Is mid-market growth a key to a healthy economy?

An independent report by BLME

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Foreword

A lot can change in a year. In 2013 BLME released its first research report looking at financing for the UK mid-market and then, the talk was very much of the green shoots of economic growth. The prevailing mood was one of cautious optimism. Fast forward a year and the UK is recognised as the fastest-growing economy in the western world. The IMF has repeatedly revised its forecast for economic growth in the UK upward, and as a consequence of this discussion regarding when interest rates will be increased is rife.

That is not to say that all is rosy. After a savage recession areas of weakness still remain, not least weak wage growth and what is being coined as the UKs 'productivity puzzle'. However a corner has been turned and the market's mind-set is now tuned into fuelling growth as the economy recovers further.

Against that backdrop, BLME has sought to understand the experiences, plans and ambitions of the UK mid-market. Too often overlooked as they sit between their smaller enterprise relations on one side and by major listed multinationals on the other, the success of those in the middle is critical to the long-term health of the British economy. So, how are they feeling about the months and years ahead? Do they share the broader sense of optimism about the economy? How are they succeeding in obtaining all-important finance and what are they doing with it? And what are their ambitions for growth, up to and beyond the 2015 General Election and the changes that could bring?

Answers to these questions and more are provided in this report, which shines a light on previously unseen thoughts and concerns held by the UK mid-market, and offers compelling food for thought for business leaders, lenders like us and policymakers alike.

Jervis Rhodes,
Head of Corporate Banking

[1] Department for Business, Innovation & Skills

"The success of those in the middle is critical to the long-term health of the British economy."

A snapshot of our key findings

48%

1. are planning to look for finance in the next 12 months – of those, 67% will most likely go to their bank.

29% ↑

2. The top priority for seeking finance over the next 12 months is to pay down debts, up from 11% last year.

47%

3. of mid-market firms applied for finance in the last four years and 94% were successful.

6% peer to peer

6% mezzanine finance

4. The use of alternative forms of finance over last four years among the mid-market is low.

76%

5. The economic outlook among the mid-market is extremely positive: three quarters (76%) are confident or very confident.

44%

6. are happy as a mid-market firm, or have no desire to get any bigger. Only 35% want to become a bigger company and have plans in place to achieve it.

17%

7. want to grow but feel there are barriers preventing them from doing so.

73%

8. of mid-market firms want to see more finance providers outside the big four banks. 74% thinks the government needs to do more to facilitate lending to the mid-market.

A pen portrait of mid-market company survey:

617

is the average headcount for these firms.

£231

Is the average company turnover.

21%

of annual turnover is the average company debt.

£24.4m

The average amount of bank finance sought over the last four years:

53%

of these firms are based in London and the South East, compared to 7% in Scotland, 4% in Wales and 1% in Northern Ireland.

20%

operates in the financial and professional services sector; 12% work in technology and 10% in healthcare.

The lending environment

Ability to access bank finance

Mid-market firms still report an appetite for finance, albeit lower than last year's research. 47% of firms surveyed had applied for finance in the last four years, down from 64% last year. However, success rates have increased; 94% were successful compared to last year's 88%, suggesting a more positive lending environment for mid-market companies. Looking ahead, just under half (48%) will look for finance in the next 12 months.

£24.4m

The average amount of bank finance sought by mid-market firms over the last four years.

The impact of bank finance

Bank finance has had a telling impact on the size and make-up of the mid-market, contributing directly to jobs and growth within the sector and as a result fuelling greater growth across the economy.

77 %

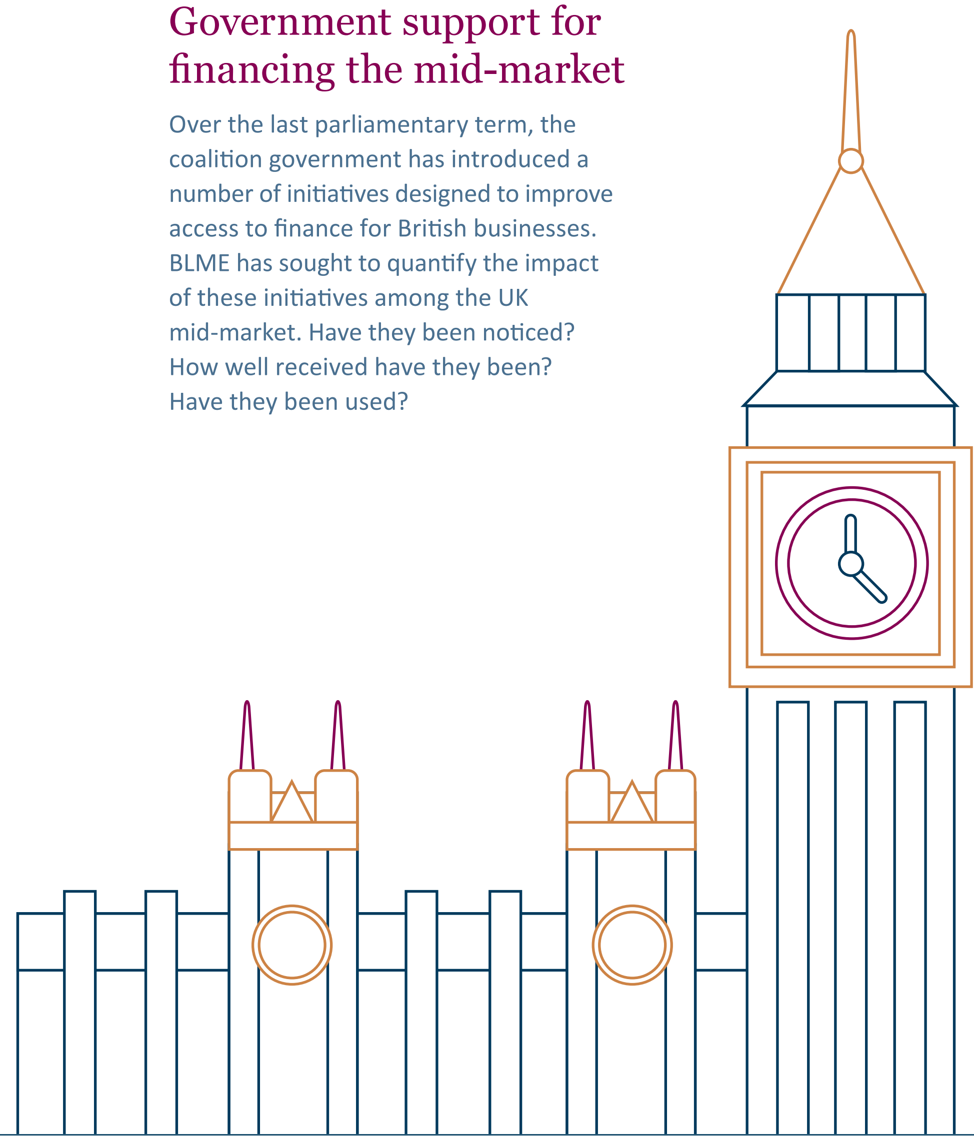
of firms who obtained bank finance saw turnover grow as a result. Based on the average levels of turnover growth reported, and the size of the UK mid-market, bank finance is projected to have contributed £68bn to national output over the last four years.

80 %

of those who received financing employed additional staff. Based on the average number of staff new staff reported and the size of the UK mid-market, bank finance is projected to have contributed 115,000 new jobs over the last four years.

Government support for financing the mid-market

Over the last parliamentary term, the coalition government has introduced a number of initiatives designed to improve access to finance for British businesses. BLME has sought to quantify the impact of these initiatives among the UK mid-market. Have they been noticed? How well received have they been? Have they been used?



The initiative which received the highest name recognition was the National Loan Guarantee Scheme.

38 %

Just over one in three firms (38%) said they had heard of it. Bottom of the list was the British Business Bank, with 24% recognition.

15 %

The scheme most used by mid-market firms is the Business Finance Partnership – by 15% of those we surveyed, a success.

7 %

7% say they have used the Export Working Capital Scheme.

6 %

6% say they have used the National Loan Guarantee Scheme.

Why finance is needed

Over half (52%) of those applying to financing from a bank did so to invest in the growth of their business. Specifically:

51 % said the money will be invested in technology.

33 % in news skills and human resources.

27 % are investing it in plant and machinery.

27 % want to use it to fund merger/M&A activity – a sure sign of renewed confidence in the economic outlook.

Use of alternative sources of finance

While 21% of mid-market firms tell us they have used private equity at some point over the last four years, broader take-up of alternative forms of finance remains unexpectedly low.

6 % of firms have used peer to peer lending over the last four years.

6 % used mezzanine finance.

9 % issued corporate bonds.

7 % listed on a stock market.

In addition, 31% will use their bank finance to provide additional working capital.

The lending environment continued

Success or Failure?

At first glance, none of the business finance initiatives receiving more than 38% recognition feels low. The 15% uptake of the Business Finance Partnership is lower still. But 15% represents more than one in seven mid-market firms accessing a key Government finance initiative. From a policy perspective, this ratio will surely be viewed as a success.

The Business Finance Partnership

The Business Finance Partnership was set up to invest £1.2 billion in lending to SMEs from sources other than mainstream banks. This money is being matched by private sector investors. According to figures from the Department for Business, Innovation & Skills, the Business Finance Partnership has helped create £5 of lending for every £1 of taxpayers' money. £172 million of government money has been used by lenders as well as £705 million from private sector investors. This has led to a total of £877 million lent to 18 medium-sized businesses and 880 small businesses thus far.

Growth ambitions – the contented middle

“*Growth comes in different forms for different businesses, and depending on what they do it may be that growth is not their number one priority. Nonetheless, the emergence of a sizeable contented middle group of mid-market firms is a real surprise.*”

Why are so many firms in the UK mid-market, firms who have grown from nothing to become already sizeable operations, seeing their appetite for growth plateau? If this question were asked in the USA, it's a safe bet the answer would be substantially different. The overriding feeling here is one of contentment. These firms appear happy with their position in the mid-market. Barriers such as the wider economy and access to finance were cited, but by a very small proportion – so these cannot be held up as the reason for this contentment.

Is there something in the British psyche that means business leaders lack the self-belief to aim as high as possible, to build their business as big they can? Perhaps the UK mid-market lacks role models, with a dearth of British equivalents to Apple, Google or Ford in terms of scale. Or it may be that the Bill Gates/John D Rockefeller philanthropist figure simply does not appeal to the average British business leader, who may instead be content with a comparatively more modest lifestyle.

Jervis Rhodes,
Head of Corporate Banking

“*What's clear is that more work is needed to identify and understand the barriers which appear to stunt ambition among British businesses.*”

With the British economy growing again, BLME is keen to better understand the mindset of mid-market firms. What are their aims and objectives? Where are they trying to get to? On the important issue of growth, our research unveiled some eye-opening findings.

44%
Almost half said that they are either happy as a mid-market firm, or have no desire to grow.

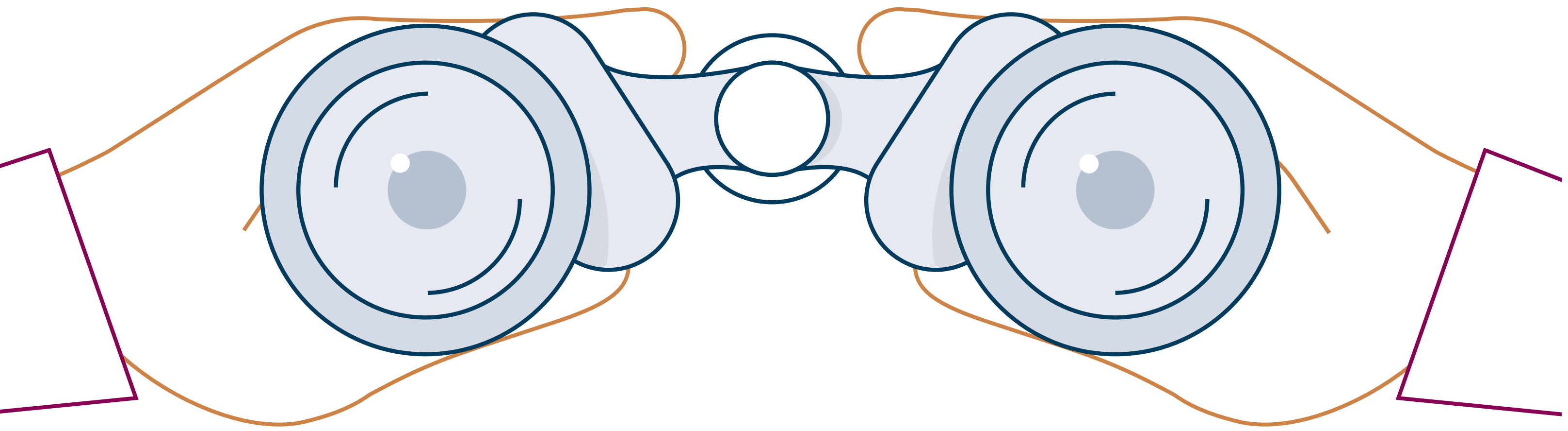
32%
Only just over a third said that they want to become a bigger company and have plans in place to achieve it.

17%
of firms said that they do want to become a bigger company, but that they feel there are barriers to them achieving it. Of these;

44%
cited the current economic landscape;

15%
blamed a lack of sufficient finance opportunities.

Outlook



Reasons for more finance

Investing in the growth of their business remains the most common reason for mid-market firms to seek bank finance, cited by 52%. Of those:

47 %

plan to invest the finance in technology and office equipment if they get it.

32 %

hope to invest in new skills and human resources.

There has also been a notable rise in the proportion of mid-market firms who say the top priority for seeking finance over the coming year is to pay down debts. Almost one in three firms (29%) planning to seek finance cited that as their primary aim, compared to just 11% last year.

> *"The growth in the number of firms planning to pay down debts is a sure sign of a renewed confidence in the economy. Over the last few years, as we've battled through recession and then close to zero growth, there has been an understandable focus on short-term priorities. In other words, ensuring the business can operate from one day to the next. With firms feeling more optimistic that the worst of things economically are now behind us, we're seeing signs that they are prepared to think about the future again and focus on reducing long-term debt. Minimising debt is vital if long term stability is to be achieved."*
>
> **Jervis Rhodes**

Outlook

After years in the doldrums, the economic situation in the UK has turned a corner. And while there is still some way to go, various indicators suggest growth has returned and, most importantly, stability.

The UK mid-market exemplifies this view. Over three-quarters (76%) of those we surveyed described their outlook for the economy as confident or very confident – up from 66% last year.

Plans to seek more finance

48% of mid-market firms plan to seek additional financing over the next 12 months. Of those, two-thirds (67%) said they would consider going to their bank to seek this finance, while 35% will weigh up the option of private equity investment and 27% issuing corporate bonds.

General Election and the prospect of change

For businesses looking to plan ahead, fundamental policy shifts brought about by a change in government can introduce unwanted uncertainty. The UK mid-market clearly shares this view. 65% of firms we asked said that the prospect of a change in Government in 2015 creates either 'some' or 'a lot of' uncertainty.

Desire for more help

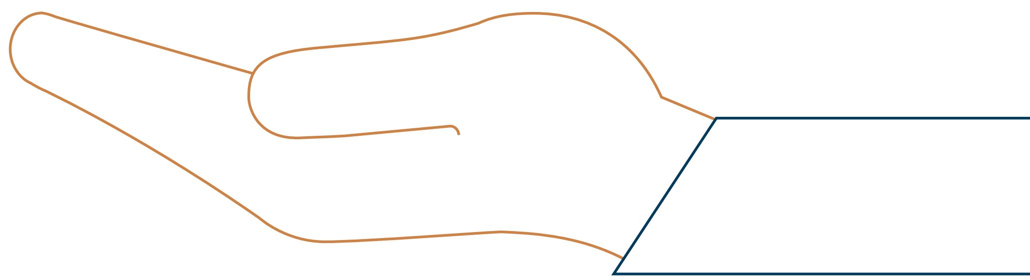
Success in applying for bank finance is high among the mid-market, and there has also been some take-up of finance initiatives like the Business Finance Partnership. But our research has found that firms think more can be done.

77 %

agree that more finance providers outside the big four banks are needed.

74 %

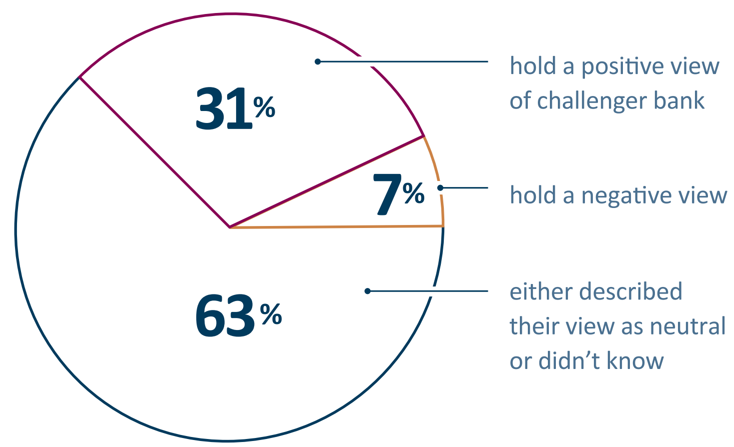
believe that the Government needs to do more to facilitate lending to the mid-market.



Who can break the big four's dominance?

Despite a desire for more alternatives to the big four banks, and for greater government support, take-up of routes like peer to peer lending and mezzanine finance has remained stagnant for the mid-market. This opens the door for the UK's challenger banks to step up and fill the void.

This group of lenders has grown both in number and in stature over recent years. Yet the mid-market view of these challengers is decidedly mixed.



There is a vibrant and innovative second tier of banks operating in the UK which is proving a high-quality service to the mid-market, and building successful long-term relationships. Yet the feedback from mid-market firms up and down the country is that the big four banks still boast an unhealthy dominance. The opportunity for these challengers is plain — but there is also a pressing onus on Government to ensure the environment is ripe for genuine competition in the banking sector.

Recommendations

Based on the findings of our research, BLME has four key recommendations for policymakers.

01

The Government needs to do more to help and inspire mid-market firms to grow – and to want to grow. Evidence suggests a lack of ambition to transition the UK's mid-market so that they become the large corporates of tomorrow. This has wider economic implications; it limits economies of scale and constrains improvements in productivity. Over time, it will affect the UK's competitiveness on the international stage.

02

There is a natural, complementary relationship between mid-market firms and mid-sized banks. The two need to be recognised as a mutually beneficial partnership. 40% of the mid-market wants to see finance or lending initiatives specific to the mid-market. It is the second tier of banks the so called "Challenger Banks" that sit below the big four, who are best placed to deliver this, providing a more tailored and more personalised service rather than operating on mass.

03

Policy makers need to beware the impact of uncertainty. The General Election understandably creates uncertainty, as it affects firms' ability to plan ahead. But there is also wider uncertainty at the moment around interest rates, compounding to create ambiguity for management teams. Future borrowing is largely targeted at paying down debts at present. While this is understandable given the debts which will have built up during the lean years, whoever leads the country next year and beyond needs to create conditions where firms can invest in growth and development instead.

04

Focus more on the initiatives that work. The Government has tried and tested a range of business finance schemes over the past few years, with varying degrees of success. With public resources remaining constrained, policymakers should be bold: ditch the less successful initiatives, and back the ones which have been popular and delivered results, such as the Business Finance Partnership.

Appendix

Research methodology

The research was carried out online by ICM, between 4 - 9 August 2014. 200 business leaders were surveyed.

Methodology for turnover created by bank lending:

According to ONS figures there were 5,148 businesses in the UK in 2011 with annual turnover between £50-500m. From our survey 47% applied for borrowing, i.e. 2,420. Of these, 94% were successful, or 2,274. 76% of these say that this created turnover growth, i.e. 1,729 companies. Our pen portrait shows that average turnover is now £230.74 million and that 17% of this is due to bank lending, therefore £39,225,800 increase in turnover. Multiply this by the number of firms that successfully borrowed: £39,225,800 x 1,729 = £67,821,408,200 or £67.8bn.

Methodology for jobs created by bank lending:

According to ONS figures there were 5,148 businesses in the UK in 2011 with annual turnover between £50-500m. From our survey 47% applied for borrowing, i.e. 2,420. Of these, 94% were successful, or 2,274. 80% of these said they employed on average 63 more people as a result. So 1,819.2 x 63 = 114,610.

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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