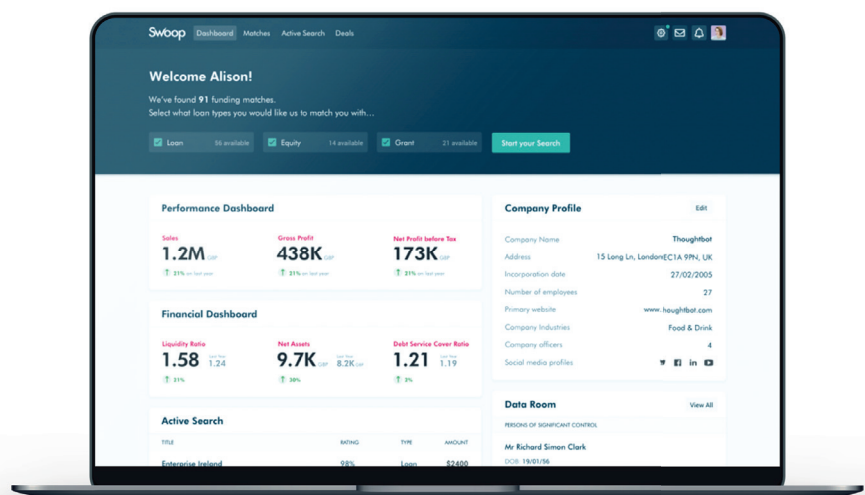
Much has changed since the financial crisis shook banking to the core and posed fundamental questions about lending and borrowing. Following a period of business contraction and severely restricted finance, the marketplace for SMEs is now healthier and certainly more varied. However, challenges remain – not least Brexit – while variety can also mean complexity and lead to indecision.

So, if you are looking for finance today, where do you begin? What are your options? Whatever the future may bring, digital technologies, open banking and other market developments are creating opportunities for SMEs. In short, there are plenty of funds available for those who know where to look and who to turn to for advice. Surprisingly, despite their dented reputations after the financial crisis, banks have remained the first choice for many SMEs. But the balance is changing. Thanks to the growth of alternative finance, driven by fintechs and market reforms, competition is growing and SMEs can often be served more quickly and effectively by non-bank lenders and challengers.

We discuss why this marketplace has yet to be embraced more fully, the different types of fund that are available, and what SMEs must consider to pick the right path for growth. There are now plenty of choices for finance, and SMEs should explore all their options to get the best deals. The key message is that it's time to rethink finance and seize the opportunities offered by a changing marketplace.

This is where organisations such as Swoop can make all the difference.

Swoop was set up to answer a simple but challenging question: 'How do I fund my business?' The final section of this report describes Swoop's role in the new financial landscape and how it is providing SMEs with the focus and clarity they need.





Funding the gap

It is often said that small and medium-sized businesses are the cornerstones for economic stability and growth. In the UK, there is no doubting their contribution. SMEs account for 99.9% of all firms, 60% of all private sector employment, and have a combined annual turnover of £1.9 trillion, which represents 51% of all private sector turnover in the UK.¹

Investing in our future

These figures tell a compelling story about economic value, but are SMEs receiving the right level of funding and advice in return? Are we investing in the future of small businesses in the same way we invest in big businesses? Not according to the Bank of England Governor Mark Carney, who in June 2019 called for an open lending platform for SMEs to plug a £22 billion funding gap.

From shops and restaurants, to IT specialists, graphic designers and marketing agencies, SMEs are the engine room of the business world. And, in turn, they require capital to keep their businesses going. SMEs need funds to establish themselves, operate day to day, and to grow. At every stage of their lifecycle, they need finance to maintain a healthy and sustainable balance sheet. Cashflow and working capital are fundamental daily requirements, ensuring a business can buy stock, pay staff and creditors, and survive if there are late payments. And, in time, any planned expansion will require a cash injection.

Finding alternative finance

Historically, SMEs have relied on banks for financial support. However, following the financial crisis, banks introduced far more stringent requirements for lending, and SMEs found that lines of credit dried up. While access to bank finance has now improved, and SMEs still see banks as their first option when seeking funds, the effects of the financial crisis run deep and the traditional lending environment is much less favourable than before 2007/2008.

This has stimulated the rise of an alternative lending market, and if businesses widen their search, they can avoid being disappointed or underserved by banks. But many simply don't think beyond traditional finance, which means they often abandon the hunt for funds if banks decline to help. And when that happens, it's not just bad for individual business growth – it's bad for the economy.

According to Improving Access to Finance for UK SMEs, a report issued in 2018 by the Genesis Initiative, a body formed to support SMEs and promote economic reform, 50% of small businesses give up when traditional lenders can't help. This is despite the fact that today's start-ups and technology-based entrepreneurs are matched by an equally diverse range of technology-based finance lenders. It's a versatile marketplace that offers flexible and tailored financial services. So why do banks remain the default solution?

The reason is simple: there is a knowledge gap as well as a funding gap. Business owners lack the insights and confidence to widen their financial horizons. Because the landscape has changed, SMEs need advice to navigate a new and more complex world of finance. And when they find the right path, the benefits are clear. In September 2019, the British Business Bank reported that SMEs who obtain external financial support and information are between 15% and 25% more likely to become high growth firms.²

Lack of knowledge is compounded by several other factors. In the following section we look more closely at the behaviours, attitudes and financial circumstances that are holding SMEs back and preventing them from exploring all their options – and, crucially, denying them finance that could put their businesses on a firmer footing.

What are the barriers to funding

Fear of the unknown



SMEs tend to stick with conventional banking because it's the only world they know, even if they feel poorly served and unenthusiastic about their bank relationship. High charges and no relationship managers (usually only for bigger businesses) are among the common gripes. Banks, for their part, have reduced their level of support and funding in the aftermath of the financial crisis, further marginalising SMEs and underlining the need to explore the wider financial marketplace.

When SMEs look for bank loans they are often hampered because they don't have substantial assets to act as security and lack the required credit history. When turned down, many simply abandon the search. This has been described as the 'discouraged borrower' syndrome.

Debt and equity traps

Because SMEs may be unfamiliar with the lending environment, they think only in terms of standard bank loans, overdrafts and credit cards. Their lack of knowledge and natural caution make them pessimistic about securing finance in other ways. They often think there is nothing to meet their needs if banks can't help, and they are fearful of trying because of trust issues. Debt aversion will make SMEs wary of all lenders and forms of finance, and this fear is multiplied when it comes to equity because SMEs don't want to lose business control. This is why many businesses would prefer to self-fund, however limited, rather than fall into debt or equity traps.

Time and resources

Even if they want to explore alternative finance, most SMEs don't have the time or resources to research all the possible options.

² Source: Department for Business, Energy & Industrial Strategy: Longitudinal Small Business Survey, June 2019



It would involve websites searches, lengthy form-filling, and other time-consuming and data-intensive activities. In other words, a bridge too far for a business that needs to focus on other tasks, particularly in the start-up phase. And supposing that SMEs did have the time to research the field, could they make an informed decision about the finance on offer? Again, it's a question of knowledge.

Education and expert guidance are the keys to unlocking finance in both the traditional and alternative sectors. This was clearly stated in a recent finance report by the House of Commons Treasury committee³. Addressing the committee, Stephen Welton, CEO of the Business Growth Fund, said:

"What we need to do a better job of is increasing the understanding in the SME population as to where to go, because one of the frustrations is if you think that the solution to your problem is an overdraft, and you go and ask for an overdraft and you do not get it, that does not mean that you cannot raise funding. It means that you have gone to the wrong place to get funding. There is a big educational piece that we need to do."

Meeting the challenge

As Welton pointed out, being turned down by a bank is not the end of the road. Thanks to new technology, market reforms and new financial players, many different types of finance have emerged since the recession, helping to bridge the funding gap and answer previously unmet needs.

Open banking and financial freedom

Digital transformation is shaping today's lending environment while also stimulating the growth of an entrepreneur culture. With the arrival of open banking, there is now much greater access to data, and fintechs and challengers are using it to tailor products and services.

Open banking means that non-bank lenders can combine their own data sets with bank records. This Information can lead to new forms of finance based on a comprehensive understanding of an SME's financial position and objectives. This is because APIs, the foundation for open banking, are building innovative platforms and ecosystems that facilitate data sharing and create greater variety.

A changing marketplace

Today, traditional banks have been joined by a wave of challengers such as Metro, Aldmore, Shawbrook and Redwood. At the same time, fintechs have been developing financial models and value-added services that provide access to alternative and more flexible revenue pools, as well as wider business advice. Bespoke and personalised financial services are growing in response to consumer expectations, and companies such as Square and Shopify are stepping in to help businesses grow.

There are many initiatives and resources to kick-start and sustain SMEs. For example, Virgin Step Up and the NatWest Accelerator programme are helping to create direction and scale; the British Business Bank is improving the supply and variety of SME funding; Banking Competition Remedies Ltd is allocating a £775 million fund for SMEs; and resources such as the UK SME Finance Monitor are providing market intelligence and insights. In addition, with post-Brexit Britain in mind, the Government has just announced the launch of the Business Finance Council, which will help SMEs secure finance, particularly working capital and investment, in what may be a challenging future.

Unlocking finance and choosing wisely

If SMEs are failing to find finance because of lack of knowledge, traditional banks are also part of problem. Banks are not known for taking a 360-degree view in order to understand the needs of SMEs. Typically, they look only at the most obvious criteria for finance, such as credit history and cash flow, which is where SMEs frequently fall short.

Bad credit is not necessarily a barrier. Alternative lenders often have a more accommodating approach and can be more willing to help SMEs. They may take on more risk and work harder to find flexible and bespoke solutions.

The UK's wide variety of external financing options and resources – including the largest alternative finance market in Europe – is a key advantage for domestic SMEs. So, what should business owners consider if they want to launch, grow, or simply keep their businesses afloat?

Finance options can divided into two main categories – equity and debt. Equity involves selling shares in a business to raise money, and debt means borrowing money and then paying it back with interest. There is also a less explored category – grants. Billions are available annually through grants, but the vast majority of business owners have never applied for one.

Below are some of the main ways businesses can secure finance.

- **Self-funding/funding through family and friends**

Self-funding is often considered because there is little knowledge or understanding of the alternatives. However, that's not to say it's a bad route, simply that it must be evaluated with all the other possible options. Family and friends may be useful investors because they are motivated by the wish to help and may be willing to accept a lower return.

- **Business angels**

High-net-worth individuals are often interested in investing in SMEs and can be useful because of their business knowledge and contacts. However, it can be difficult to find the right investor and match supply to demand.

- **Trade credit**

Like all companies, SMEs can seek credit from their suppliers,



which is a short-term solution to free-up capital. Terms for SMEs are usually less favourable than those for larger and more established companies because SMEs are often viewed as a default risk.

- **Invoice factoring/discounting**

These are methods of raising finance against the value of outstanding receivables (ie, invoices). With invoice finance, you are selling an invoice to gain cash up front, which means you get less than the invoice value but benefit from an immediate cash injection. This can be invaluable for working capital.

There are numerous options and providers, including innovative newcomers such as Populous, a bitcoin platform. Fees and services vary, so researching the market and getting the right advice is vital.



- **Asset-based finance**

Assets can provide companies with much-needed capital, since machinery, equipment, real estate, intellectual property and other inventory can all be used as collateral to secure funds. Asset-based finance is a useful way to fill gaps in a company's cash flow, but is often underused to assess a company's true credit score. This is where better data comes in – to build a more complete profile of a company – and where better education would highlight the role that assets can play.

- **Traditional banking**

Naturally, banks still have their place. Overdrafts and loans have always been a mainstay for SMEs, but it's important to



look beyond the immediate and the obvious. The world of finance has moved on, and because banks' traditional conservatism was reinforced by the financial crisis, there is now even more reason to explore alternative finance. With banks, lending is

heavily influenced by the 'maturity gap'. It means that banks are reluctant to provide finance because SMEs often have a high risk relative to their assets and liabilities. There is also the likelihood that a bank will ask for personal guarantees, meaning business owners may have to risk their own money.

- **Private equity**

Private equity providers, such as venture capitalists, can invest substantial sums in exchange for a stake in the business. According to the British Business Bank, small businesses received a record £6.7bn in equity funding in 2018⁴, while the Business Growth Fund, a government-backed organisation supporting enterprises in the UK and Ireland, has invested £2 billion in some 300 businesses since 2011⁵. Equity finance does not involve taking on debt but it can be uncomfortable for business owners because it means giving up a share of the business to the investors. However, when carefully selected, equity can be a solid platform for growth. If SMEs are to attract the right kind of private equity, they must present a solid and credible business proposition.

- **Peer-to-peer (P2P) lending**

P2P lending is growing in popularity as a form of alternative debt finance. This is where individual investors join forces to

provide business loans, and it's usually a faster and easier way to secure finance than a bank loan. P2P loans are normally secured online through a range of platforms. While lenders look for a high rate of return on their investment, the benefit to the borrower is that they are no longer reliant on banks and may get more favourable terms.

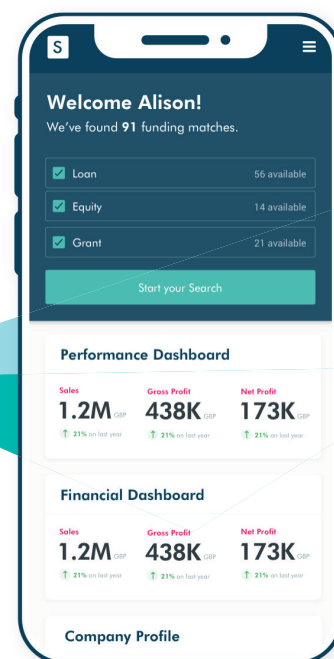
- **Crowdfunding**

Crowdfunding is like peer-to-peer funding, in that capital is provided by people who come together to support your business. However, while peer-to-peer is a debt solution, crowd funding is a form of private equity. Crowdfunding usually focuses on a single project, and the lenders know exactly where their money is going. Peer-to-peer lending is broader, with capital pooled into a fund to support multiple borrowers. With crowdfunding, people can search for and invest in businesses that mirror their interests and beliefs. This creates a stronger lender-borrower relationship, with lenders sometimes taking on more risk (or accepting lower returns) than other lenders.

- **Grants and other support**

Government aid is often available because of the value of SMEs to the economy. The range of possibilities is wide and includes grants for innovative enterprises, tax breaks, loan guarantees, and government-backed venture capital through initiatives such as the Enterprise Capital Funds programme.

No single type of finance is right for every SME. It all depends on the size and nature of the business and where it is on its growth journey. Different types of finance are more suitable for different stages in the growth cycle. But one thing is certain: as the amount of data grows and technology advances, we will see more providers and more options and opportunities.



⁴ British Business Bank report: Small Business Equity Tracker 2019

⁵ Figures provided on the British Business Bank website www.bbgf.co.uk



Finding your way with Swoop

This expanding and diverse marketplace requires expert knowledge to match supply with demand. Swoop provides this knowledge and is a bridge between lenders and borrowers. It is the only business funding and savings platform that spans debt, equity and grants, and therefore offers access to the widest range of finance.

Swoop harnesses vast amounts of data and uses algorithmic analysis to find the right finance for your business. It's a fast, straightforward, and highly focused service. There is only one form to complete, just one application, and then Swoop takes care of the rest. Whatever your needs, Swoop will match you to suitable finance by assessing more than 1,000 funding providers, including traditional banks, challenger banks, crowdfunding and peer-to-peer platforms, private equity providers, angel investors, SEIS/EIS funds, and grant agencies.

Swoop can also identify potential savings, helping you to switch to better deals for foreign exchange, utilities, broadband, mobile phones, and insurance. Savings can improve your credit score, which will make your business more attractive to investors and funding providers.

Put simply, Swoop is creating clarity and focus in a new era of finance. Lending has recovered after the financial crisis, although banks are now less amenable, and SME activity has grown in parallel with digital technology and will benefit from open banking. Looking ahead, Brexit means economic uncertainty and will present challenges for SMEs, but external funding will remain in great demand whatever happens to the economy – which is why SMEs need organisations such as Swoop to help them make informed decisions about finance.

In the words of the Financial Services Consumer Panel:

*"Small businesses need help to navigate the market. [...] Authoritative, independent and impartial guidance would enable small businesses to make informed decisions about whether to borrow or not, and the most appropriate options open to them, as well as help with their wider financial arrangements. It would give them the confidence to look beyond their main bank to find more suitable products and better service."*⁶



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