BLME
BANK ON OUR PRINCIPLES

A spotlight on funding mid-market companies.

An independent report by BLME

As an ESOMAR member, CoreData Research complies with the ICC/ESOMAR International Code of Marketing and Social Research Practice.

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by Jervis Rhodes

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Foreword

The ability of British businesses to access finance is an issue never far from the headlines. A successful economy relies on healthy, productive businesses and crucial to that is the ability of businesses to fund their operations and fuel growth plans. Since the financial crisis, much has been said about the difficulties businesses have found in getting finance from their bank. Consequently, we have seen numerous attempts by the Government to stimulate lending and jump-start the economy – most recently, the Funding for Lending scheme.

Among the vast amount of debate on small businesses, an undeniably important group of businesses for the UK economy, the plight of the mid-market sector has been lost; stuck in the middle between large companies, who have the weight to shape agendas themselves, and the community of small companies, keenly championed by the Government and their own membership organisations.

The 'SME' phrase is deployed to cover both small and mid-sized companies, but should the UK's mid-market companies really be grouped with their smaller counterparts at all? Do they genuinely face the same issues? Are we missing the specific needs of mid-market businesses by thinking of them solely within the SME context? Given the importance of a group of 33,000 businesses that contribute around £700bn[1] each year to the economic output of the UK, getting the measure of mid-market companies is vital.

Our report aims to cut through much of the anecdote that surrounds lending to mid-sized businesses and ask the leaders of these companies what their experiences have been over the past four years and through the financial crisis. To do this we focused specifically on mid-market businesses with between 50 and 250 employees, to gauge their opinions on topics including their success in securing bank finance, their experience in securing financing from other sources like peer-to-peer lending, and their opinions on attempts by the Government to improve their access to much-needed funds.

At BLME we recognise the value and potential in the UK mid-market, which is why we focus our corporate lending on this sector. This report provides the mid-market sector with an understanding of the opportunities and challenges its companies face. It gives a platform to suggest a new approach and direction for ensuring their future success. I hope you enjoy reading it.

Jervis Rhodes.

Jervis Rhodes,
Head of Corporate Banking

[1] Department for Business, Innovation & Skills

> *"At BLME we recognise the value and potential in the UK mid-market, which is why we focus our corporate lending on this sector. This report provides the mid-market sector with an understanding of the opportunities and challenges its companies face."*

Introduction: The UK mid-market – the medium in SME

What do we mean when we talk about the

mid-market?

(mɪd) (/'ma:kɪt) *(n)*

BLME defines these companies as:

those that can sustain debt of

£2-20m

and have an enterprise value of

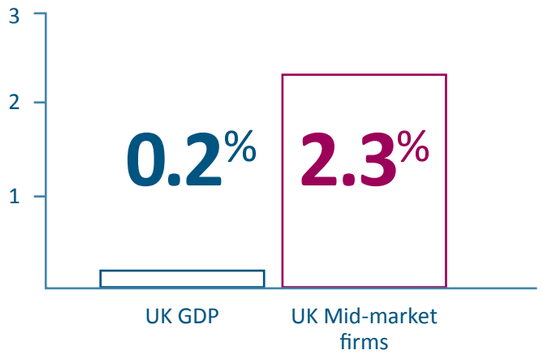
£5-20m

More broadly, the European Commission defines medium sized businesses as having between

50-250

employees

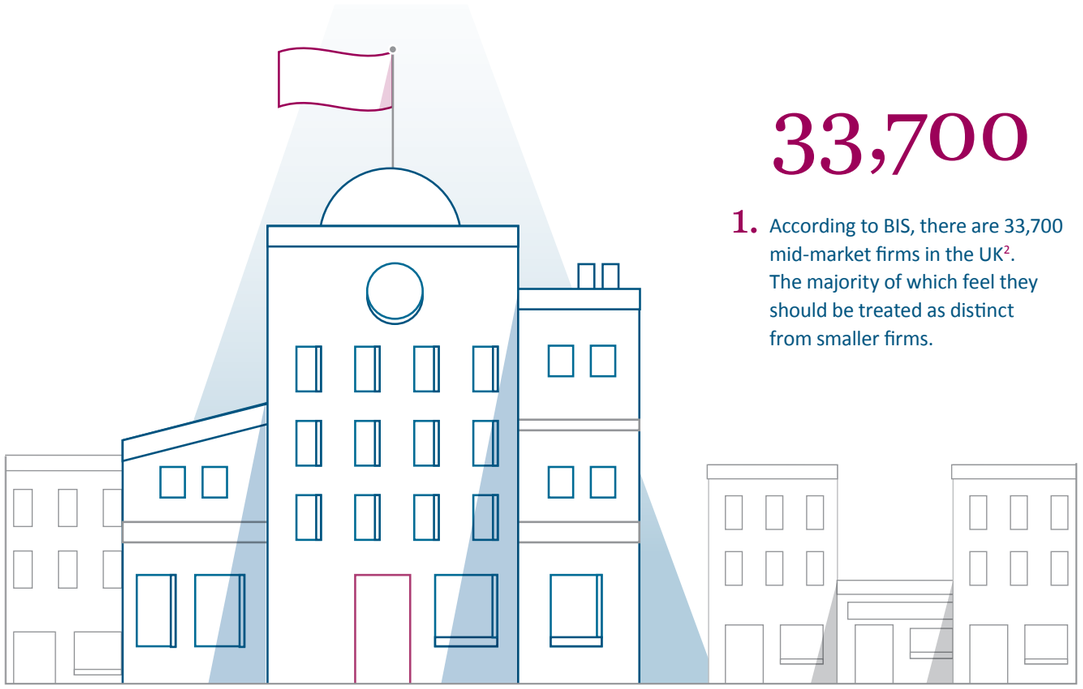
Growth in sales from mid-market firms



G E Capital found that on average UK mid-market firms grew sales by an average of 2.3% in the last year (compared to overall GDP growth in the UK of just 0.2%), with each mid-market firm contributing on average £11 million to GDP.

A snapshot of our key findings

These findings present some interesting food for thought for the UK's mid-market companies themselves, but also for banks, alternative finance providers and government. These companies in the middle of the food chain, neither the largest nor the smallest, are telling us they face a distinct set of challenges unlike those faced by smaller or bigger firms. As such, they need recognition of that fact from Government, and appropriate steps taken. One such step might just be the abolition of the SME tag, which our respondents think is outdated and inaccurate.



33,700

1. According to BIS, there are 33,700 mid-market firms in the UK[2]. The majority of which feel they should be treated as distinct from smaller firms.

2. According to our research, the majority (88%) of mid-market businesses looking for bank finance over the last four years have been successful in securing it.

3. Use of alternative forms of finance is, not surprisingly, smaller, but they do have a foothold – especially among younger business leaders in mid-market firms.

4. More needs to be done to support alternative forms of financing, such as peer-to-peer lending, outside London.

5. Access to this finance has had a tangible impact on jobs and growth.

The key findings are split into the following topics:

- **Perceptions and realities about the UK mid-market**
- **Availability and impact of finance**
- **The role of alternative finance**
- **The use of finance by young business leaders**
- **The outlook for mid-market companies**

A pen portrait of the typical mid-market business the research uncovered:

£27m
Turnover

19.4%
Debt equal to annual turnover

+18
On average new staff were employed by those who successfully borrowed from banks

125
Employees

19%
Increase on turnover as a result of new bank lending

£3m
Applied for in bank finance over the last four years

[2] The Mighty Middle: Growth and opportunity in the UK's mid-market. GE Capital and Warwick Business School. 2013

Perceptions and realities about the UK mid-market

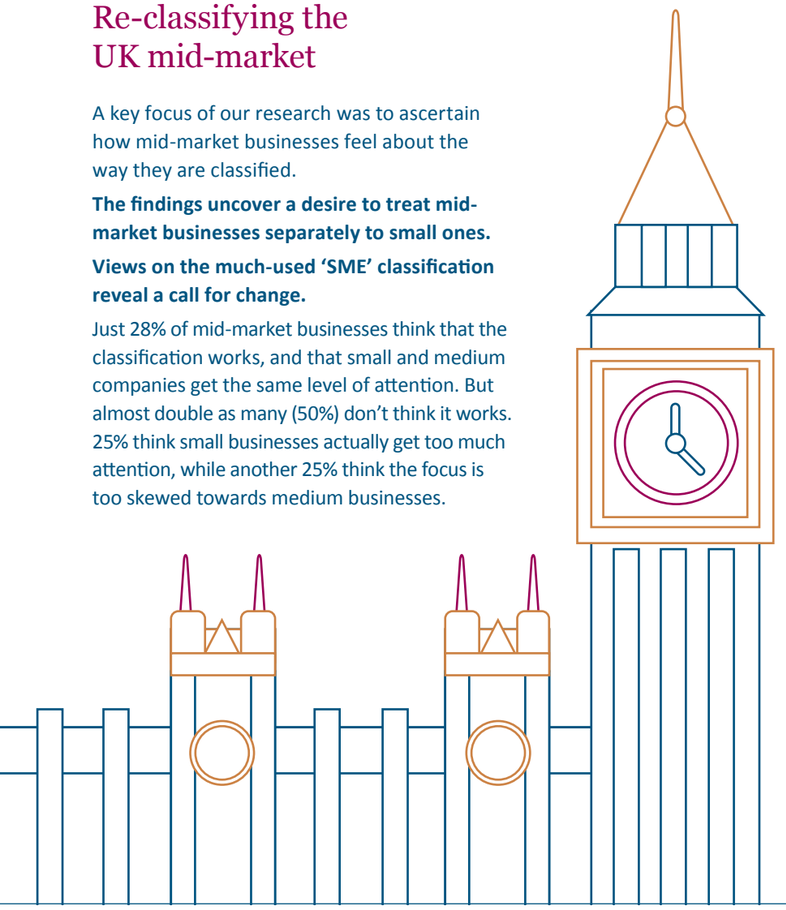
Re-classifying the UK mid-market

A key focus of our research was to ascertain how mid-market businesses feel about the way they are classified.

The findings uncover a desire to treat mid-market businesses separately to small ones.

Views on the much-used 'SME' classification reveal a call for change.

Just 28% of mid-market businesses think that the classification works, and that small and medium companies get the same level of attention. But almost double as many (50%) don't think it works. 25% think small businesses actually get too much attention, while another 25% think the focus is too skewed towards medium businesses.



What do mid-market firms think about Government support?

77%

Nearly eight in ten businesses 77% think the Government needs to do more to support medium-sized companies in the UK. **53%** think the Government needs to do 'much more'.

50%

of mid-market business leaders would like to see the Government address the needs of medium sized businesses as a separate

39%

would like a body created to represent the views of medium sized businesses in the UK

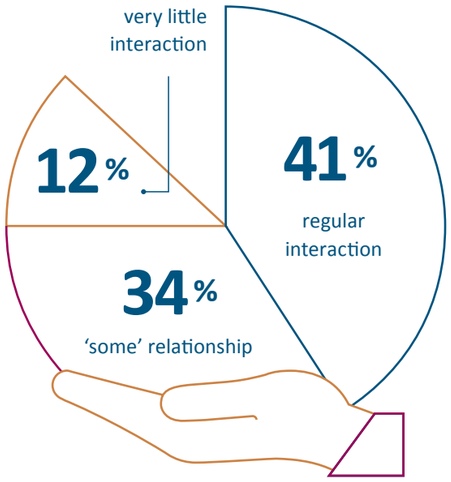
24%

1 in 4 said they'd like to see a specific minister appointed to promote the views of medium sized businesses in Government

> *British businesses have been resourceful throughout a credit restrained period. Bigger businesses exploited opportunities in the corporate bond market, while smaller companies turned to private equity support and the emerging peer to peer lenders. What we see from mid-market companies is that they straddle the plethora of alternative sources of credit whilst the young business leaders in this area, who are arguably more open to new forms of lending, are ready and willing to raise money from sources such as peer-to-peer lenders.*
>
> **Jervis Rhodes**

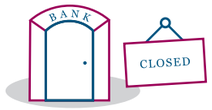
Are mid-market firms receiving formal support from their banks?

It appears that they are – when asked about the relationship they have with their bank:



Demand for formal governmental support:

Launched in July 2012 to support lending by giving banks access to cheaper loans from The Bank of England, the Government's flagship Funding for Lending Scheme received a mixed reception.



4 in 10

Despite the scheme's intentions, four in ten mid-market businesses (39%) said they have actually found UK banks either less willing or much less willing to lend since its introduction.

13%

Just 13% have found banks more or much more willing to lend.

39%

have noticed no difference.

23%

In addition, since Funding for Lending was introduced, 23% of businesses believe the cost of borrowing has gone up.

13% **48%**

13% think it has gone down, while 48% have not noticed any difference.

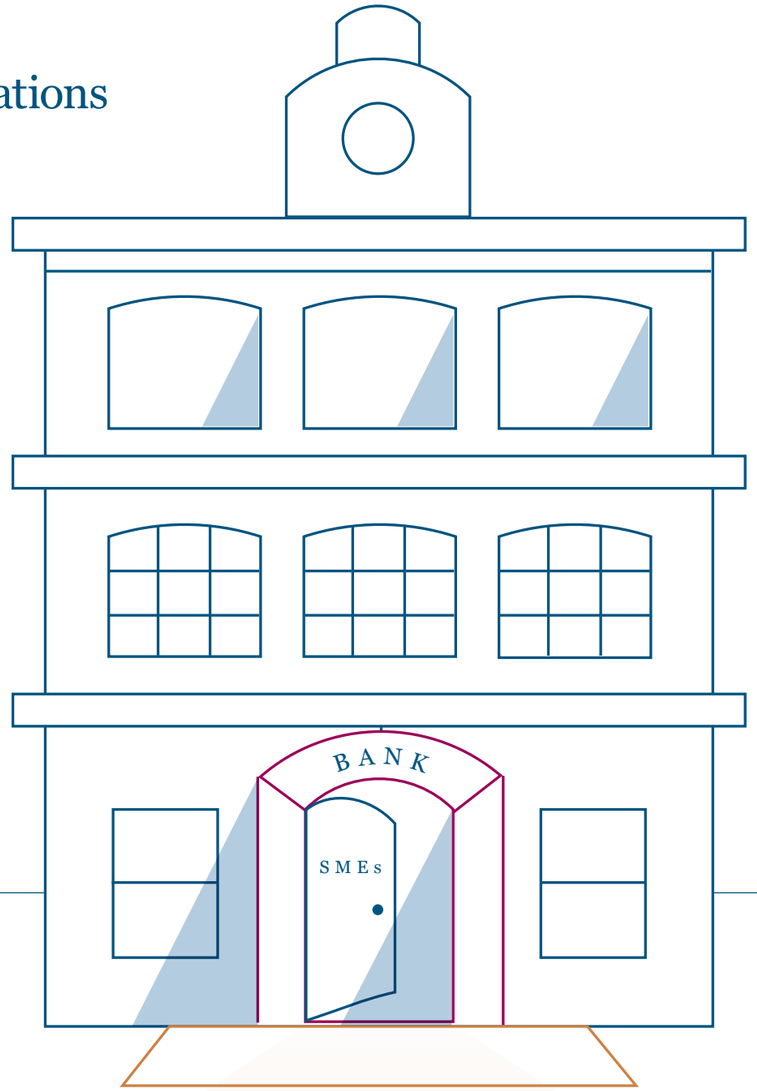
Availability and impact of finance

Volume of applications for bank finance

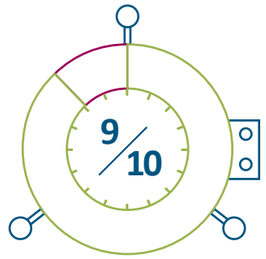
Despite one of the most turbulent economic environments in recent history, mid-market businesses demonstrated a real appetite for bank lending.

64%

Two-thirds of the businesses surveyed (64%) said they had applied for financing from a bank over the past four years.



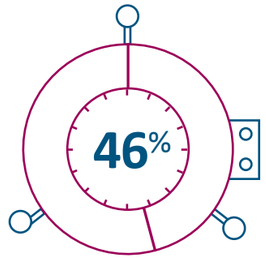
Success in obtaining finance



Of the businesses that have applied for bank finance in the last four years, 88% were successful. In other words, nearly nine out of ten businesses that wanted to borrow funds from their bank secured the money.

"This figure is a surprise, and not what we expected to find. But it does represent mid-market firms' ability to access finance over a four-year period. And while other research doesn't decouple mid-sized businesses from smaller ones, ours has. It suggests the experiences of the two groups are somewhat different. It may also be a nod to the credit quality of mid-market business"

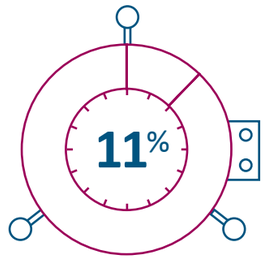
Jervis Rhodes



Of those who were unsuccessful in their application for bank financing, 46% felt it was because the bank failed to understand their business.

Just under one in four (23%) said the bank felt the application represented too much risk.

Of the 34% of businesses who told us they did not apply for any financing, the majority (70%) said they felt they had enough money to fund the business.



11% said they raised money from other sources, while 10% said they were not confident enough to invest in their business due to the economic climate.

£3,013,083

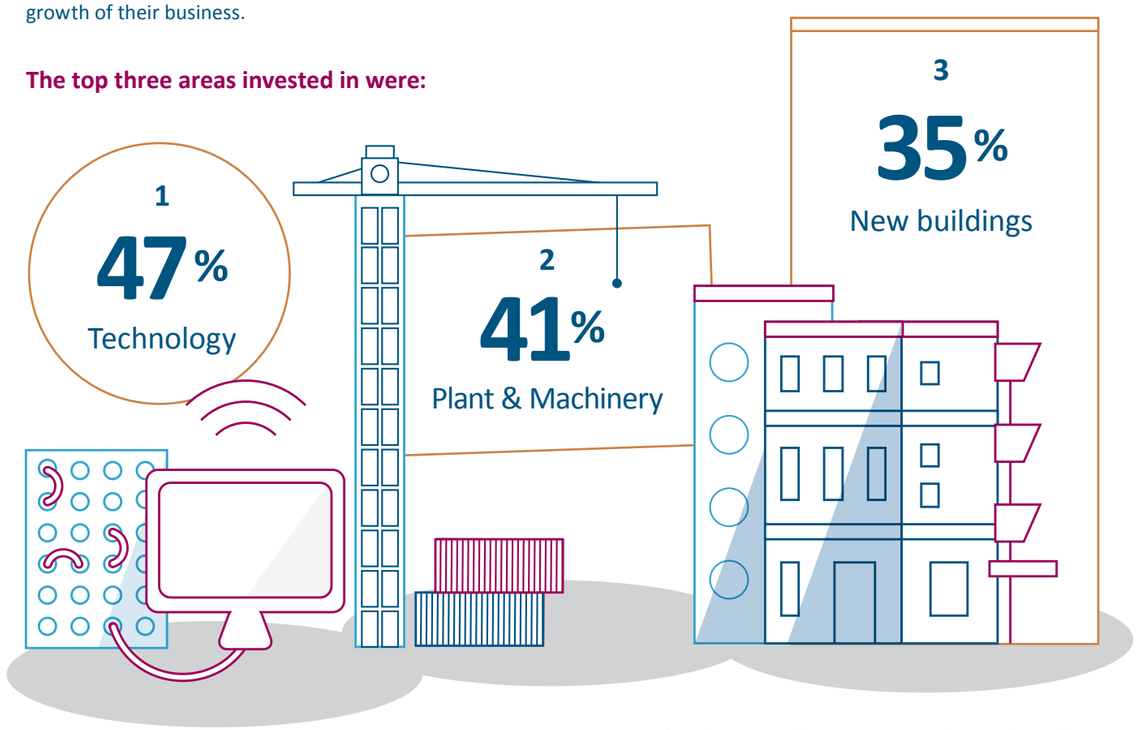
Among those businesses who secured bank finance in the last four years, the mean amount borrowed was £3,013,083. 40% of businesses borrowed more than £500,000.

Availability and impact of finance continued

Where the financing has been invested

We asked businesses why they had applied for bank finance. 59% said it was to invest it in the growth of their business.

The top three areas invested in were:



One in four businesses also applied for financing in order to provide additional working capital.

Only 4% said the finance was to pay down debts.

Case Study: TeamSport

TeamSport was founded in 1990 and now has nine go kart tracks across the UK, making it the largest operator in Europe. In 2012 TeamSport alongside Connection Capital approached BLME to provide debt for a £9 million Management buy-out.

The management buy-out came at a time when demand was growing, TeamSport have witnessed a 40 per cent rise in visitor numbers in just three years. TeamSport has circuits across the south of England and Wales, but with the management buy-out successfully completed and additional debt to fund expansion they will expand north across the UK – and strengthen its foothold in London, where they have two tracks already. Opened in 2011, its Tower Bridge track is a 'green' site, with world-first, fearsomely fast eco- karts. It is London's only carbon neutral leisure venue.

The growth strategy for the business also includes the acquisition of new and existing tracks in what is a very fragmented UK market. There is estimated to be some 100 go karting operators many of which are small and lacking ongoing investment. This will provide additional employment opportunities in the leisure industry across the UK.

40%

Rise in TeamSport's visitor numbers in three years

"Now we have financial support in place, the next few years represent a fantastic opportunity for TeamSport to continue its growth across the UK. We have already completed on our first acquisition in Warrington, and we are currently working on several more acquisitions we hope to complete in the coming months. We have advanced plans for several new track builds next year. The buyout has also helped us to engage employees with the business plan. Our people are proud to be part of a growing business, particularly in the tough economic environment we currently face."

Dominic Gaylor
TeamSport Managing Director

The impact

This lending has resulted in growth for mid-market businesses, generating economic output and jobs at a time when the UK has faced considerable economic headwinds.

72%

The good news for mid-market businesses is that 72% saw their turnover grow as a result of the bank financing they secured.

19%

On average, turnover increased by 19%.

£71bn[3]

Based on the number of mid-sized companies in the UK and the attributes covered in our earlier pen portrait this has led to an increase in output of £71bn.

208,000 jobs

The funding also helped create 208,000 jobs in the UK, according to mid-market companies that had received it.

61%

61% said they had employed more staff as a result of the additional bank financing. On average 18 new staff were employed, with 23% employing more than 20 as a result.

[3] See appendix for methodology

The role of alternative finance

As well as looking at the use of bank finance by mid-market firms, we also asked business leaders about the extent to which they'd utilised alternative sources of finance over the last four years.

These included:

Issuing corporate bonds

Borrowing money from individuals

Peer-to-peer lending

Private equity

Mezzanine finance

Stock market listing

Government initiatives e.g investment innovation fund, capital enterprise fund

Levels of use

Over the last four years just under one in five mid-market businesses (19%) used private equity to raise additional funds. 17% had borrowed from individuals. Less than one in ten had utilised issuing corporate bonds (7%), peer to peer lending (8%) or mezzanine finance (7%).

Looking at the findings in more detail, they uncover a stark regional split in uses of alternative forms of finance. The percentage of businesses in London applying for non-bank lending is much higher than anywhere else in the UK.

Volumes secured

Of those businesses who did raise funds from non-bank sources, the mean amount raised was £4.1m. Interestingly, this is bigger than the mean figure of just over £3m that businesses raised from banks. Fewer companies applied for financing from non-bank sources than from banks, and fewer were successful, but the fact those who were raised these amounts is a promising sign for fledgling industries like peer-to-peer lending and mezzanine finance.

Why London?

Arguably, businesses in London may be more willing to explore new options, but another factor playing a part is that alternative forms of finance are simply more accessible in London than in other parts of the UK.

Alternative finance across the UK

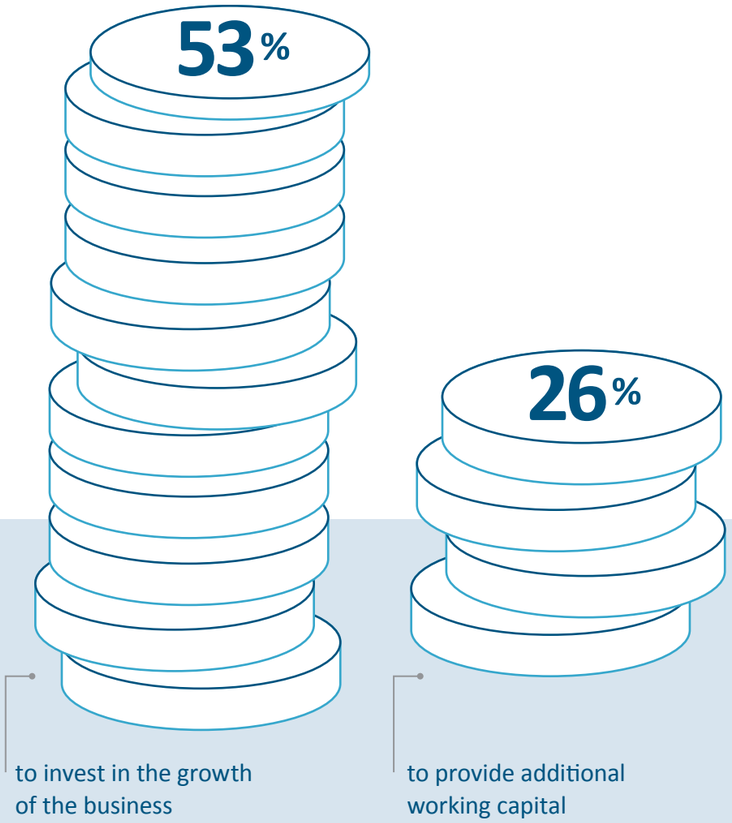
	East	East Midlands	London	North East	North West	Scotland	South East	South West
Issuing corporate bonds	0%	0%	17%	2%	0%	0%	7%	5%
Peer-to-peer lending	4%	7%	16%	0%	6%	4%	4%	0%
Mezzanine finance	4%	7%	13%	0%	6%	4%	6%	0%
Borrowing money from individuals	13%	21%	29%	0%	6%	9%	10%	21%
Private equity	17%	14%	30%	33%	11%	22%	11%	16%
Stock market listing	0%	0%	12%	0%	6%	9%	1%	0%
Government initiatives	17%	7%	18%	0%	6%	0%	3%	5%

The role of alternative finance continued

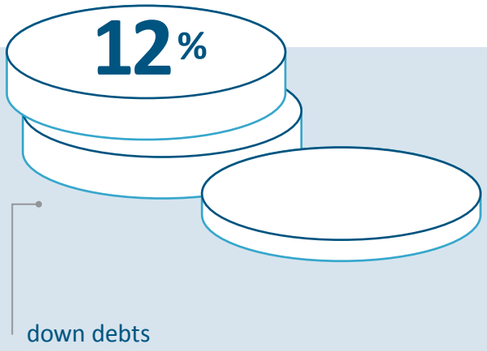
Where the money went

The most common reason for businesses raising funds from alternative forms of finance is the same as those raising funds from bank finance:

- to invest in the growth of the business. Over half of businesses (53%) cite it as their reason for applying.
- One in four (26%) used the funding to provide additional working capital
- Just under one in eight (12%) paid down debts, a significantly higher proportion than those who sought bank finance for the same reason



> *"Businesses should get more targeted support from the Government and lenders. The first step towards achieving this is for banks to deal with businesses on an individual basis and not lump a wide range of companies together as 'SMEs'."*



This suggests that many mid-market business leaders see alternative forms of finance as like-for-like substitutes for bank finance, choosing to obtain it for largely similar reasons.

The impact

68%
As a result of the financing from non-bank sources, two thirds (68%) of companies grew their turnover.

19.4%
On average turnover grew by 19.4% over four years,

19%
similar to the average 19% growth businesses who received bank finance witnessed.

The split of businesses who hired more staff as a result of non-bank finance is roughly half and half:

50% did

47% didn't

3% didn't know

Companies that have seen growth in staff thanks to non-bank finance have seen a similar growth rate to those who used bank finance. Clearly, as far as they are concerned, funding is funding.

18.8+
Those who did employed an average of 18.8 extra people.

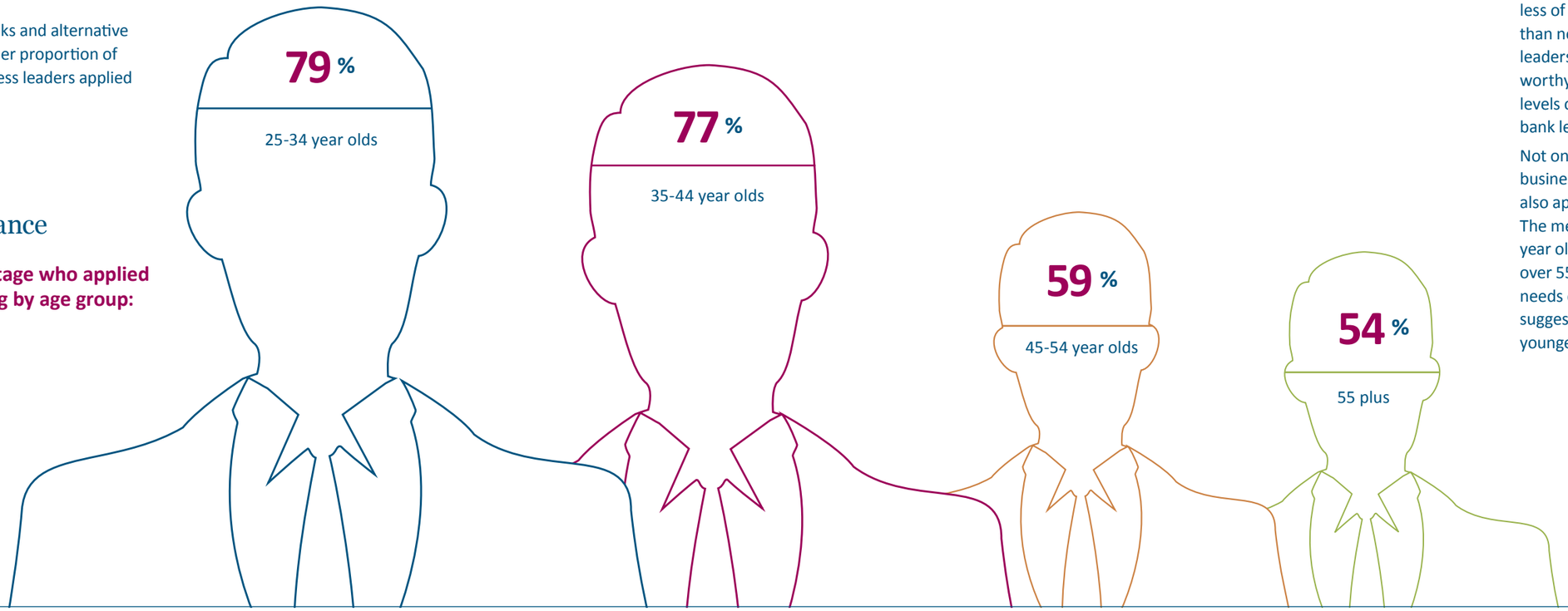
The use of finance by young business leaders

A fascinating pattern emerges when we look at the age of the mid-market business leaders we surveyed.

From both banks and alternative sources, a higher proportion of younger business leaders applied for financing.

Bank finance

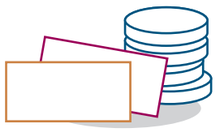
The percentage who applied for financing by age group:



This likely indicates a higher propensity to take a risk among younger business leaders, but it might also reflect the maturity of the businesses they lead. Executives in their fifties or sixties may lead mature businesses with a steady cash flow and less of an immediate need for external financing than newer businesses owned or managed by leaders in their twenties and thirties. It is also worthy of note that those businesses with higher levels of turnover are more successful at securing bank lending.

Not only have a greater proportion of younger business leaders applied for finance, they have also applied for greater quantities, on average. The mean average amount secured among 25-34 year olds is £8.8m, compared to £1.3m among over 55s. Again, this is likely to be indicative of the needs of their respective businesses, or it might suggest more willingness to take a risk among younger leaders.

Alternative sources of finance



Non-bank finance is also a far more popular option with younger business leaders.

12%
Only 12% of 25-34 year olds said they had not raised any funds from alternative sources.

35%
Among 35-44 year olds the figure goes up to 35%

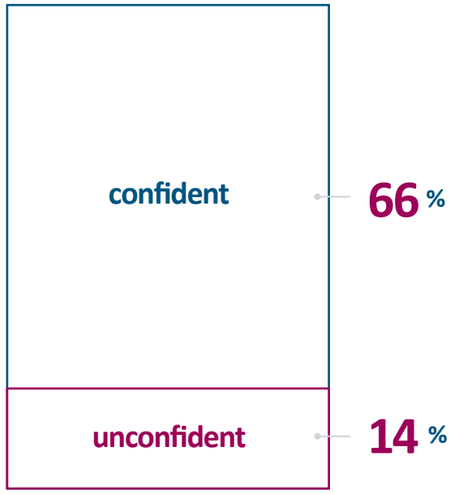
72%
45-54 year olds

73%
55 plus

The relative reticence of older business leaders to embrace alternative forms of finance could be a sign that they know their banks better, and have longer and more established relationships. They may also be more wary of sources they have little familiarity with.

The Outlook for Mid-Market Companies

Since the Spring of 2013 there has been a stream of improved data for the UK economy and a further period of recession appears to have been averted.

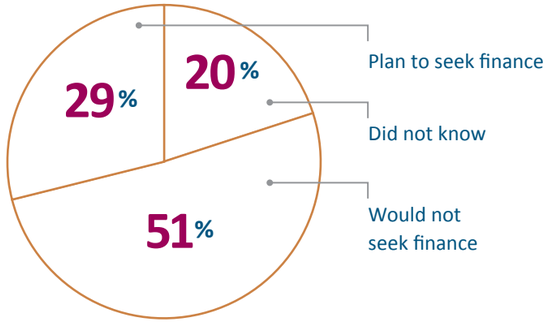


The improving outlook has clearly affected the sentiment of business leaders of the mid-market businesses. Two in three (66%) said they were confident or very confident, with only 14% saying they felt unconfident.

Plans to seek more financing

Given the economic contribution made by mid-market firms, this propensity to borrow and invest is encouraging for the UK economy and provides further evidence to demonstrate how these companies are a crucial element to any recovery.

Businesses looking ahead to the next 12 months:



Sources of those who do plan to seek finance:

65 % banks

38 % private equity

37 % Government initiatives

10 % peer to peer lending

14 % Mezzanine finance

9 % listing on a stock exchange

Of those business leaders who said they would consider options other than bank finance, the main reasons for doing so are they believe those sources are:

41 % More willing to lend

40 % More accessible

Additional financing

Of those seeking additional financing over the next 12 months:

58% plan to use it to invest in the growth of the business.

53% The investment areas coming out on top are plant & machinery...

47 % ...and technology/office equipment

37 % Just over a third of businesses (37%) said they would consider raising money through selling equity as an alternative to bank borrowing.

57 % said they would not.

The interest in alternative forms of finance like peer to peer lending is small, but significant.These are still relatively new forms of finance, but our findings show they have increased their share of the market.

The future of financing for mid-market companies

By doing this research we hoped to shine a light on the priorities and challenges facing the businesses in the middle of our economy. We wondered if the mid-market, too often lumped in with the UK's small businesses, needed reclassifying. A large factor in any reclassification would be determined by the ability of these businesses to access finance, from banks and from other sources.

Conclusion

The findings of our research into the financing available to mid-market businesses has produced a number of surprises and gives rise to possible changes in the way we traditionally group companies, serve them and legislate for them.

As such BLME has made two main recommendations to Government and industry, for how to best support the UK mid-market – a vital growth engine of the economy.

Separate small and medium

Mid-market businesses need to be decoupled from small businesses in the minds of Government, policymakers and industry. The 'SME' tag is outdated and inappropriate. If anything, the research suggests that mid-market businesses have more in common with large businesses, from an access to finance perspective, than they do with small businesses. Throughout the past four years they have been successful in generating finance when required, similar to the way many much larger businesses have.

Indeed, it is potentially damaging to continue to treat mid-market businesses as the same as small businesses. They have different priorities, different needs, and as far as British banks are concerned, they represent altogether different propositions to lend to. Indeed, the interventions created for SMEs, such as Funding for Lending, appear to be having little effect on mid-market companies. By decoupling the small from the medium we believe that the needs of both can be better made; however, in doing so it is important that mid-market businesses are still championed in business and political spheres.

Alternatives need to grow outside London

The appetite for alternatives, including peer-to-peer lending and mezzanine finance, is overly focused in London and the South East. These forms of finance need to step out and increase their reach across the UK, so that they are more visible and accessible to businesses outside the capital. This includes the so called "challenger banks" and niche funders, who started in the South East and now need to expand their offering to the rest of the UK.

A failure to do this will create an environment of haves and have nots when it comes to access of non-bank finance, leading to a disparity and an imbalance the UK mid-market business community can ill-afford.

Appendix

Research methodology

The research was carried out online by ICM, between 24 June – 3 July 2013. 318 business leaders were surveyed.

Methodology for turnover created by bank lending:

According to BIS there are 33,700 mid-sized businesses in the UK. From our survey 64% of these applied for borrowing i.e. 21,568. Of these 88% were successful, or 18,980. 72% of these say that this created growth, i.e. 13,666 companies grew. Our pen portrait shows that average turnover is now £27,400,000 and that 19% of this is due to bank lending, therefore £5,206,000 increase in turnover. Multiply this by the number of firms that successfully borrowed: £5,206,000 x 13,666 = £71,145,196,000, or £71bn.

Methodology for jobs created by bank lending:

According to BIS there are 33,700 mid-sized businesses in the UK. From our survey 64% of these applied for borrowing i.e. 21,568. Of these 88% were successful, or 18,980. 61% of this number said they employed on average 18 more people as a result. So, 11,578 x 18 = 208,404

About BLME

BLME is an independent wholesale bank which received FSA authorisation in 2007 and now has a balance sheet in excess of £1 billion. The Bank is highly liquid with supportive Middle Eastern shareholders. Since 2009 the Corporate Banking division has been building a full service offering for the UK mid-market. As of June 2013, BLME's Corporate Banking division was providing £650mn in funding to the UK mid-market. In October 2013 the bank was ranked by Savills as the third largest big ticket property lender in the UK.

In September 2012 the final piece of our mid-market offering; Acquisition Finance was launched with the first transaction closing later that year. The Acquisition Finance team joins our more established Leasing, Property, Trade Finance and ABL Finance teams. In 2012 we also arranged several club deals and have capacity for more in 2013. This range of specialist teams and services make BLME the only UK bank with a full product range dedicated to the mid-market, which we define as a business with a debt requirement of £1 million to £25 million.

For more information visit www.blme.com

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