OXFORD ECONOMICS

Funding Circle

THE ECONOMIC IMPACT OF LENDING THROUGH FUNDING CIRCLE

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EDELMOND

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FOREWORD

Small businesses are the unsung heroes of our economy. They're the ones who've taken a risk and worked hard to realise their ambitions. At Funding Circle, their work inspires us, and we've made it our mission to help small businesses across the world go even further.

Our business was founded in direct response to the 2008 financial crisis, when banks pulled back from lending. There are over 150 million small businesses in the world, all of which are driving much-needed job creation and productivity across their local economies. Despite this valuable output, they continue to struggle with an unfair and broken financial system. This report, which is our first global impact study, reveals the extent to which banks have retreated and how online lending platforms are stepping in to fill the gap.

Over the years, it's become evident that small businesses are underserved in every country we operate and it is our view that these difficulties exist well beyond our own footprint. Today, the vast majority of lending still comes from banks, however they struggle to support this part of the market. Bank branch closures are also on the rise, including over 2,000 in the US last year, and half of German branches since the year 2000.

To a certain extent, this is inevitable in an internet age. Technology has led to the emergence of online lending, bringing vital innovation to the way small businesses can access finance for growth and ensuring even businesses in the most rural locations can do the same. By combining proprietary risk models and cutting-edge technology with advanced data analytics, these platforms have made deep pools of capital available to them for the first time. This powerful combination also allows us to expand the market and help more small businesses; 16% of businesses tell us they wouldn't have been able to access finance without us.

Within this report, it's particularly rewarding to see the enormous economic impact that is stimulated as a result of lending through Funding Circle. When a business accesses finance through our platform, a ripple effect is seen through supply chains further boosting local communities. In 2017 alone, this activity unlocked 75,000 jobs across our four markets, many of which were created as a direct result of the loan or would have ceased to exist without the funding.

From butchers and bakers, to IT consultants and accountants, these are the businesses that are made to do more, creating jobs and driving the economy forward. Supporting them is a mission that continues to inspire us; we help them as they change the world.

Samir Desai
CEO and co-founder of Funding Circle

EXECUTIVE SUMMARY

£3.9 bn

Annual gross value added supported by Funding Circle's loans across its four markets in 2017.

SMALL FIRMS CONTINUE TO STRUGGLE TO ACCESS FINANCE

In the decade since the financial crisis in 2007/08, small businesses have continued to have difficulties in obtaining bank loans in industrialised countries, despite wide-ranging measures to improve access to finance for this demographic.

Central bank data suggests that banks have treated their small business customers less favourably than larger businesses. The stock of bank loans to small firms is growing less rapidly than for larger corporates, and in some countries, the decrease in interest rates has not been passed on to small firms to the same extent as to larger businesses. Banks have also operated different policies on the fees and commissions they charge. This has, and continues to, disadvantage small businesses and hinder their vital contribution to the global economy, reducing innovation, competition and the number of jobs created.

THE GROWING IMPORTANCE OF ONLINE PLATFORMS FOR SMALL BUSINESS LOANS

A less accommodating stance by banks and the advent of technology has meant small businesses have developed an increased appetite for other forms of finance. Online lending is at the forefront of these non-traditional options.

Funding Circle is the leading small business loans platform in the United Kingdom, United States, Germany and the Netherlands. By connecting supply directly with demand, a wide range of investors are able to lend directly to small businesses. This allows creditworthy firms to receive a loan to grow and expand in days rather than months.

In the UK, where Funding Circle has been established the longest, the platform is now competing directly with banks in the small business lending market – with net lending through the platform exceeding that of the entire UK banking system for two successive quarters at the end of 2017. A survey of Funding Circle's customers undertaken for the study suggests 89 percent of the platform's UK small business customers would approach Funding Circle first again in future, rather than going to a bank.

This report investigates the impact of the loans extended through Funding Circle on economic activity in each of the four countries it operates in. As well as establishing its full contribution to GDP, jobs and tax revenues, the comparisons give an indication of how Funding Circle's impact may grow in its newer markets—and in any others it may enter in the future.

75,000

Jobs enabled by lending through Funding Circle in 2017

KEY FINDINGS ABOUT THE IMPACT OF LENDING THROUGH FUNDING CIRCLE

In total, Funding Circle's loans under management to small businesses at December 2017 supported an additional £3.9 billion annual gross value added contribution to Gross Domestic Product (GDP) across the four markets. In practical terms, this means that every £1 million of loans issued through the platform helped small firms to contribute £2 million to GDP.

Across the four countries, Funding Circle's loans were found to enable over 75,000 jobs at the end of 2017. Some 41,500 (55 percent of the total) were directly employed at the small businesses that took out loans through the platform, and the remaining jobs were sustained indirectly through supply chains or by employees' wage-financed spending.

The activity and employment supported by Funding Circle's loans also generates significant tax revenues for local and central governments in the four countries. The total loans under management at December 2017 are estimated to have supported £1.3 billion in annual tax receipts. Some 45 percent of the taxes supported were generated by Funding Circle's customers**,** with the remaining 20 and 35 percent, respectively, generated in the small businesses' supply chains and stimulated by the wage-financed consumption of staff.

£2.4 bn

Annual gross value added supported by lending through Funding Circle in the UK

FOCUS ON THE UNITED KINGDOM

Since Funding Circle issued its very first loan to a small business in August 2010, lending through the platform has grown rapidly in the UK. The value of new loans issued increased by 77 percent in 2017. At December 2017, its stock of loans under management in the UK was £1.5 billion—four times what it was at the end of 2014. When all impacts are included, we estimate these loans supported a £2.4 billion gross value added contribution to UK GDP per annum.

Funding Circle's loans also have a significant impact on the UK labour market, enabling an estimated 44,600 jobs in 2017. This activity and employment generated some £730 million in annual UK tax revenues for HM Treasury.

The economic impact of Funding Circle in the UK has grown significantly over the last three years. We estimate that, at the end of 2017, the annual gross value added contribution to GDP associated with its stock of loans under management was 3.8 times what it was three years earlier, with the jobs associated with these loans having increased by 3.5 times in that period.

FOCUS ON THE UNITED STATES

Lending through Funding Circle to small businesses in the United States has also grown rapidly. In December 2017, its stock of loans under management ($479 million) was 12 times larger than three years earlier.

The platform's loans make a sizable economic contribution in the US. Its loans under management to small businesses in December 2017 are estimated to have supported a total gross value added contribution to US GDP of $2.0 billion per annum; 27,700 jobs were sustained and the activity supported $790 million in annual tax revenues.

FOCUS ON GERMANY

Lending through the platform is making an increasing contribution to the German economy. Having only started serving German small businesses in 2015, Funding Circle's loans under management at the end of December 2017 supported an annual €103 million gross value added contribution to German GDP. Some €61 million (59 percent) of this contribution was generated by the platform's small business customers. Funding Circle's loans under management at December 2017 are estimated to have enabled some 1,700 jobs in Germany, with 900 of these (55 percent) located at Funding Circle's small business customers.

$2.0 bn

Annual gross value added supported by the platform's loans in the US

FOCUS ON THE NETHERLANDS

Funding Circle has more loans under management than any other online lending platform in the Netherlands. Despite only launching in 2015, Funding Circle Netherlands' loans under management at December 2017 are calculated to have supported an annual total gross value added contribution to the Netherlands' GDP of €65 million. Of this, 58 percent was generated by the platform's customers and 21 percent in their supply chains, while 22 percent was associated with the retail and leisure outlets at which all these employees spend their wages. The platform's lending also sustained some 900 jobs in the Netherlands, and €20 million in annual tax revenues.

SIMILARITIES ACROSS ALL FOUR COUNTRIES

The results of a survey of 1,243 borrowers undertaken in February 2018 show small businesses have the same motivations in taking a loan extended through Funding Circle across all four countries. The simple loan application and the speed of the process were the main reasons firms borrowed from the platform, according to the survey results.

1. INTRODUCTION

Small firms are very important to industrialised economies. According to the OECD, small and medium-sized enterprises (SMEs) account for approximately 99 percent of all firms.[1] They provide 70 percent of jobs and between 50 to 60 percent of GDP on average across the OECD countries.

£1.5 bn

In loans under management in the UK at December 2017

Borrowed by 25,500 customers in the UK.

Historically, small businesses have been heavily dependent on banks for their external finance. However, the 2007/08 financial crisis—which crippled banks' ability and willingness to lend—exposed the dangers of small firms being dependent on only one source of finance. Many creditworthy small businesses were denied access to credit or suffered a funding shortfall when they most needed it. Although, the picture is different across the four countries this study covers, banks seem to have pursued different policies on the interest rate spreads, and the fees and commissions they charge small firms relative to their larger counterparts. This has hindered many businesses' economic performance, and forced some into liquidation.

In the aftermath of the financial crisis and global recession, a number of non-bank sources of finance to small businesses emerged and expanded—often facilitated by innovations in technology, such as online lending. This has served to decrease small firms' dependency on banks for external finance.

This study looks at one online lending platform for small businesses: Funding Circle.

Funding Circle serves as an intermediary between small firms wanting to borrow and investors wanting a return. For firms seeking external finance, the platform undertakes a credit assessment, facilitates the loan to the business, and collects the repayments. For investors, it opens up lending opportunities not previously available to them, facilitates the extension of the loan, and collects and pays the interest and principal they are owed.

The report assesses the impact of lending through Funding Circle in four countries: the United Kingdom, United States, Germany and the Netherlands. The platform's business is at different levels of maturity across these four economies, having issued its very first loan in the UK in August 2010. At December 2017, 25,500 small businesses customers had current loans through Funding Circle in the UK, with the stock of loans under management standing at £1.5 billion—72 percent of the loan portfolio across its four markets (see Fig. 1).

[1] OECD, *Enhancing the contributions of SMEs in a global and digitalised economy*, 2017.

The first Funding Circle loan in the United States was issued in October 2013. By December 2017, the platform had a stock of £479 million loans under management in the US (23 percent of its total portfolio). Funding Circle issued its first loans in Germany and the Netherlands in November 2015.

Analysis of the impact of Funding Circle in the UK and US may offer insights into how it will develop in Germany and the Netherlands—and any other economy the platform enters in future.

Each chapter looks at the impact of the financial crisis on bank lending to small business, contrasting this with the growth in non-bank forms of finance, and reviewing survey evidence of small businesses' perceptions about the credit conditions they face.

Each chapter then examines Funding Circle's loan portfolio in each particular country. It investigates the industries in which the platform's small business customers operate and their location, and reviews the average size, duration and terms of the loans issued in 2017.

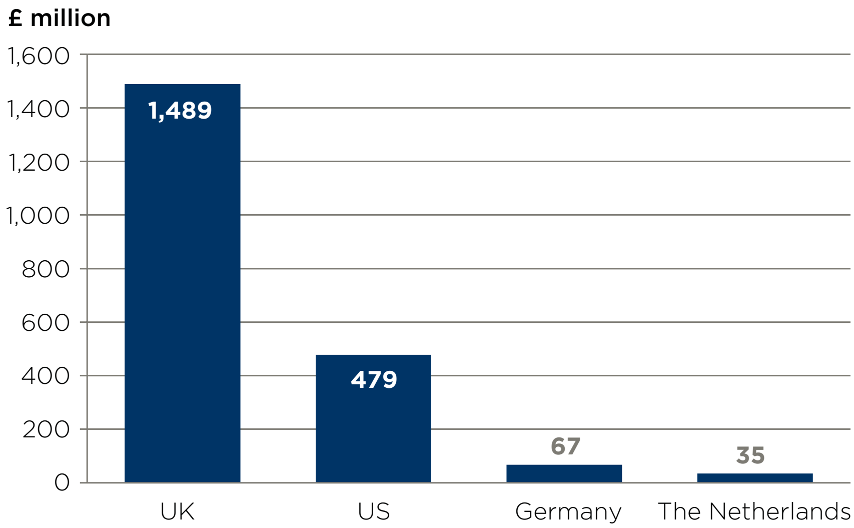
The analysis investigates why Funding Circle's customers use the platform to obtain loans in each country. It reports the results of a customer survey undertaken in February 2018 on 1,243 borrowers' motivations for using Funding Circle, looks at the impact of the loan for a small business, and asks what would have happened had it been unable to obtain a Funding Circle loan.

Each chapter also estimates the full economic impact of the lending extended by Funding Circle in that country. It does so by investigating the three types of expenditure that may flow from Funding Circle's small business loans:

- economic activity generated at the borrower company by the loan;
- economic activity the loan stimulates along the borrower's supply chain;
- impact from the payment of wages supported by the loan, which are subsequently spent in the consumer economy.

For each country, the results are presented across three metrics: the gross value added contribution to GDP, employment, and tax receipts generated.

Fig. 1: Funding Circle's stock of loans under management at December 2017



Source: Funding Circle

2. UNITED KINGDOM

Mainstream finance has not served small businesses in the UK well in recent years, with data showing the gradual recovery of the value of outstanding bank loans since mid-2015 has concentrated on large businesses.

Various forms of non-bank finance, including lending platforms, are stepping in to meet small businesses' needs. Funding Circle's loans to small businesses support economic activity across all sectors and regions of the UK. The value of new loans extended to small firms through Funding Circle in 2017 increased by 77 percent, following growth of 57 percent in 2016. Survey evidence suggests customers are attracted to the platform by its fast and simple application process (see Section 2.3).

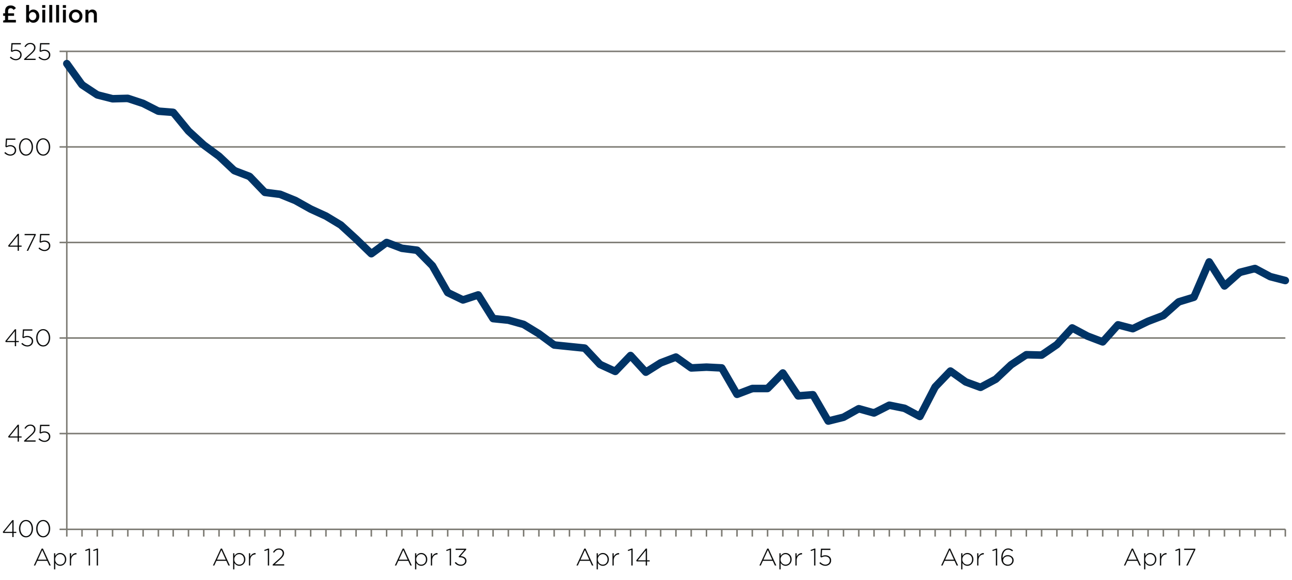
2.1 SMALL BUSINESSES' ACCESS TO FINANCE

Banks continue to disadvantage small firms in the amount they lend and the interest rates they charge.

After a deep and prolonged decline, the stock of bank loans to non-financial businesses has gradually recovered since mid-2015. Bank of England data show the value of banks' outstanding loans to all UK non-financial businesses declined by 18 percent between April 2011 and June 2015. Since then, this value has made a gradual recovery, and now stands 11 percent lower than at the start of the period (Fig. 2).[2]

However, small businesses have not benefitted from the recovery of bank credit. The proportion of outstanding bank loans held by SMEs fell from 38.2 percent in June 2015 to 35.6 percent at the end of 2017 (Fig. 3). This equates to a one percent increase in the value of SME loans over that time (Fig. 4)[3] – far below the equivalent 13 percent rise for large businesses. The stock of loans held by SMEs was still 16 percent lower in December 2017 than in April 2011, compared with a net decline for large firms of just eight percent.

Fig. 2: Outstanding bank loans to non-financial businesses



Source: Bank of England

[2] Bank of England, *Money and credit – December 2017*. The dataset starts in April 2011. It relates to lending by all 'monetary financial institutions', but as the majority relates to banks we use the term 'bank loans' for simplicity.
[3] For these purposes, small and medium sized enterprises are those businesses with annual debit account turnover on the main business account less than £25 million, as per the Bank of England definition.

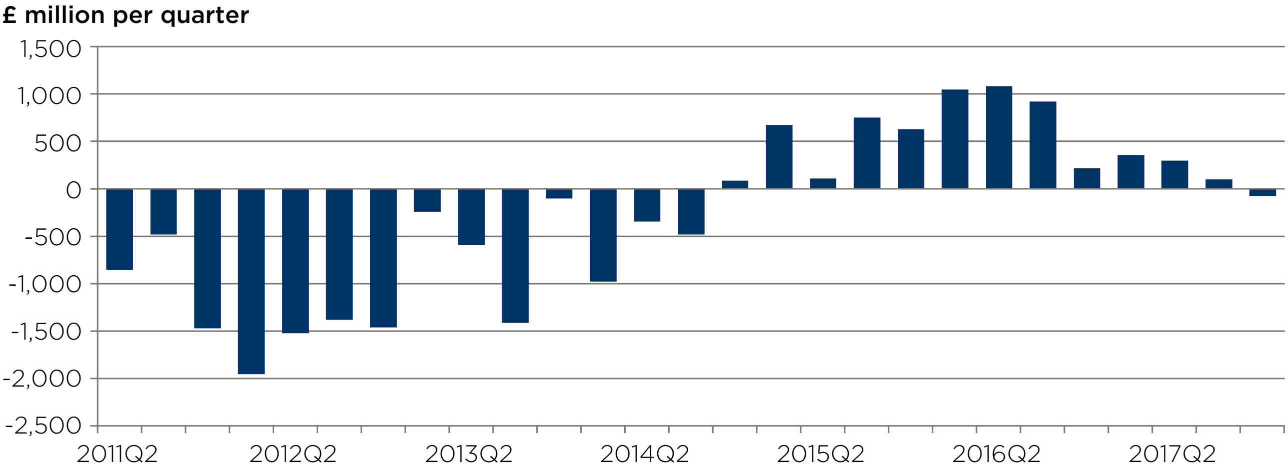
Fig. 3: Small businesses' share of outstanding bank loans to non-financial businesses

Source: Bank of England

Fig. 4: Outstanding bank loans to small businesses

Source: Bank of England

Fig. 5: Net lending by the banks to small businesses



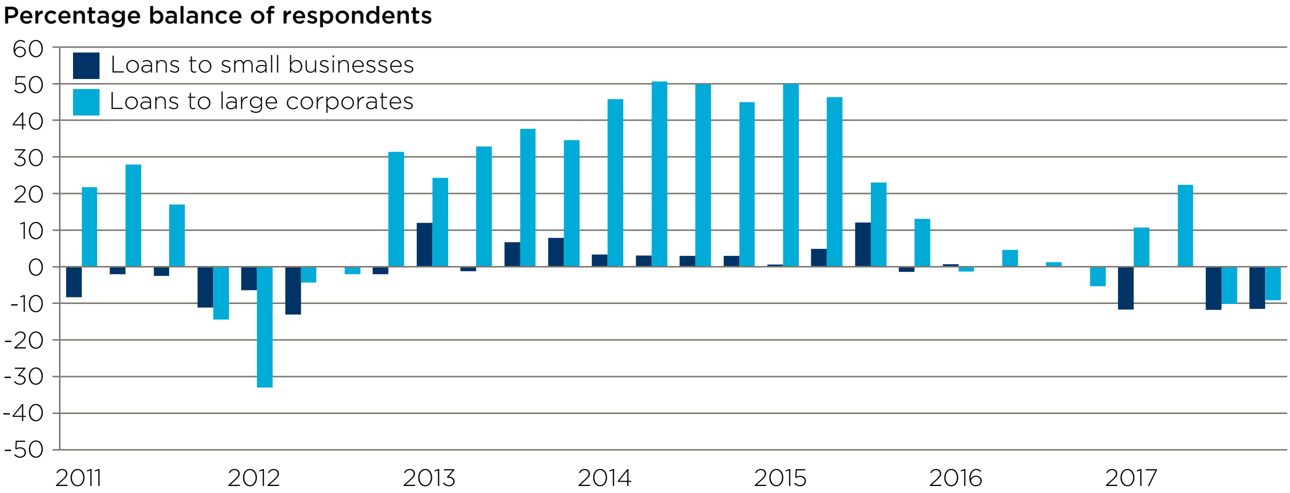
Source: Bank of England

Part of the story here is that net lending by the banks to small businesses—a measure of credit extended by banks published by the Bank of England—was negative for a long time following the financial crisis, only turning positive in late 2014. These flows then turned negative again towards the end of 2017 (Fig. 5).

At the same time, the size of the SME sector has been increasing. Between 2011 and 2017, the number of SMEs grew by 28 percent[4], and their turnover and employment rose by 17 and 10 percent respectively. With that in mind, it is likely their demand for external finance will have risen over the same period.

Evidence of gaps in the market for loan finance, due to structural problems, was identified in the British Business Bank's 2016/17 report.[5] This pointed to high loan rejection rates both among younger small businesses and those wishing to scale up — with constraints on the latter having potentially negative consequences for the creation of new jobs.

Fig. 6: Trend in interest rate spreads on loans: small versus large businesses[6]

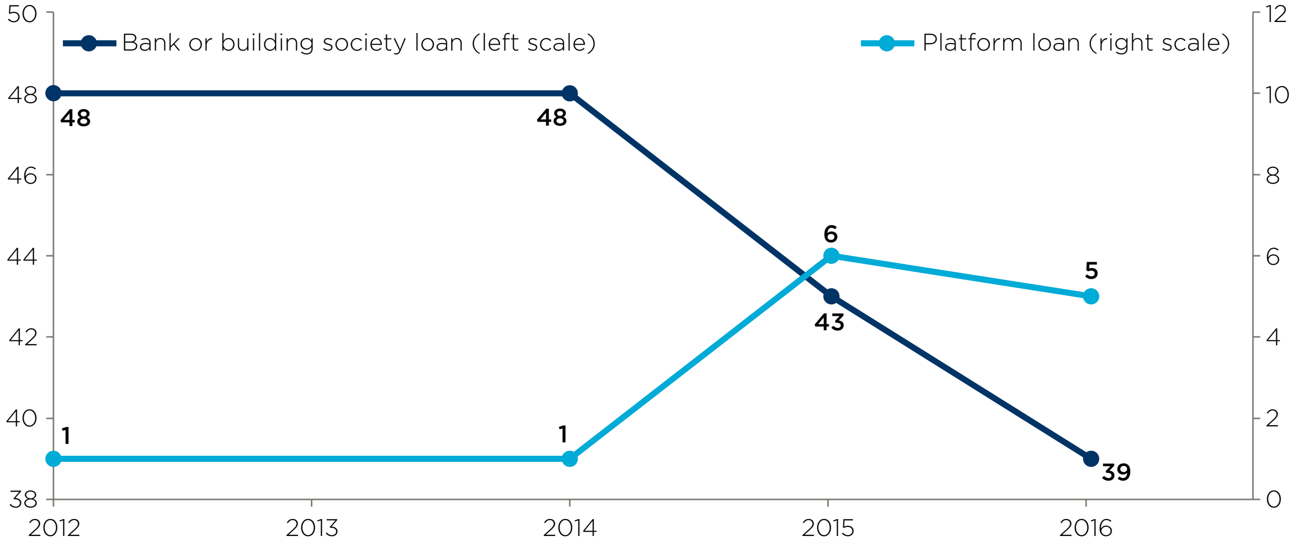


Source: Bank of England Credit Conditions Survey

[4] ONS, UK business: activity, size and location – 2017, 1 November 2017.
[5] British Business Bank, Small business finance markets 2016/17.
[6] A positive balance indicates a fall in spreads, making it cheaper for businesses to borrow.

Fig. 7: Type of loan sought by SME employers

Percentage of SMEs seeking any kind of external finance in past 12 months



Source: BEIS Small Business Surveys

Banks have chosen to treat small firms differently in the interest rates they charge. The Bank of England's Credit Conditions Survey suggests banks have reduced the interest rate "spreads" they charge large businesses over the past five years, as measured by the differential with key benchmark interest rates (Fig. 6). However, banks have chosen to keep the interest spreads they charge small firms broadly constant. As a result, small firms which rely on banks for external finance have not seen the same reduction in their borrowing costs that large firms have enjoyed.[7]

Small businesses are increasingly looking to lending platforms for their loans. The Department for Business, Energy & Industrial Strategy's survey of SME employers, carried out in mid-2016, shows a rise in the proportion of firms seeking funding who specifically sought a loan through an online platform—up from one to five percent when compared with a similar survey carried out in 2014 (Fig. 7).[8] Over the same period, the proportion seeking a bank loan fell from 48 percent to 39 percent.

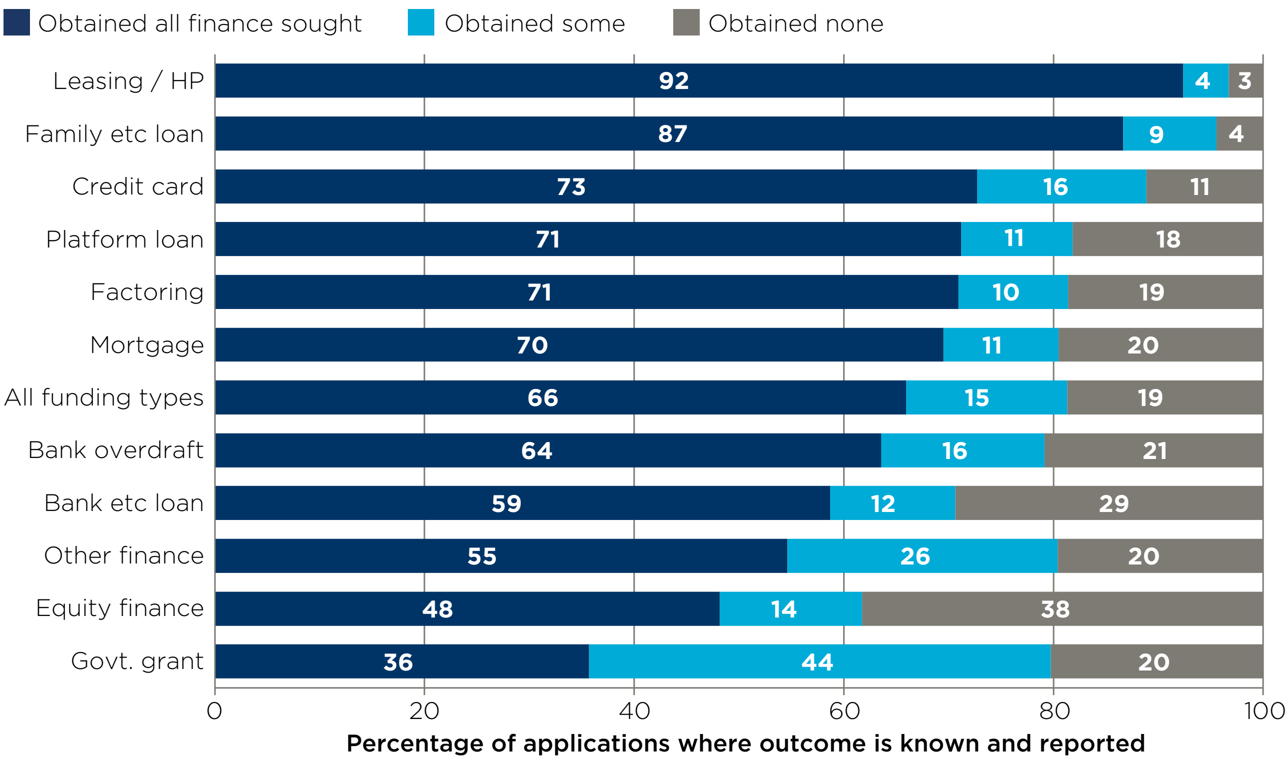
[7] Bank of England, *Credit conditions survey, Q4 2017*. The survey covers bank and building society lenders. Here, small businesses have an annual turnover of under £1 million, with medium-sized corporates between £1 million and £25 million.

[8] Department for Business, Energy & Industrial Strategy (BEIS), *Longitudinal Small Business Survey 2016,* and earlier surveys in the same series. SME employers have between one and 249 employees. The surveys are carried out in mid-year and the question covers finance sought over the previous 12 months.

The same survey also shows that 71 percent of SME employers seeking a platform loan over the 12 months to mid-2016 received *all* of the funding they sought (Fig. 8).[9] This compares with 66 percent of firms applying for funding of any type, and 59 percent of those seeking a bank loan.

When widened to include SME employers who had received all or some of the funding sought, the results were 82 percent (platform loans), 81 percent (any funding), and 71 percent (bank loans). This suggests that small businesses are finding it easier to access the funds they need from lending platforms.

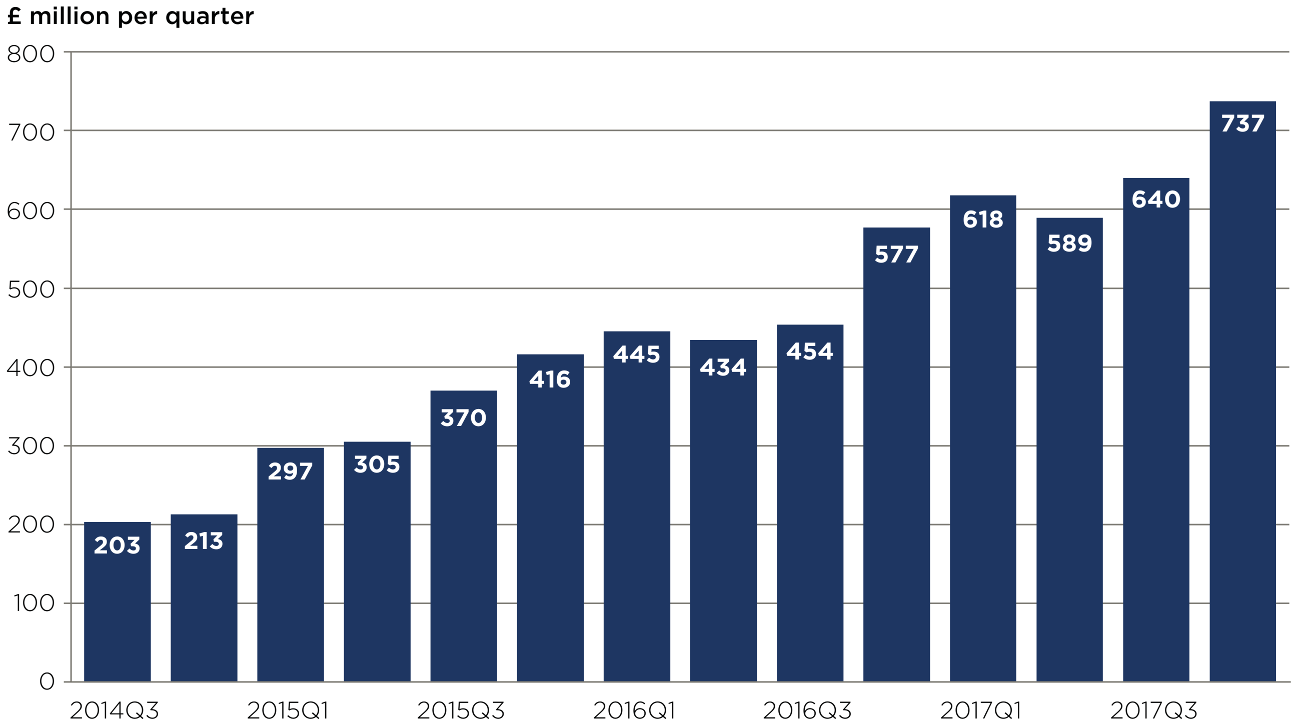
Fig. 8: Outcome of SME employers' funding applications in 2016[10]



Source: Oxford Economics interpolation of BEIS Small Business Survey 2016

[9] The results cited here have been adjusted by Oxford Economics to exclude 'pending', 'don't know' and 'refuse to answer' options. The raw results were 'all' 47%, 'some' 7%, 'none' 12%, 'pending' 0%, 'don't know' 29%, and 'refuse to answer' 5%. The raw results for all finance types were 'all' 60%, 'some' 14%, 'none' 17%, 'pending' 3%, 'don't know' 5%, and 'refuse to answer' negligible. For bank lending they were 'all' 54%, 'some' 11%, 'none' 27%, 'pending' 4%, 'don't know' 4%, and 'refused to answer' negligible.
[10] Excludes 'pending', 'don't know' and 'refuse to answer'.

Fig. 9: Value of new platform loans to businesses



Source: P2PFA, with Oxford Economics adjustment for non-P2PFA members that have originated more than £1 billion

The flow of new loans through lending platforms is growing at a remarkable pace. Take-up of new platform loans reached £737 million in the final quarter of 2017 (Fig. 9).[11] Consequently, the flow of lending through platforms in 2017 was up more than 25 percent on the previous year, more than 75 percent higher than in 2015, and over three times the volume seen at the end of 2014.

[11] Based on P2PFA quarterly data on new lending to businesses by its members, with an upward adjustment by Oxford Economics to allow for non-members. The estimate is also made on the basis that the vast majority of platform loans to business are made to SMEs rather than larger firms.

CASE STUDY: ARAPINA

Arapina is an award-winning, healthy-lifestyle bakery based in south-east London. Founded in 2013 by Michaela Pontiki, the business began with a single product—the "classic chocolate" Arapina cake—which proved highly popular in food markets around London. Now this Mediterranean bakery employs 12 members of staff, serving up some 2,500 meals and cakes a week via its own bakery in Deptford and through delicatessens, a weekend stall at Greenwich Market, and catered parties and events.

With demand for Arapina's "guilt-free" treats growing fast, in 2017 Michaela—known universally as "Lady M"—decided it was time to open her own shop and production unit. Having located a new premises, she sought the funding for a complete refit—and, while researching different financing options, came across an advert for Funding Circle on social media.

Attracted by its ease of communication and straightforward application process, Michaela took out a loan through Funding Circle in May 2017. Together with Arapina's own funds, this was used to purchase new equipment for the kitchen and soft furnishings for the front of house—enabling the bakery to offer a much wider menu of vegan and "free-from" savouries, cakes and treats, both in person and through its online shop, wholesale and catering arms.

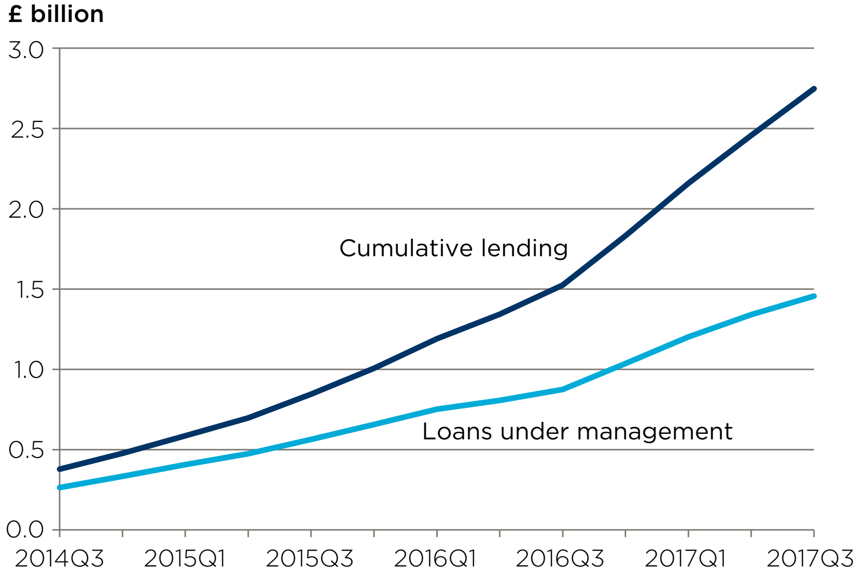
Michaela credits the loan with helping to kickstart Arapina's growth; since then, the business's turnover has doubled. "Without the equipment," she observes, "you don't have legs to walk." But her ambitions don't stop there—Lady M is now looking into new locations for an additional market stall, and another Arapina shop.

2.2 FUNDING CIRCLE'S UK LENDING PROFILE

Funding Circle's loans to small businesses in the UK continue to increase at a significant pace. At the end of 2017, cumulative lending since the firm's inception was six-and-a-half times the value reached at the end of 2014, at close to £3.1 billion (Fig. 10). The total value of business loans under management was nearly five times higher, at £1.5 billion, helped by growth of 43 percent in 2017 alone. By end 2017, some 32,000 UK businesses had taken just under 43,000 loans through Funding Circle, an average of 1.4 loans each.

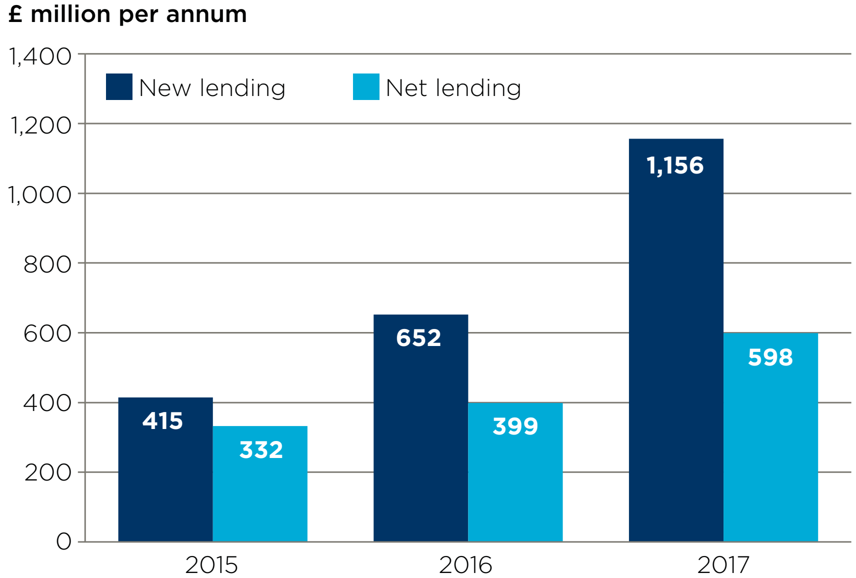
In 2017, the flow of Funding Circle's new UK lending reached £1.2 billion, following growth of 77 percent in that year and 57 percent in 2016 (Fig. 11). Net lending—the difference between new lending and capital repayments made during the year—grew by 50 percent, to reach almost £600 million.

Fig. 10: Lending through Funding Circle to UK businesses: 'stock' measures



Source: Funding Circle

Fig. 11: Lending through Funding Circle to UK businesses: 'flow' measures



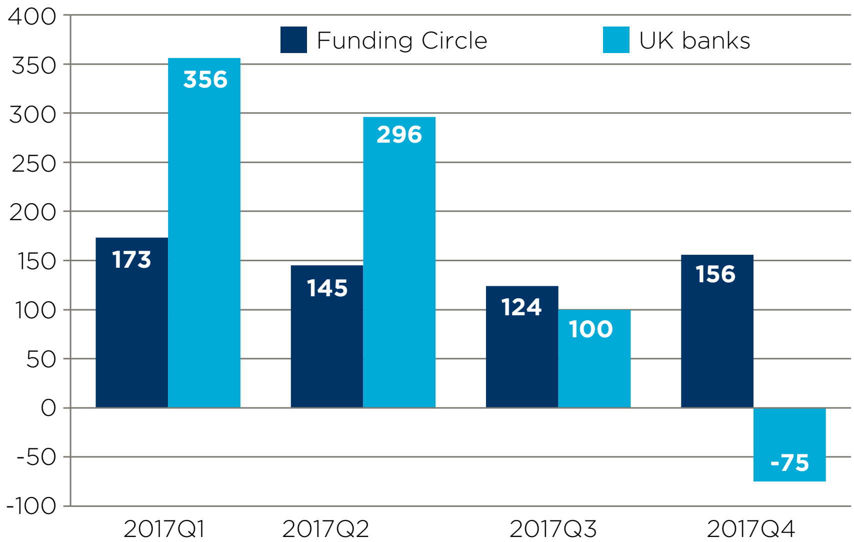
Source: Funding Circle; Oxford Economics

While net lending to SMEs by UK banks fell into negative territory at the end of 2017, net lending originated by Funding Circle remained strongly positive (Fig. 12). This marked the second successive quarter in which net lending to SMEs through the platform exceeded that of the entire UK banking system. As a result, net lending through Funding Circle in 2017 stood at £598 million for the year as a whole, compared to £677 million by all UK-resident banks.

Funding Circle's loans are spread broadly across the small business sector. At the end of 2017, the largest share of loans under management was held by companies in the construction and property industry (17 percent), followed by manufacturing and engineering, professional and business support services, and retail (all at 12 percent).[12]

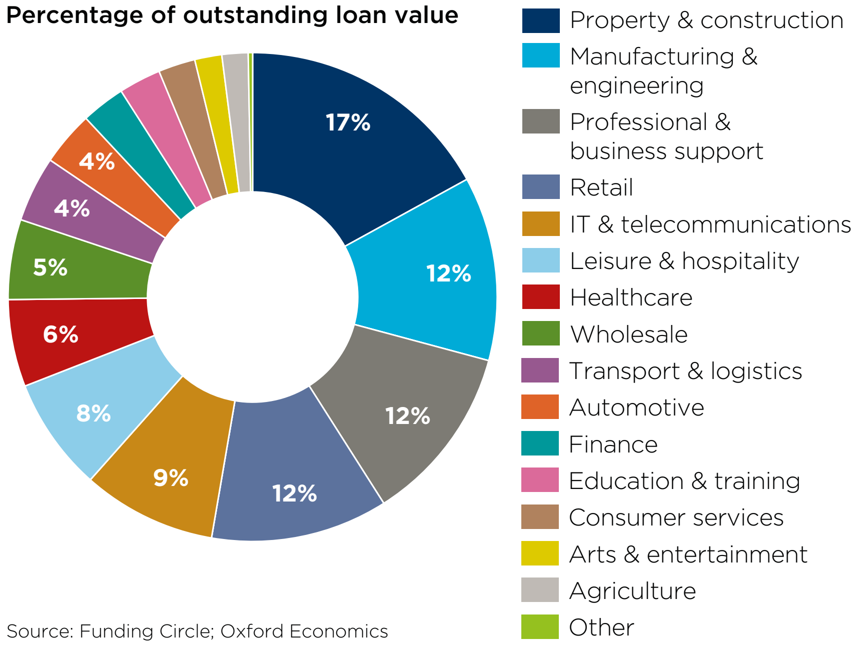
Funding Circle investors lend to small businesses in some of the industries that are predicted to grow most rapidly (Fig. 14). For example, Oxford Economics' Global Industry Model forecasts the IT and telecommunications sector will grow its contribution to UK GDP by 3.8 percent per annum over the 10 years to 2025. This is well ahead of the forecast for the UK's overall annual growth rate of 1.9 percent.

Fig. 12: Recent net lending to SMEs, by Funding Circle and UK banks



Source: P2PFA; Funding Circle

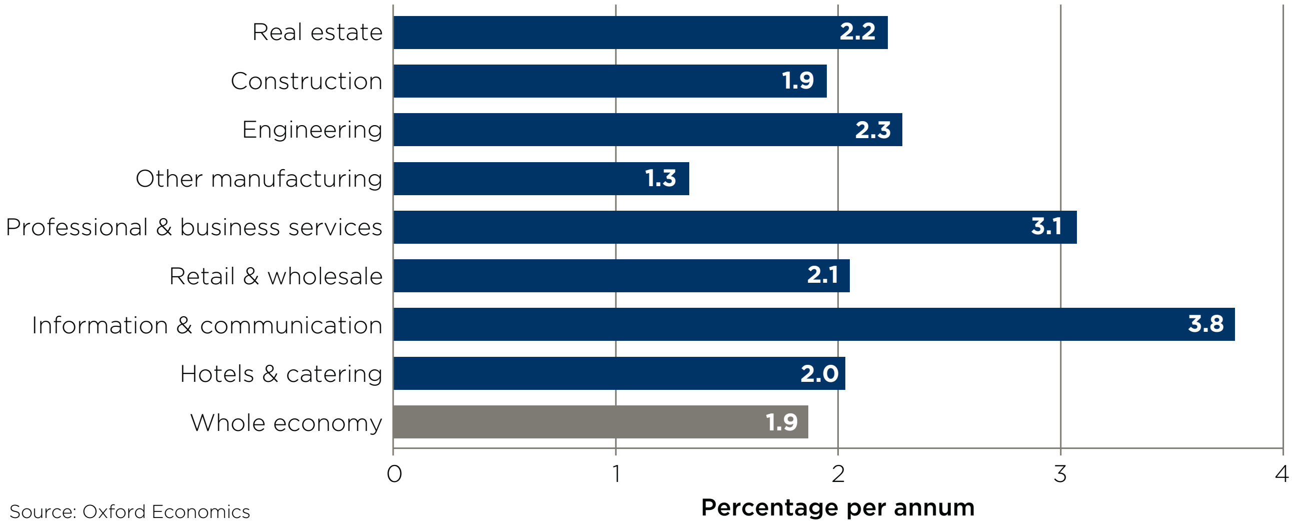
Fig. 13: Loans under management by Funding Circle by industry of borrower, end-December 2017



Source: Funding Circle; Oxford Economics

[12] These figures relate to outstanding loans excluding those in default.

Fig. 14: Projected annual GDP growth by industry, 2015-2025

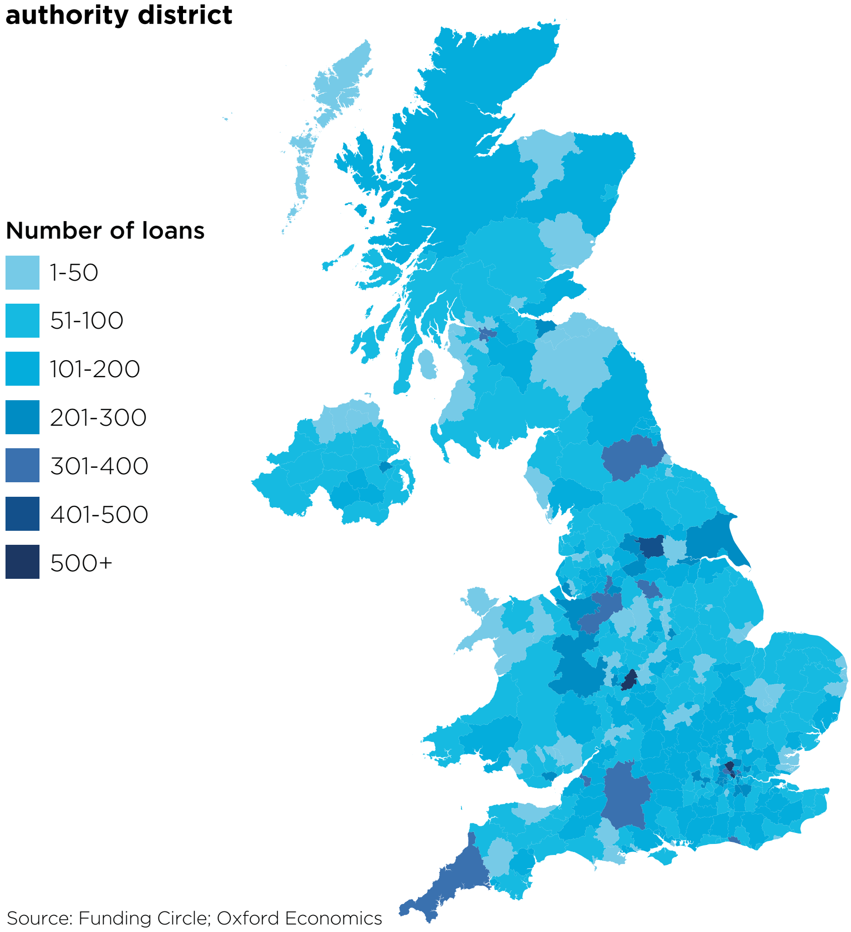


Source: Oxford Economics

Funding Circle's loans are also spread right around the United Kingdom (see Fig. 15). This includes areas where disposable income is below the UK average, from cities such as Glasgow to rural counties such as Cornwall, as well as Northern Ireland, Wales, and the North East of England.

The distribution of Funding Circle's customers across the UK is broadly in line with the location of all SMEs.[13] There is a slight skew towards the North of England: the share of Funding Circle's customers in the North West, North East, and Yorkshire and the Humber is 26, 17 and six percent higher than these regions' share of the number of SMEs. Compared to the regional bank lending data to SMEs, Funding Circle's loans under management at the end of 2017 were more heavily concentrated in the South East, the North West, Yorkshire and the Humber, and London.[14]

Fig. 15: Loans made to UK businesses by 2017, by local authority district



Source: Funding Circle; Oxford Economics

[13] Department for Business, Energy, & Industrial Strategy, *Business population estimates for the UK and regions 2017*, 30 November 2017.
[14] UK Finance, *UK lending by postcode sector – Q3 2017*, 3 April 2018.

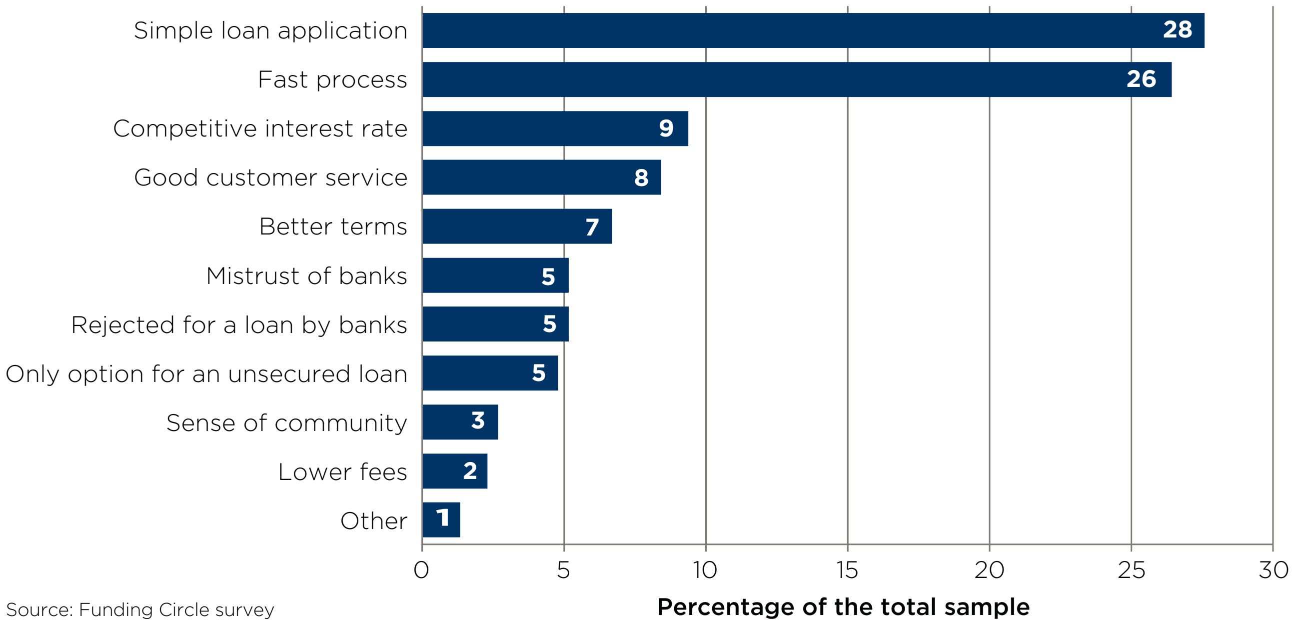
2.3 WHY DO SMALL BUSINESSES USE FUNDING CIRCLE?

Customers appreciate Funding Circle's fast and simple process. Among the 522 UK customers surveyed, two explanations stand out as the key reasons for borrowing from Funding Circle: the simplicity of the loan application process (cited by 28 percent), and the speed of that process (26 percent). These factors proved almost three times as popular as the next most important reason (Fig. 16).

Customers are put off borrowing from banks by lengthy processes. Fifteen percent of the sample had approached a bank for a loan prior to applying to Funding Circle (below the 20 percent of customers surveyed in June 2016).[15] Of these firms, 44 percent said their bank loan application had been rejected, 39 percent that the process had taken too long, and 15 percent that the bank's rates and/or fees were too high (Fig. 17).

Amongst those businesses who had not approached a bank first, **74 percent of those responding believed the decision would have taken too long or involved too much hassle** (Fig. 18). Nine percent thought the bank would have been too expensive, while eight percent believed they would have been rejected.

Fig. 16: Main reason for borrowing from Funding Circle

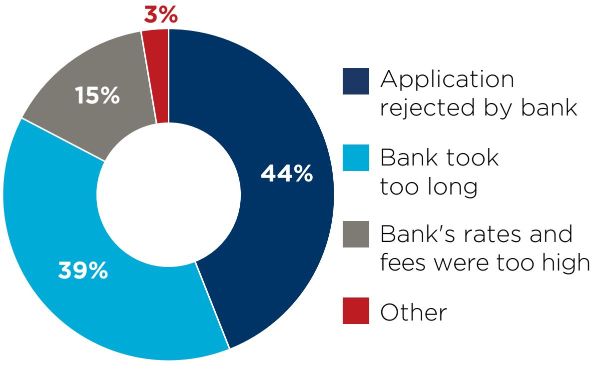


Source: Funding Circle survey

[15] Cebr, *Small business, big impact: The changing face of business finance, evidence from Funding Circle*, August 2016.

Fig. 17: Reasons for not completing a bank loan application[16]

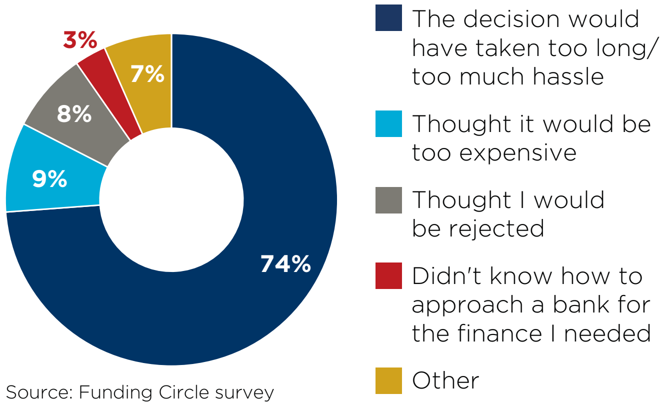
Percentage of responses



Source: Funding Circle survey

Fig. 18: Reasons for not approaching a bank first[17]

Percentage of responses



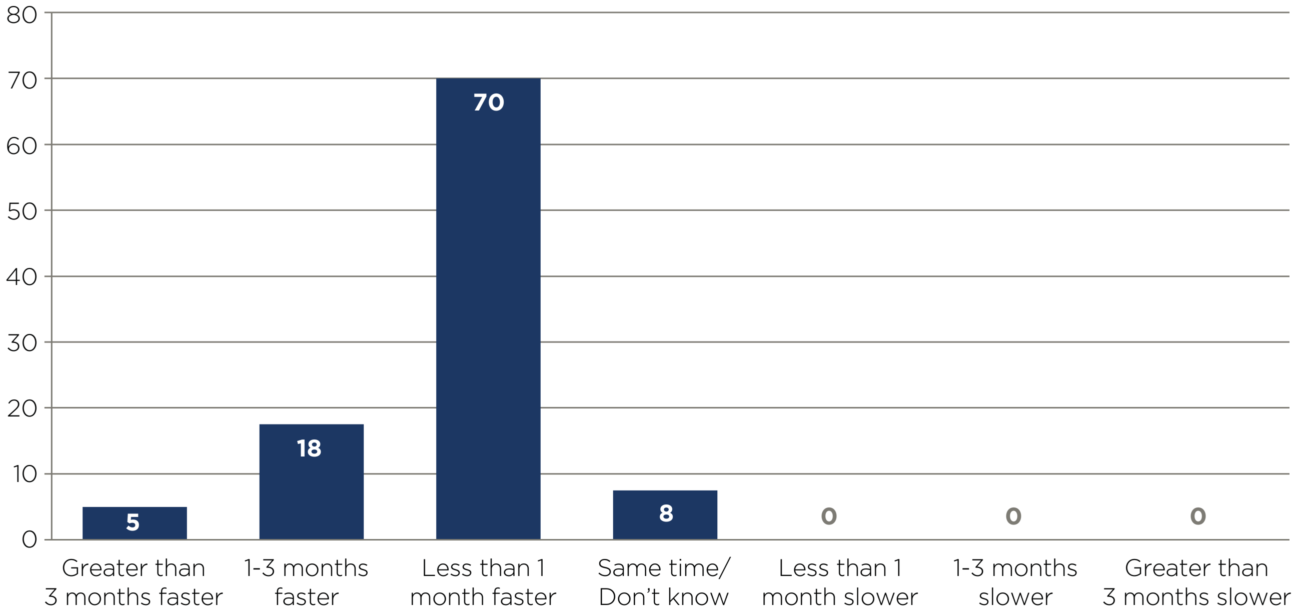
Source: Funding Circle survey

The firms who had approached a bank first were also asked for their views on the relative speed of the process. A total of 92 percent believed the Funding Circle process would have been faster than the bank alternative (Fig. 19), **while none of our respondents thought Funding Circle would have been slower**. Some 23 percent believed the Funding Circle process would have been at least one month faster than the bank alternative.

The strength of Funding Circle's offer means that 89 percent of the customers surveyed would approach the lending platform first should their business require external funding in the future.

Fig. 19: Perception of Funding Circle process time versus an alternative[18]

Percentage of responses



Source: Funding Circle survey

[16] This question was asked of 80 firms who said they had applied for a bank loan before turning to Funding Circle, out of the whole sample of 522. The percentages here relate to the 75 non-blank responses.
[17] This question was asked of 442 firms who said they had not applied for a bank loan before approaching Funding Circle, out of the whole sample of 522 The percentages here relate to the 424 non-blank responses.
[18] This question was asked of the 80 firms who had approached a bank first, all of whom responded.

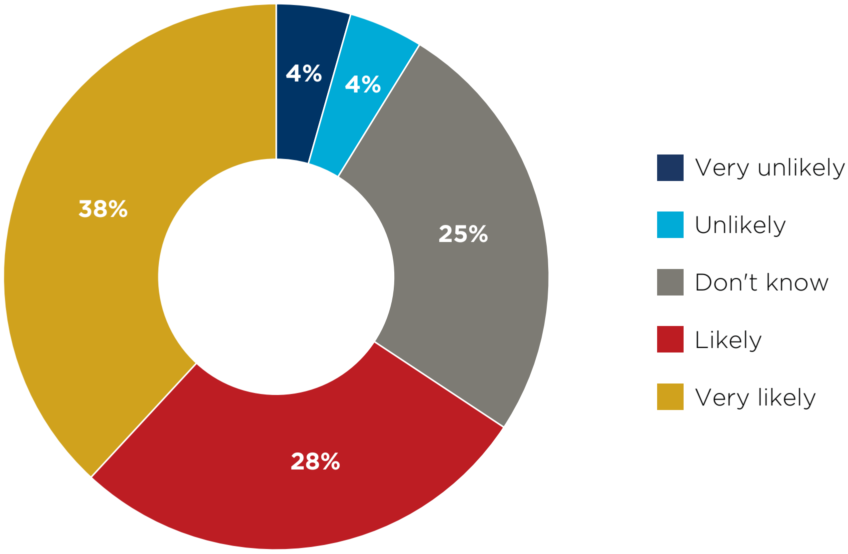
Most customers could obtain finance in Funding Circle's absence, but negative consequences were feared by those who could not.

If Funding Circle did not exist, eight percent believed it was unlikely or very unlikely that they would have obtained the funds required (Fig. 20). This is a significantly smaller proportion than the 21 percent who thought they would be unable to secure external funding in the absence of Funding Circle in the June 2016 survey.[19] This suggests the vast majority of Funding Circle's customers in 2018 can source external finance from a range of providers, and are therefore choosing the platform as its offer is more attractive than the alternatives.

Amongst those firms expecting to obtain funding from somewhere else in those circumstances, 59 percent said they would have used a bank loan, 20 percent another online lending platform, seven percent a loan from a family member or business associate, and six percent a bank overdraft (Fig. 21).

Fig. 20: Likelihood of obtaining funds in Funding Circle's absence

Percentage of total sample

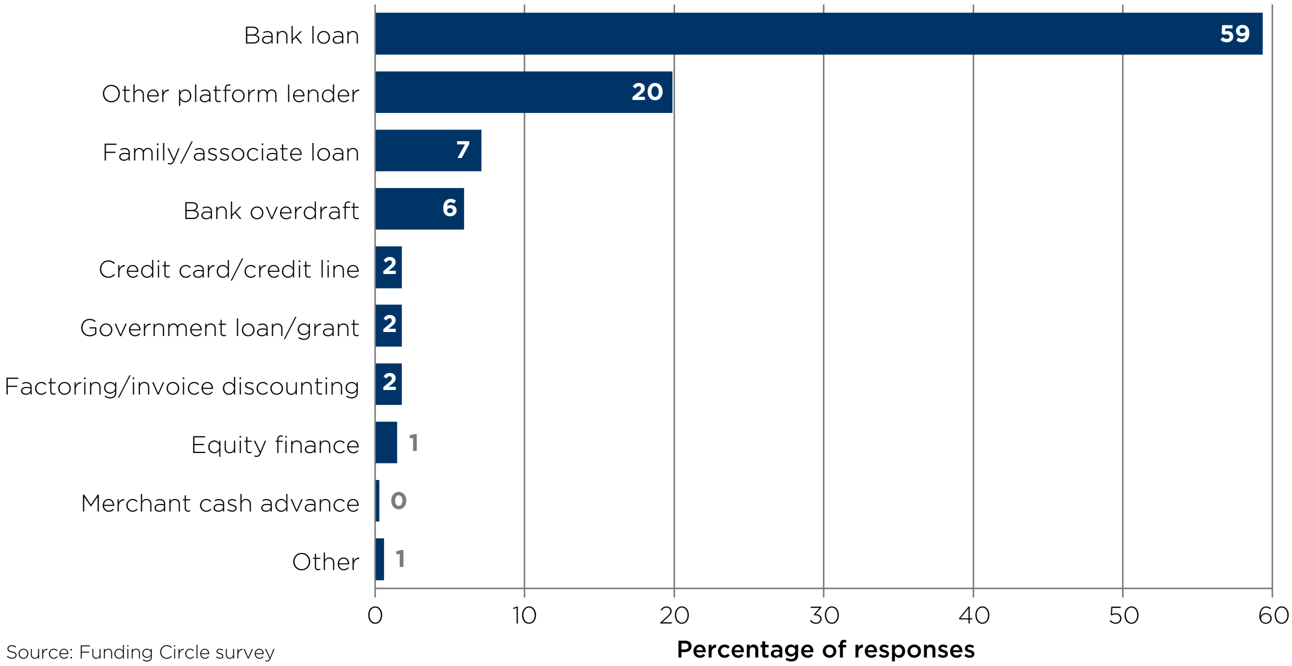


Source: Funding Circle survey

However, amongst the minority of firms who believed that they could not have obtained the funds elsewhere, 98 percent pointed to negative impacts of one kind or another (Fig. 22). Some 22 percent expected that their business would have failed, 37 percent pointed to a negative impact on profits, while 26 percent said the failure to borrow would have resulted in a missed opportunity.

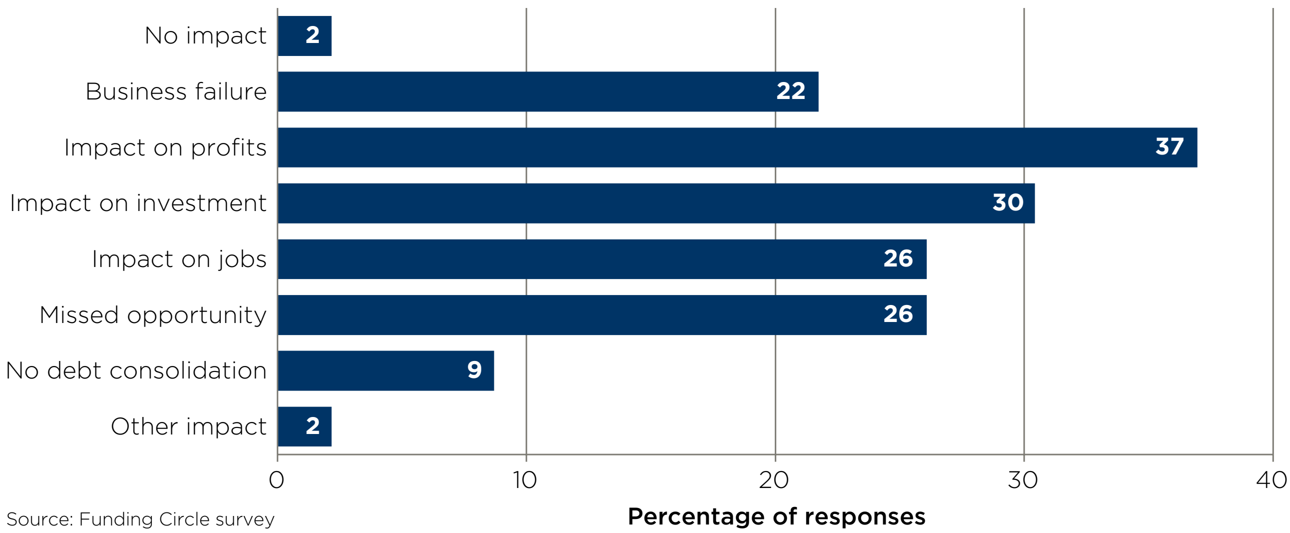
[19] Cebr, *Small business, big impact; The changing face of business finance, evidence from Funding Circle*, August 2016.

Fig. 21: Alternative funds to be used in Funding Circle's absence[20]



Source: Funding Circle survey

Fig. 22: Perception of impact of not receiving funding[21]



Source: Funding Circle survey

[20] Asked of 343 firms expecting to have received the funds elsewhere. 337 responded.
[21] Asked of the 46 firms expecting not to have obtained finance in Funding Circle's absence. Firms could tick more than one option, and all ticked at least one. Additional options ticked are excluded in the case of firms citing 'business failure'.

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

The Funding Circle survey's respondents were also asked about their revenues, employment, purchases from other firms, imports, and tax payments. These results were used, along with information on Funding Circle's total loan book, to work out the platform's impact on the wider UK economy.

Lending through Funding Circle directly supports £1.2 billion per annum of gross value added, and 25,200 jobs, in the UK.

Scaling up from the survey to all those holding Funding Circle loans at the end of 2017, the total annual revenues of these UK-based borrowers amounted to £23.5 billion.[22] As a Funding Circle loan accounts, on average, for eight percent of all debt and equity finance supporting these firms, we can say that the "Funding Circle share" of this revenue is £1.9 billion.

Of this £1.9 billion, £0.7 billion covers the annual cost of inputs of goods and services purchased from other firms. The remaining £1.2 billion is the sum of these firms' employment costs, capital costs, and net profits, and represents the firms' direct gross value added contribution to UK GDP (Fig. 23).[23] Some 25,200 people were employed at Funding Circle's customers, producing this output and generating £0.4 billion of annual tax revenues.[24]

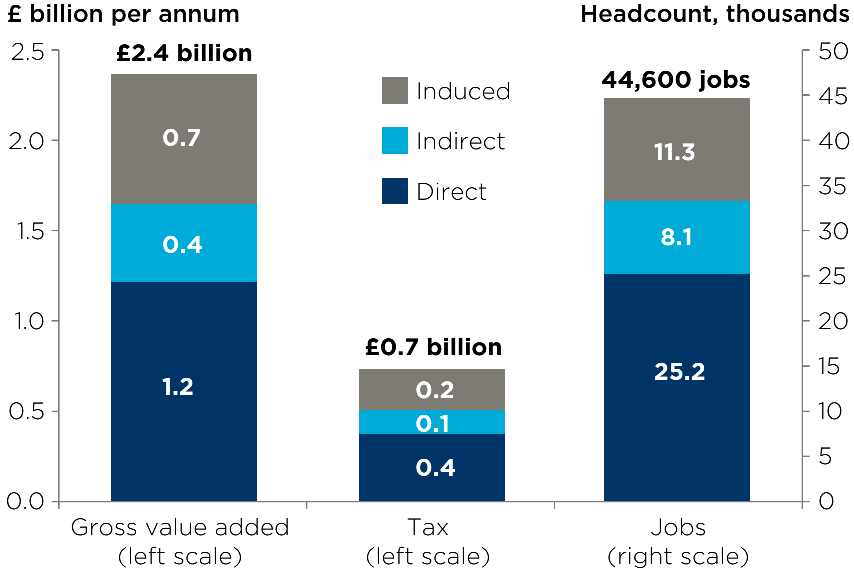
However, Funding Circle's total economic contribution includes two further channels of impact: the *indirect* channel (activity supported in UK supply chains due to the purchases of goods and services from other firms), and the *induced* channel (other UK activity funded out of wage income that is ultimately dependent on Funding Circle's share of its borrowers' economic activity).

The loans to SMEs managed by Funding Circle are estimated to have supported £0.7 billion of purchases of inputs of goods and services in 2017.

This expenditure is likely to have sustained £0.4 billion in gross value added per annum along the small businesses' UK supply chain. This activity would have generated some 8,100 jobs and £0.1 billion of annual tax revenue.

Funding Circle's customers' payment of wages, plus those by firms in their supply chain, are estimated to have sustained a £0.7 billion gross value added contribution to GDP per annum. This induced impact would have supported some 11,300 jobs, and £0.2 billion of yearly tax revenues.

Fig. 23: Funding Circle's total contribution to the UK economy per annum (2017)



Source: Oxford Economics

[22] This is based on loans under management as at 31 December 2017, excluding loans in default.
[23] This gross value added measure of production is similar to the well-known gross domestic product measure (GDP). The only difference is that gross value added is valued at the 'basic' price received by the producer, excluding taxes on sales such as VAT, rather than at the 'market' price paid by the purchaser, including those taxes.
[24] The taxes included are corporation tax, employers' national insurance and business rates paid by the firm, income tax and national insurance paid by its employees, taxes on the firms' purchases from other firms (such as road fuel duty and 'green' levies), and VAT and duties targeting final consumers of the firms' products.

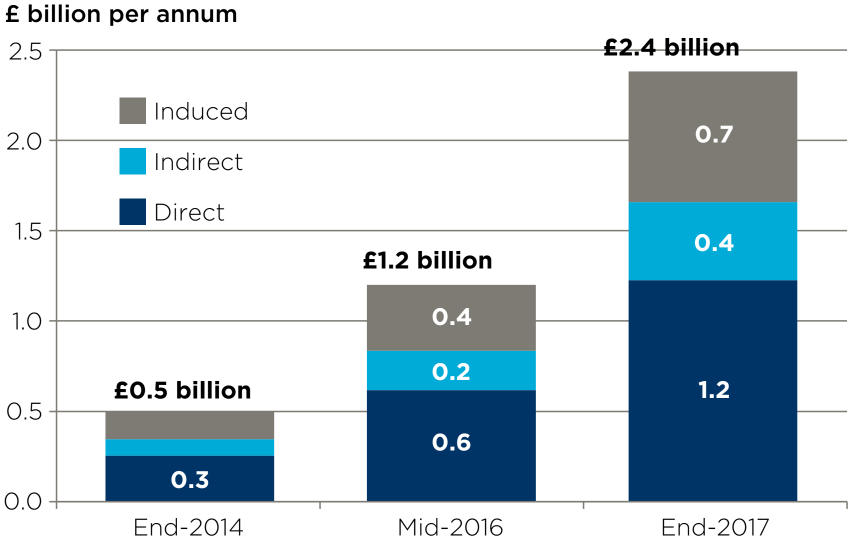
Taking all three channels together, lending through Funding Circle can be said to have supported an annual gross value added contribution to GDP of £2.4 billion in 2017—equivalent to all the value added produced in Rugby or Chesterfield in a year.[25]

In 2017, 44,600 jobs depended on lending through Funding Circle. Some of these are new jobs created as small firms expand, others are existing jobs that are saved by the business activity the loan enabled. This is roughly the number of people employed in Darlington. It is also calculated to have generated £730 million in annual UK tax revenues.

Funding Circle's impact has grown substantially over time, with its gross value added impact doubling in the past 18 months.

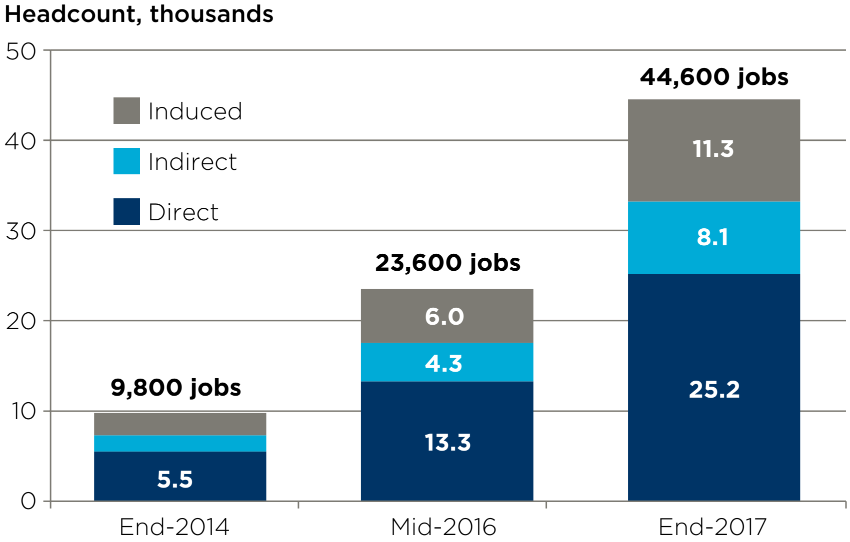
We estimate that, at the end of 2017, the direct and total annual gross value added impacts were around 4.8 times those associated with the stock of loans under management three years earlier, with the jobs impacts 4.5 times higher (see Fig. 24 and Fig. 25). These annual value added impacts were 98 percent higher than in mid-2016—i.e. virtually double the amounts seen then—with jobs impacts up by 89 percent in that time.

Fig. 24: Approximate gross value added supported in the year prior to three points in time



Source: Oxford Economics

Fig. 25: Approximate number of jobs enabled at three points in time



Source: Oxford Economics

[25] These amounts reflect the ongoing annual GDP and tax impacts, and associated ongoing jobs impact, supported by the amount of Funding Circle loans under management at a single point in time, namely 31 December 2017. No impact is attributable to Funding Circle loans made in the past, but which had been repaid (or defaulted on) by that date. The estimates are not, therefore, comparable to those set out in the 2016 report on Funding Circle's impact, which included effects relating to all loans made by the platform since its inception in 2010.

CASE STUDY: TEASDALE MOTORCYCLES

Teasdale Motorcycles, based in North Yorkshire, is a one-stop motorcycle shop that has become one of the largest dealerships in the North of England. Founded in 2003 by Andy Walker, a lifelong motorbike enthusiast, the company has grown both online and instore, and now employs 18 staff members who serve thousands of customers each year. The company sells approximately 650 motorcycles annually across the UK, and has expanded its product range to include clothing, accessories and repair services.

Teasdale's development has been supported by three loans accessed through the Funding Circle platform, which over time have enabled the company to launch a new website, improve its instore branding, hire more staff and expand its shop footprint.

The first loan came at the height of the recession in 2008-09. At the time, Andy had been approaching banks for finance to purchase a website—an exhausting process, he says, as the banks were putting up many obstacles. He then decided to apply for a loan from Funding Circle—within a matter of days, he had the funds that allowed his company to buy and adapt a spare parts website, which also resulted in the recruitment of an additional team member. According to Andy, this loan was crucial to Teasdale's growth. He says: "Funding Circle is great, it's a little bit more personal than dealing with a faceless bank."

After purchasing a new premises, the company then required additional finance for its fit-out, so Andy applied for a second loan through Funding Circle. A couple of years later, he received a third loan to add an extension to the back of the shop, increasing Teasdale's footprint by two-thirds. By moving to the new premises, completing instore branding, and adding an extension, the company was able to add a new manufacturer to its franchise list, and has seen its revenues triple. But the story doesn't end there: in the near future, Andy has plans to open a second shop.


KTM

CASE STUDY: ELIJAH'S XTREME GOURMET SAUCES

Elijah's Xtreme Gourmet Sauces makes and sells gourmet hot sauces based on recipes that Bret Morey and his son Elijah dreamt up at home in Gaston County, North Carolina, using chilis grown in their garden. The pair have long had a mutual love of chilli peppers and hot sauces—when he was six, Elijah wanted to become the youngest person to eat the world's hottest chilli pepper.

In 2013, after distributing samples of their homemade sauce to widespread acclaim, they found a contract packager who was able to replicate the recipe. Since then, the company has grown to sell a range of hot sauces through local, national and online outlets—with financing secured through Funding Circle proving instrumental in allowing the company to develop new sauces, purchase bottles, and enhance the packaging of its products.

A crux moment came after a couple of years of expansion, as Elijah's Xtreme looked to create a grilling glaze for game meat, aimed at the hunting market, and a hot sauce gift box. One major US retailer was so impressed with the samples that it asked to stock both products—but to meet this order, Elijah's Xtreme would have to pay the co-packer up front. After receiving a letter from Funding Circle, Bret applied online for a loan. They received the money in a matter of days, allowing them not only to launch the two products, but to purchase a large order of square bottles for a new spicy BBQ sauce as well.

"The biggest challenge for us has been finding the resources necessary to help us grow the business," Bret explains, adding that a common frustration is banks' inability to understand their need to pay upfront for the manufacture of the sauces. Released from such frustrations, the pair have big plans: in the next two or three years, they hope to take over one of the co-packers used to manufacture and bottle the sauces, giving Elijah's Xtreme access to a commercial kitchen—and greater control over its products.

4. GERMANY

In the wake of the global financial crisis, German bank lending to non-financial corporations only started to recover in 2015. It remains eight percent lower in real terms than at the end of 2008, yet the economic output of non-financial firms' has increased by 15 percent over the same time period.[37]

Non-bank sources of finance are still in their infancy in Germany, but growing very rapidly. Funding Circle issued its first loan there in November 2015. Its stock of loans under management in 2017 was three times the size of the year before. This chapter looks at the full economic impact of lending through Funding Circle in December 2017 on German GDP, employment, and tax receipts.

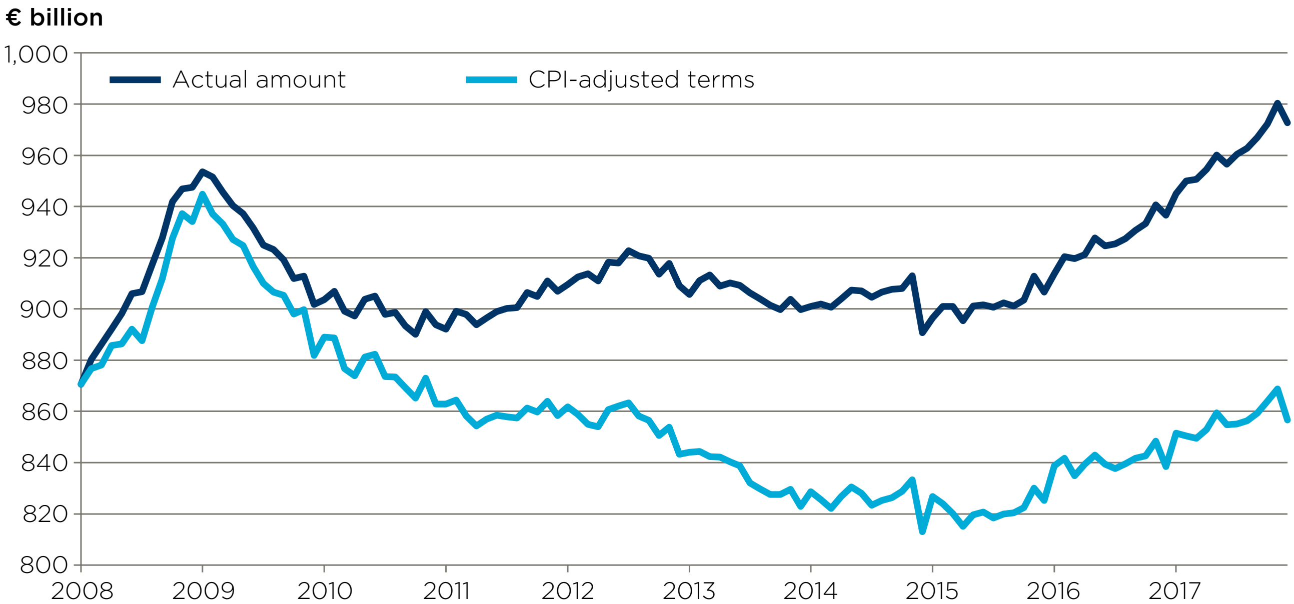
4.1 SMALL BUSINESSES' ACCESS TO FINANCE

Data from the European Central Bank (ECB) point to a recovery in business lending over the last three years, with the total stock of outstanding loans that German banks issued to non-financial corporations some nine percent higher at the end of 2017 than three years earlier (Fig. 41).[38] However, following the prolonged period of decline and stagnation in business borrowing post-financial crisis, this value is still only three percent higher in money terms than at the end of 2008—or down by eight percent in real terms after adjusting for the CPI measure of German inflation.

As the real GDP of the German non-financial business sector grew by more than 15 percent between late 2008 and late 2017, this implies the credit conditions facing enterprises of all sizes are much tighter today.

The ECB's survey on the access to finance of enterprises (SAFE) suggests small businesses in Germany have clearly felt the impact of this wider picture of constrained business lending. In the latest survey, covering the six months to September 2017, 16 percent of small firms report taking up a new or renewed bank loan—3 percentage points lower than in the six months to March 2015 survey.[39]

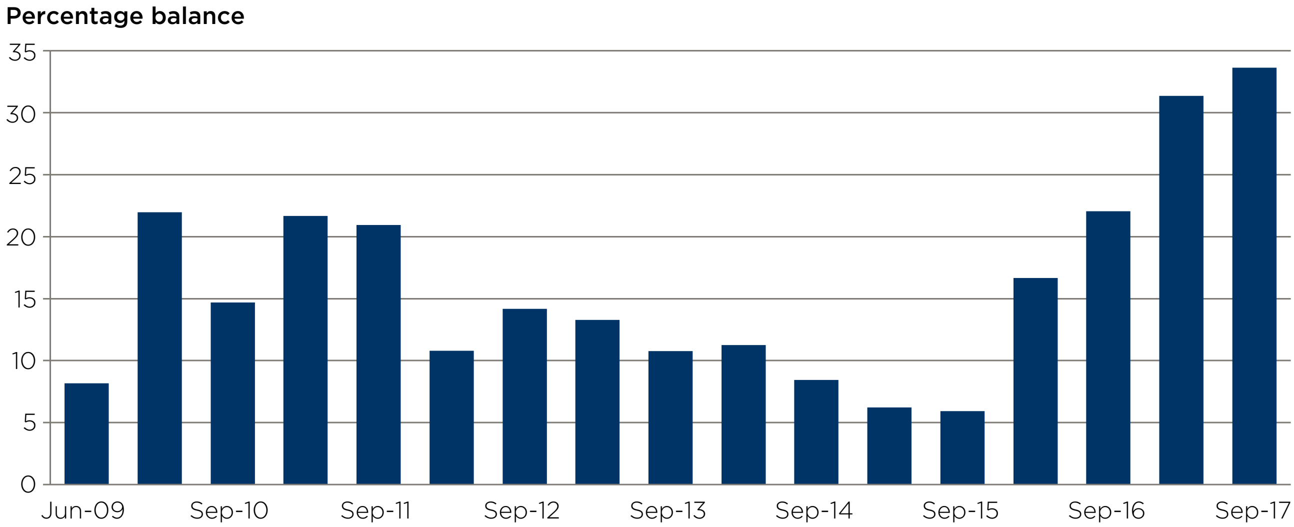
Fig. 41: Outstanding bank loans to non-financial businesses, January 2008 to December 2017



Source: ECB, Federal Statistical Office, Oxford Economics.

37 Federal Statistical Office data on real gross value added by economic sector.
38 ECB Statistical Data Warehouse. 'Bank lending' here includes all loans by German monetary financial institutions, other than the Bundesbank. The non-financial corporation borrowers in this series could be located anywhere in the Euro Area in principle, but are likely to be predominantly German.
39 European Central Bank, *Survey on the Access to Finance of Enterprises,* November 2017. The first survey covered the six months to June 2009, the second the six months to December 2009, but the third covered the six months to September 2010. Since then, it has been undertaken every six months.

Fig. 42: Trend in bank finance costs other than interest costs[40]



Source: ECB

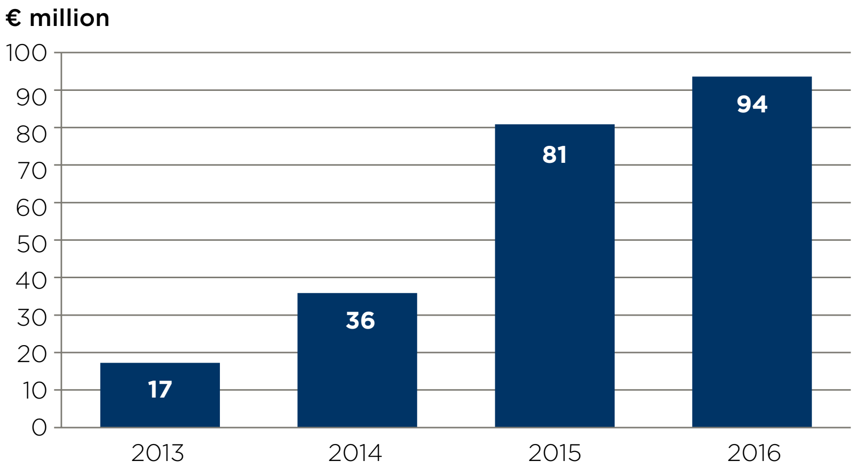
The proportion of small businesses stating they did not take up a bank loan despite that option being "relevant" to their business was broadly unchanged, at 32 percent (versus 31 percent in 2015).[41] But the proportion for which the bank loan option was "not relevant" (namely, they had not used them in the past and were not considering using them in the future) rose from 30 percent to 51 percent.

The same survey points to a continual decline, since late 2011, in the interest rates paid by small firms to their banks. But it also shows a continual increase in bank financing costs other than interest costs, such as charges, fees or commissions—a trend that dates back to the first surveys in 2009 (Fig. 42). Furthermore, over the year to September 2017, these fees rose at a higher pace than previously recorded.

As mentioned above, the market for online non-bank forms of finance in Germany is still in its infancy. In 2016, €94 million of funds were made available to businesses by non-bank options in Germany, making it the fourth largest national market in Europe for this category of funding.[42]

Despite its small size, the market has experienced strong growth over the past four years, with the value of debt, equity and other funding raised more than five times greater in 2016 than three years earlier (Fig. 43).

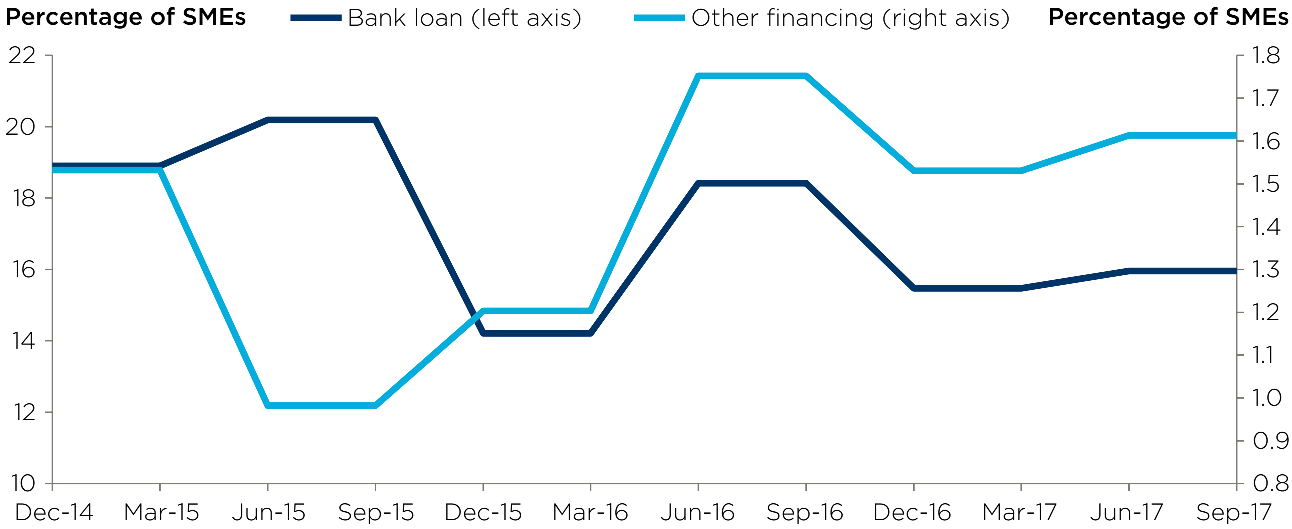
Fig. 43: Online non-bank business finance market volumes, 2013 to 2016



Source: Cambridge Centre for Alternative Finance

[40] A positive balance indicates that, in the previous six months, more firms experienced a rise in charges, fees and/or commissions than a decline.
[41] Where relevant in the SAFE questionnaire is defined as "have you used them in the past or considered using them in the future".
[42] Cambridge Centre for Alternative Finance, *Expanding Horizons: The 3rd European Alternative Finance Industry Report*, 2018. Where Business finance is defined as P2P business lending, balance sheet business lending, debt-based securities, profit sharing, equity-based crowdfunding, and real estate crowdfunding.

Fig. 44: Types of finance used by SMEs, 2014Q4 to 2017Q3[43]

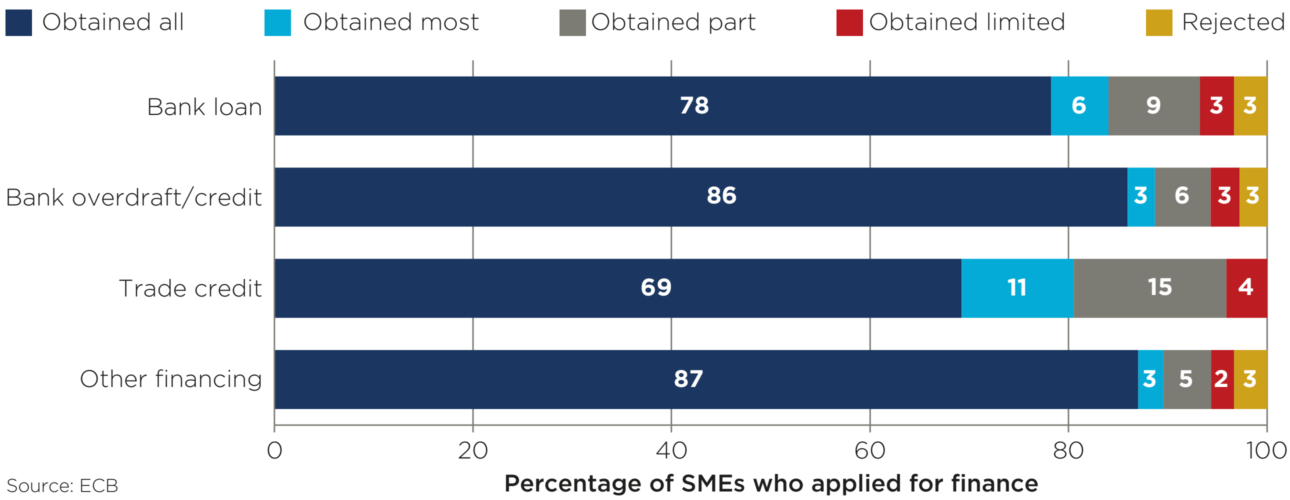


Source: ECB

The newness of the availability of non-bank forms of financing in Germany is mirrored in the borrowing habits of its small firms. In September 2017, only 1.6 percent of small businesses reported using "other" forms of financing, including online lending, in the ECB survey—one tenth of the number who said they used bank loans (Fig. 44).

However, the survey also found that small firms were more likely to receive all of the funding when they applied for non-bank sources of credit. Of firms who applied for "other" sources of financing, 87 percent received all of the funding sought (Fig. 45). This is higher than the 80 percent for firms applying for any type of finance, and the 78 percent for firms who applied for a bank loan. While rejection rates were consistent across the funding types, the proportion of firms who received only some of the funding they had applied for varied considerably.

Fig. 45: Outcome of SMEs' funding applications in 2017[44]



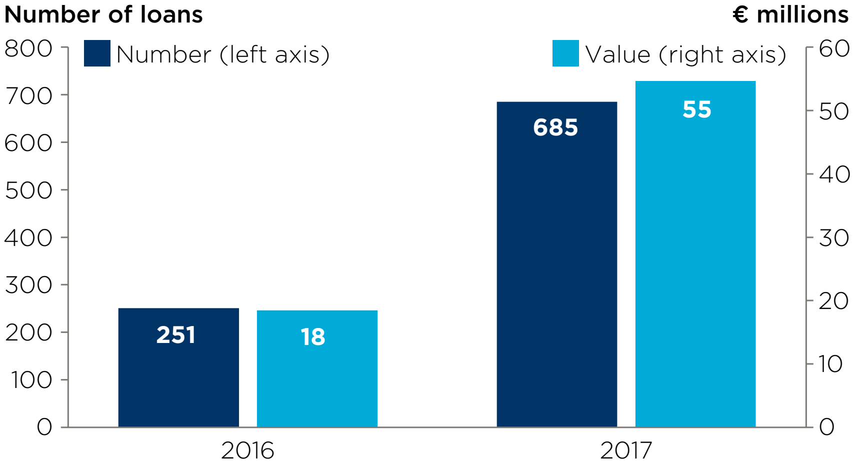
Source: ECB

[43] Other financing here includes peer-to-peer lending, crowdfunding, participating loans, subordinated debt instruments, loans from a related company, shareholders or family and friends, leasing, factoring, grants and issuance of equity and debt securities.

[44] The results cited here have been adjusted by Oxford Economics to exclude 'pending', 'don't know' and 'refuse to answer' options. Other financing here includes peer-to-peer lending, crowdfunding, participating loans, subordinated debt instruments, loans from a related company, shareholders or family and friends, leasing, factoring, grants and issuance of equity and debt securities.

4.2 FUNDING CIRCLE'S GERMAN LENDING PROFILE

Fig. 46: New loans issued through Funding Circle, 2016-2017



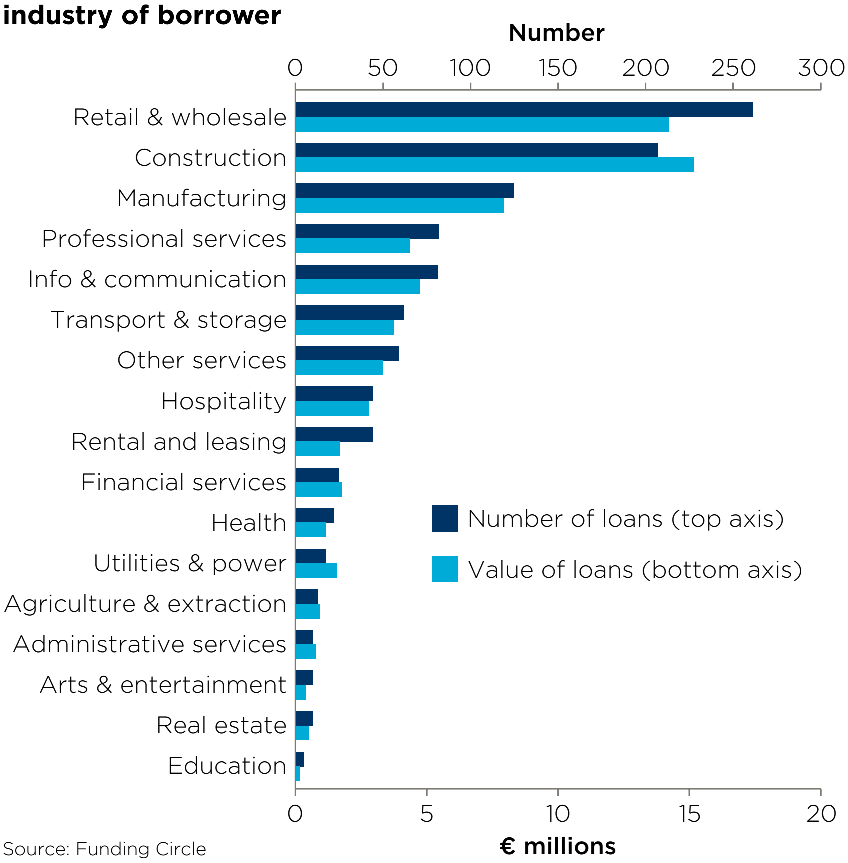
Source: Funding Circle

Many Funding Circle loans go to businesses in high-growth industries. Comparing the industries that Funding Circle loans are supplied to with the nearest corresponding sectors in Oxford Economics' Global Industry Model, four out of the top five industries by share of loans under management are forecast to grow more rapidly than the economy as a whole. In particular, IT and communication is predicted to grow at an annual rate of 3.3 percent between 2015 and 2025, against the whole economy average of 1.5 percent.

Funding Circle's German activities have grown substantially. The 685 new loans issued in 2017 was 170 percent higher than the previous year, the first full year of Funding Circle operations in Germany (Fig. 46). The amount of money loaned has grown at an even faster rate: the value of new loans issued in 2017 totalled €55 million, three times larger than the amount issued in 2016.

Funding Circle originates loans to companies in almost every industry in the German economy. By number, the largest share of loans under management are with firms in retail and wholesale, accounting for 25 percent of the total (Fig. 47). By value, the largest share of loans under management (23 percent) goes to construction firms, reflecting the higher average value of the loans taken out by firms in this industry.

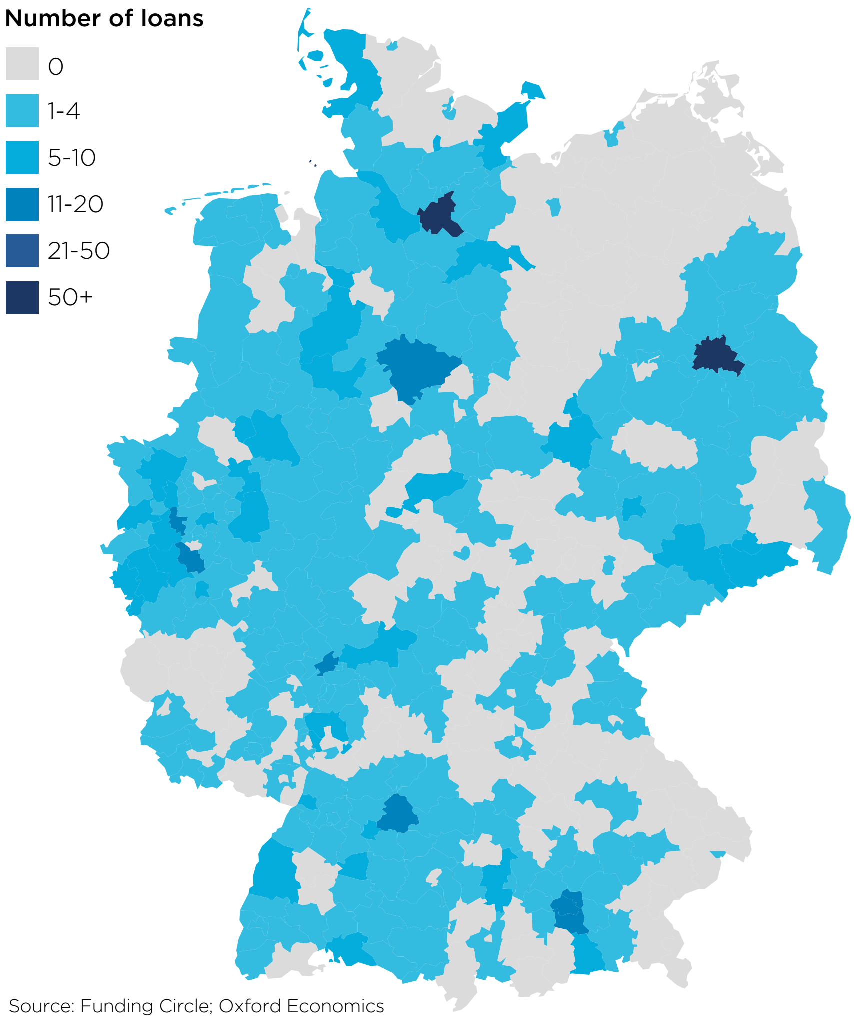
Fig. 47: Loans under management to Funding Circle by industry of borrower



Source: Funding Circle

Funding Circle's customers are also based across the length and breadth of Germany. In 2017, loans were made to companies located in 56 percent of the country's districts (Fig. 48).[45] The largest number of loans were made to small firms located in Berlin and Hamburg.

Fig. 48: Funding Circle loans made by 2017, by geography



Source: Funding Circle; Oxford Economics

4.3 WHY DO SMALL BUSINESSES USE FUNDING CIRCLE?

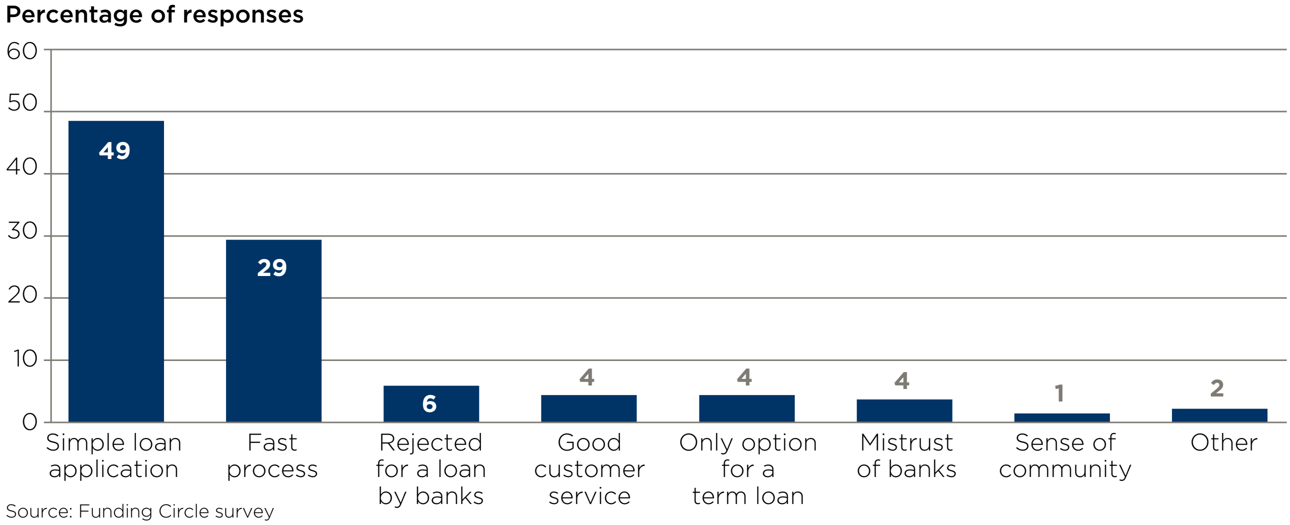
To understand what motivated businesses to take out loans through Funding Circle, some 140 customers were surveyed in Germany as part of this project. In this section, we explain the survey's key findings.

Customers value the speed and simplicity of the application process.

Forty-nine percent of the German Funding Circle customers surveyed reported that the simplicity of the loan application procedure was their main reason for borrowing through the platform. The speed of the application and judgement process ranked second, attracting 29 percent of respondents (Fig. 49).

[45] Districts defined as NUTS level 3.

Fig. 49: Reasons businesses borrow through Funding Circle



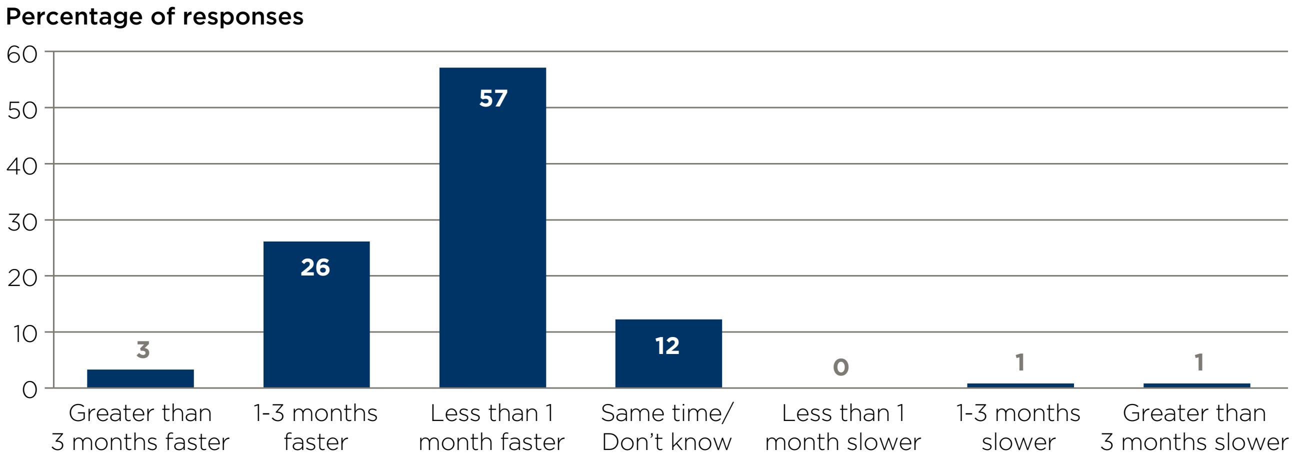
Source: Funding Circle survey

Many customers are put off bank lending by the time and hassle. Just 29 percent of Funding Circle's customers had first attempted to secure a bank loan. Of these, 31 percent were rejected by the bank, while 61 percent reported that their bank loan was not completed because the process took too long or because it was too expensive.

Focusing on why the remaining 71 percent of firms did not seek a bank loan before approaching Funding Circle, the vast majority—some 90 percent— reported that they were put off by the time or hassle involved in applying, rather than the risk of rejection or expense.

Borrowers' belief that applying for online lending is faster than a bank loan is supported by their experience. Some 86 percent of firms reported that the process of securing a loan through Funding Circle was faster compared to other providers considered (Fig. 50). Some 29 percent of firms reported that the process was at least a month faster.

Fig. 50: How the speed of Funding Circle's loan applications compared with other providers



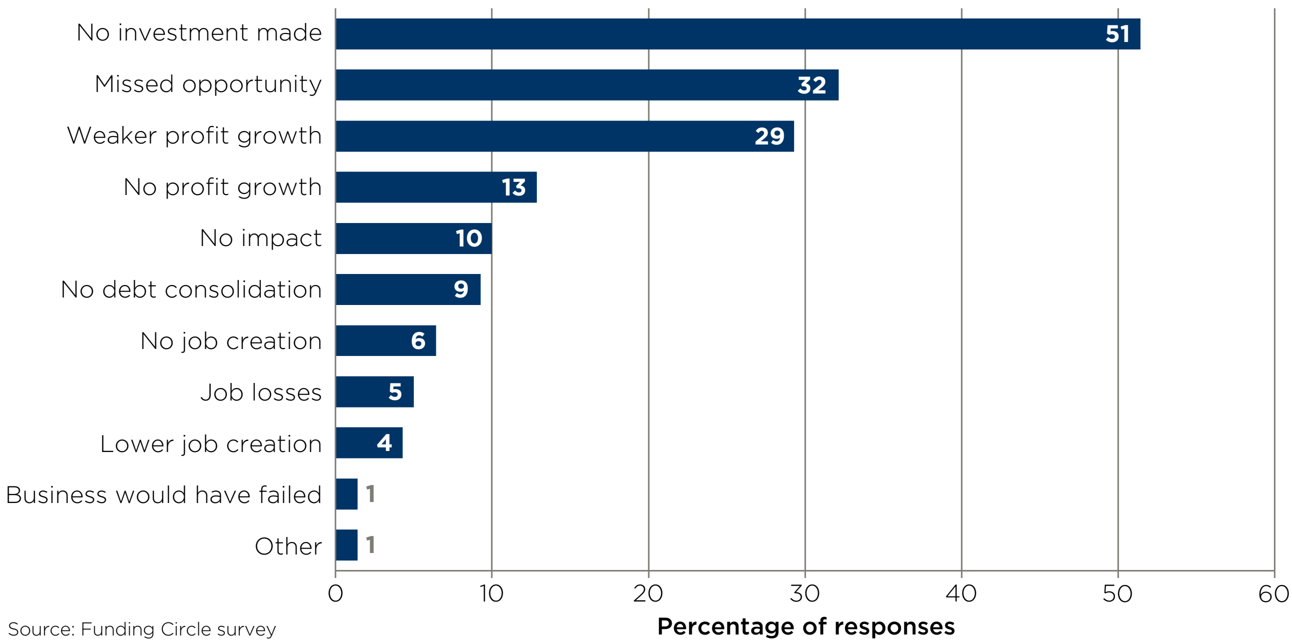
Source: Funding Circle survey

Nonetheless, most small businesses said that if they were unable to use Funding Circle, they would have applied for other types of finance. A large share of firms (64 percent) viewed it as "likely" or "very likely" that they would have received other financing. This suggests they are opting to approach Funding Circle first, for its simple and fast loan application process, and other aspects of its offer.

Customers fear reduced investment and missed opportunities.

Had the small businesses not received their loan through Funding Circle, many felt their prospects would have been adversely affected. Some 51 percent of firms said they would not undertake an investment (Fig. 51), while 32 percent thought they would have missed an opportunity—again highlighting the importance of speed of access to finance for borrowers. A further 29 percent and 13 percent said they would have had weaker, or no, profit growth.

Fig. 51: Perceived impact had a business not received its required financing



Source: Funding Circle survey

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

As part of the survey, Funding Circle customers were asked for details of their revenues, employments, procurement of inputs of goods and services, imports and tax payments. This information, taken in conjunction with Funding Circle's total loan book, was used to estimate its total impact on the German economy.

Funding Circle directly contributes an estimated €61 million per annum to German GDP, and 900 jobs.

At the end of December 2017, the lending platform had almost 1,077 loans under management in Germany, totalling more than €65 million. These supported the activities of the borrowers by funding investment or acting as working capital, for example. Analysis of the survey of borrowers revealed that Funding Circle's loans account for an average of six percent of the companies' total liabilities.

The small businesses that use Funding Circle for finance generated an estimated €991 million gross value added contribution to German GDP in 2017. Taking Funding Circle's share of these companies' total liabilities, it is possible to estimate the share of this contribution supported by its loans. This means Funding Circle's direct contribution to annual GDP was almost €61 million per annum (Fig. 52).

This "direct" economic activity also sustains employment and generates tax revenues: the platform's lending in Germany directly supported some 900 jobs and €4.6 million in tax revenues in 2017.

Lending through Funding Circle also supports activity via small businesses' spending on goods and services, and their payment of wages.

The supply chain ("indirect") impact arises as borrowers spend money on inputs of goods and services from Germany-based suppliers. The wage-financed consumption ("induced") impact reflects the payment of wages by Funding Circle's customers, and the firms in their supply chain, to their staff, who in turn spend a portion of their income in Germany's consumer economy.

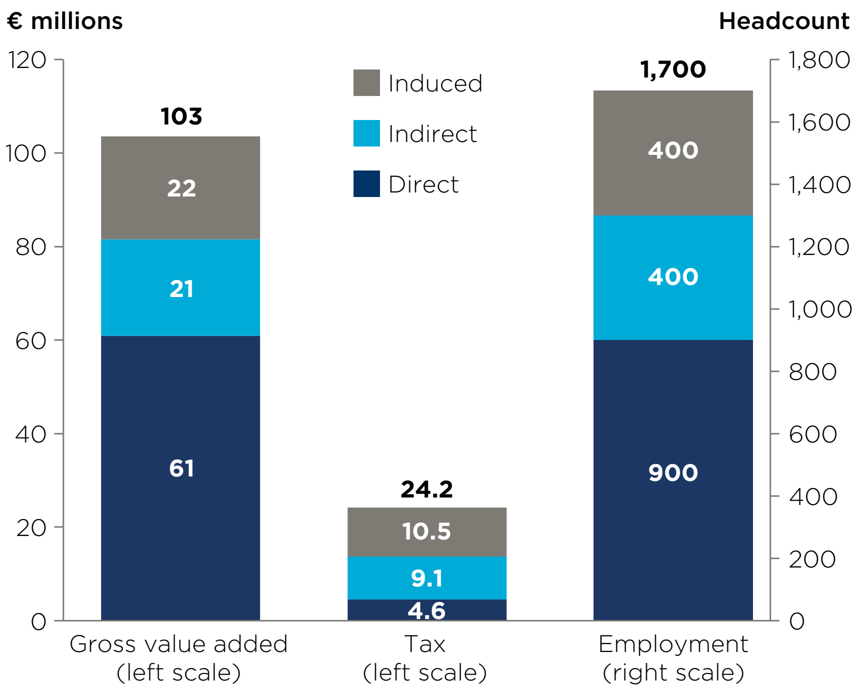
Funding Circle's loans supported €26 million of procurement spending from German suppliers in 2017. Mapping how this spending generates activity along the length of German supply chains, Funding Circle's indirect impact generated a €21 million annual gross value added contribution to GDP, 400 jobs, and €9.1 million in annual tax revenues.

The payment of wages by Funding Circle's customers and the firms in their supply chains sustained a further €22 million in gross value added, both at retail and leisure outlets and in their supply chains. This activity supported 400 jobs and €10.5 million in taxes.

In total, Funding Circle supported a €103 million gross value added contribution to Germany's GDP in 2017, and enabled 1,700 jobs.

Adding the direct, indirect and induced impacts together gives us the total annual impact of Funding Circle's loans on the German economy. Based on the value of its loans under management at the end of December 2017, these loans supported a gross value added contribution of €103 million to German GDP in 2017, sustained 1,700 jobs, and generated €24 million in annual tax revenues.

Fig. 52: Funding Circle's total contribution to the German economy, 2017



Source: Oxford Economics

CASE STUDY: EDELMOND CHOCOLATIERS

Edelmond is a small German company that makes luxury handmade chocolates in Luckau, a rural town south of Berlin. Founded seven years ago, this “bean to bar” chocolatier uses Fairtrade, organic cocoa beans imported directly from the source country, rather than purchasing cocoa from an intermediary. The company typically buys its beans from single-family farms in the developing world, without the interference of middle-men or the anonymity of a wholesaler. Additionally, the team keep the production of their chocolate in-house, giving them full control of their product at every step of the process.

Christmas is always peak time for the company, which now boasts more than a thousand customers a year. In 2017, Edelmond decided to invest in a refrigeration tunnel that would increase the speed at which it could make and store its chocolates — thus helping to meet the festive periods increased demand. However, at the time the business didn’t have sufficient reserves to undertake the investment and needed some financial support in order to progress with its development plans.

The application procedure for a traditional bank loan would have proved too lengthy for Edelmond to buy the tunnel in time to meet last year’s Christmas surge. Although its application was likely to be approved, it would take more than four months to get a decision, followed by another 6-8 weeks to receive the tunnel — thus putting Edelmond far behind schedule. So instead, the company approached Funding Circle.

In contrast to a bank loan application, the speed and simplicity of Funding Circle’s application meant Edelmond received its loan agreement within a matter of days. This meant that the business could purchase the refrigeration tunnel and boost its production well ahead of Christmas, which in turn allowed it to earn considerably more revenue over this key period.

Without the loan, the company would have had to delay the project for a year, until it had built up sufficient reserves to purchase a tunnel — or until its cashflow was large enough to lease one. Either way, the 2017 Christmas period would have been a lost opportunity without Funding Circle’s support.


EDELMOND

5. THE NETHERLANDS

We find a similar story to Germany when analysing financing trends in the Netherlands, where lending to firms by banks has declined sharply since the financial crisis (in contrast to banks in the US and, more recently, the UK). Furthermore, the three major Dutch banks' lending to small businesses in the Netherlands has decreased more rapidly than to larger firms, with the banks appearing to have pursued different interest rate policies that disadvantage smaller firms—a similar finding to the UK.

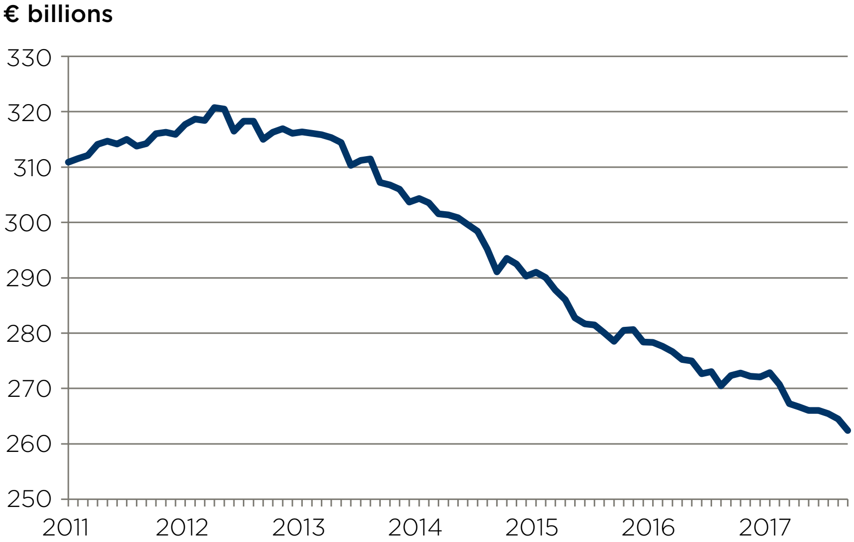
Funding Circle issued its first loan in the Netherlands in November 2015. Less than two years later, it had increased its loans under management to €40 million (at December 2017). This chapter estimates the full impact of that lending on the Netherlands' GDP, employment, and tax receipts.

5.1 SMALL BUSINESSES' ACCESS TO FINANCE

Data from De Nederlandsche Bank shows that bank lending to non-financial businesses has fallen substantially in recent years. Between April 2011 and December 2017, Netherlands-based banks' lending to non-financial businesses fell by 16 percent (Fig. 53)[46]—whereas in the United States and, more recently, the UK, banks have increased lending levels to these customer types.

Information collected from the three major Dutch banks indicates that this downward trend has been more pronounced for loans extended to small businesses.[47] The data, collected since September 2013, show a 16 percent decline in outstanding loans to small firms between 2013Q3 and 2017Q3 (Fig. 54).[48] This is slightly larger than the 14 percent decrease in the value of outstanding loans to all non-financial businesses over the same period.

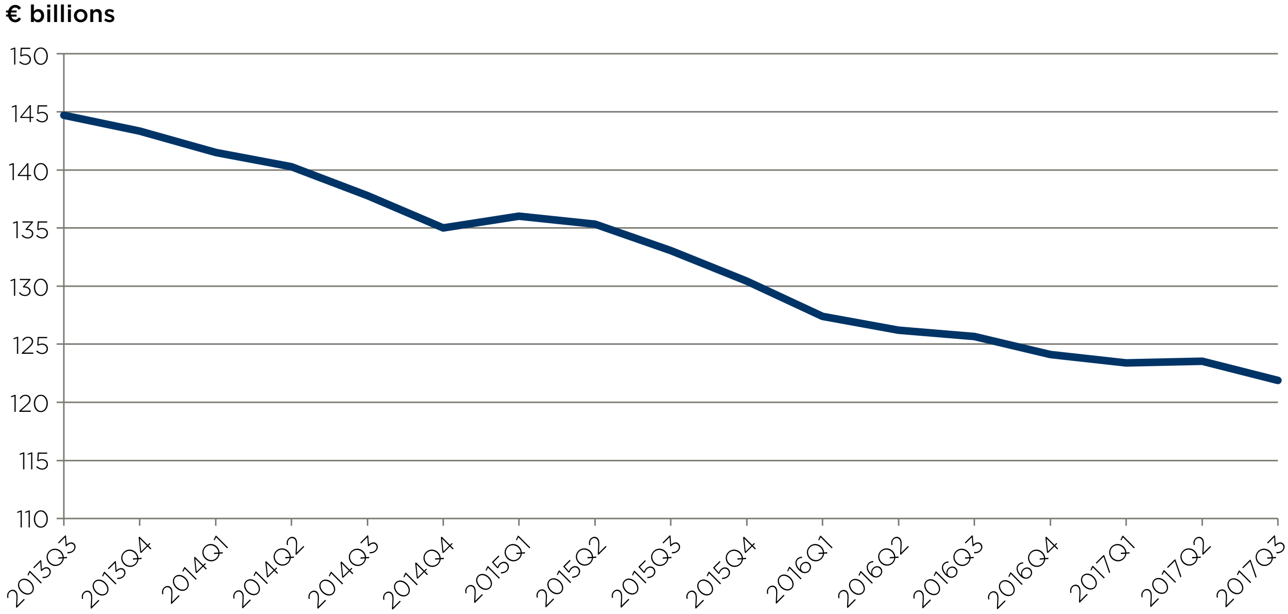
Fig. 53: Outstanding bank loans to non-financial businesses, April 2011 to December 2017



Source: DNB

[46] De Nederlandsche Bank, *Key indicators monetary statistics – February 2018*. The data relate to lending by 'monetary financial institutions' but the majority will relate to banks. We use the term 'bank loans' for simplicity.
[47] De Nederlandsche Bank, *Lending by Dutch large banks to the Dutch SME sector*, last updated January 2018.
[48] For these purposes, SMEs are defined as private companies and institutions which are involved in non-financial services or production of goods, with a maximum turnover of €50 million.

Fig. 54: Outstanding bank loans to small firms from the three major Dutch banks, 2013Q3 to 2017Q3

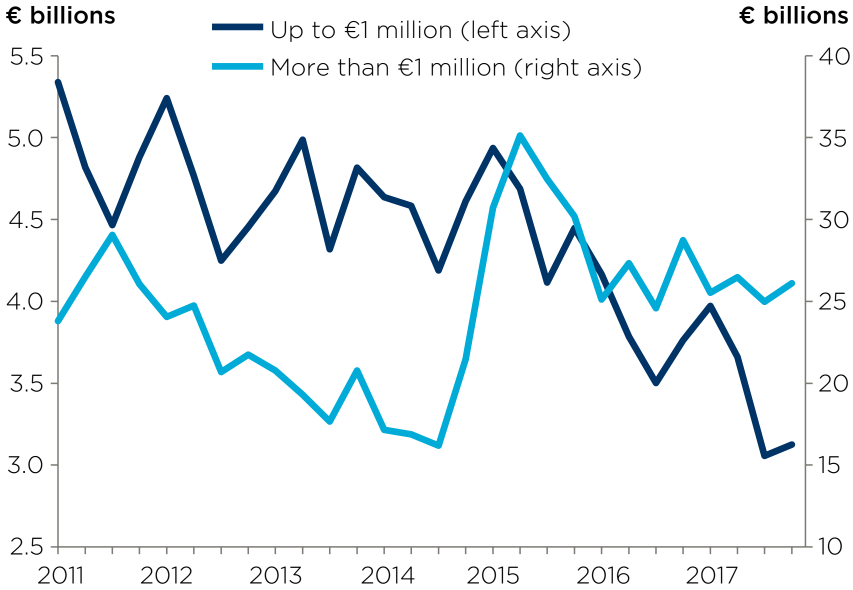


Source: DNB

The gap is more striking when bank loans to business are compared by the size of the principal. The value of new bank loans with a principal of less than €1 million was 29 percent lower in 2017 than in 2011. In contrast, the value of new business loans over €1 million was around 2 percent lower (Fig. 55).

To put this decline in bank lending to small businesses into context, over the same time period the number of small businesses in the Netherlands has been increasing. The number of firms with 249 employees or less grew by some 29 percent between 2011 and 2017 [49]—suggesting that access to bank credit is now much harder for small businesses than five years ago.

Fig. 55: Value of new business loans, 2011Q1 to 2017Q4

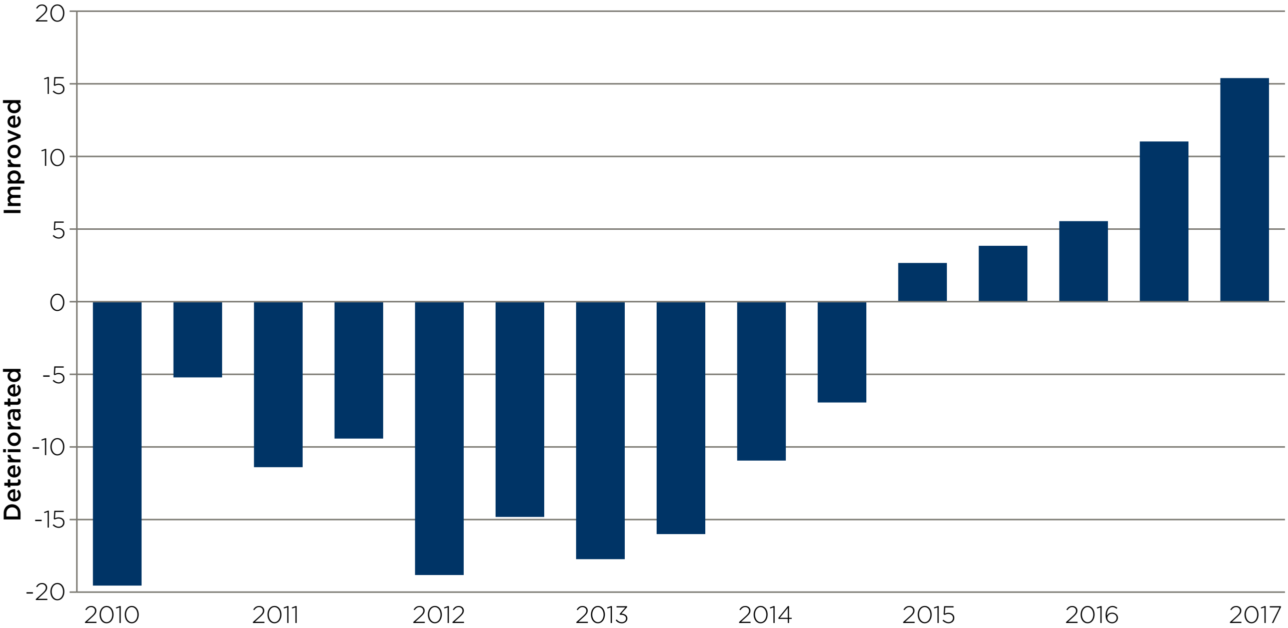


Source: Eurostat

[49] Statistics Netherlands, *The State of SMEs, Number of companies by company size and legal form*, accessed February 2018

Fig. 56: Change in availability of bank loans or credit facilities for SMEs, 2010H1 to 2017H1

Net weighted percentage



Source: DNB

This is broadly reflected in the ECB's SAFE survey. Its data show the percentage of small firms reporting decreased availability of bank loans exceeded those reporting increased availability every half year from 2010-2015 (Fig. 56).[50] The results to the survey question subsequently became more positive, but that conflicts with the continuous fall in the lending data.

There is some evidence that banks in the Netherlands have pursued different policies in the interest rates they charged. The ECB's Bank Lending Survey shows the cost of borrowing for small businesses increased every quarter from April 2012-July 2014, as measured by the size of banks' margins on average loans (Fig. 57), while the spreads banks charged large enterprises fell. Since July 2015, the survey shows a similar picture for firms of both sizes.

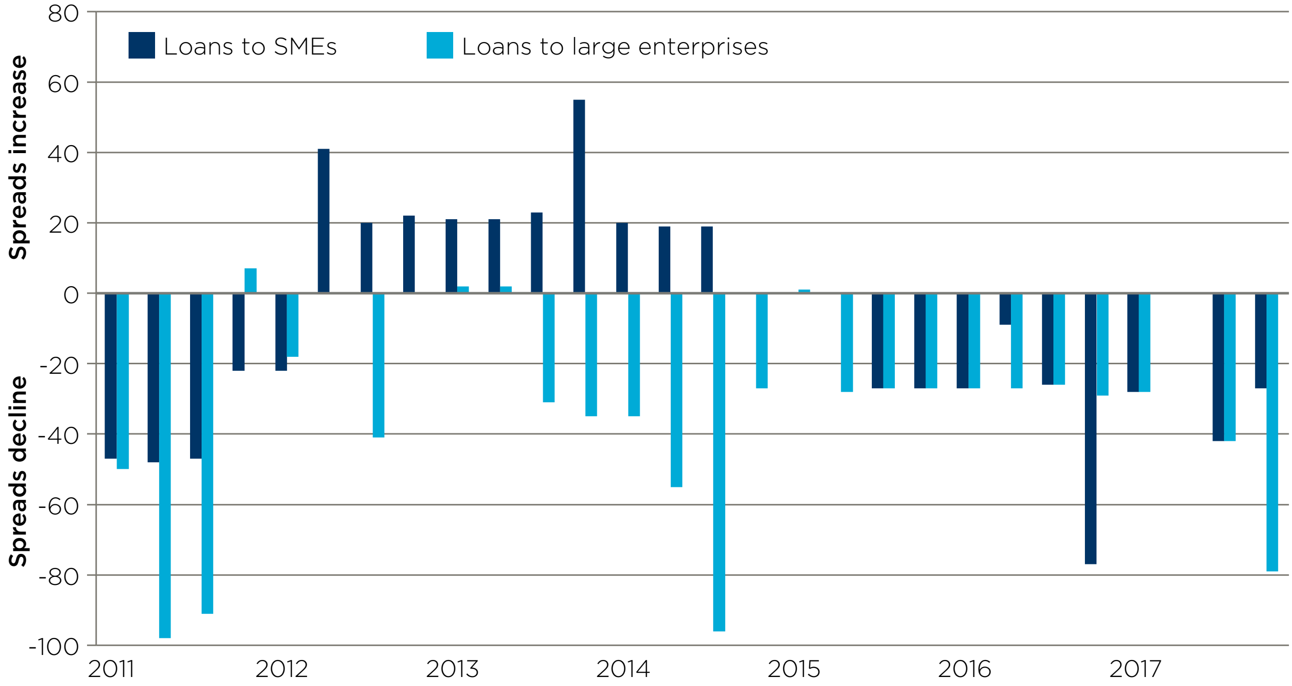
The market for non-bank finance for business in the Netherlands is the second largest in continental Europe.[51] In 2016, it generated around €179 million in net new finance for firms, exceeded only by its French counterpart. Online business lending accounted for around 74 percent (or €132 million), followed by equity-based crowd funding at 15 percent and debt-based securities at eight percent. The market for online lending has grown rapidly: between 2015 and 2016, the volume of lending through online platforms increased by 79 percent.

[50] European Central Bank, *Survey on the access to finance of enterprises*, November 2017

[51] Cambridge Centre for Alternative Finance, *Expanding horizons, the 3rd European alternative finance industry report*, 2018. Where business finance is defined as P2P business lending, balane sheet business lending, invoice trading, debt-based securities, profit sharing, equity-based crowdfunding, and real estate crowdfunding.

Fig. 57: Trend in banks' margins on average loans, April 2011-Dec 2017

Net weighted percentages

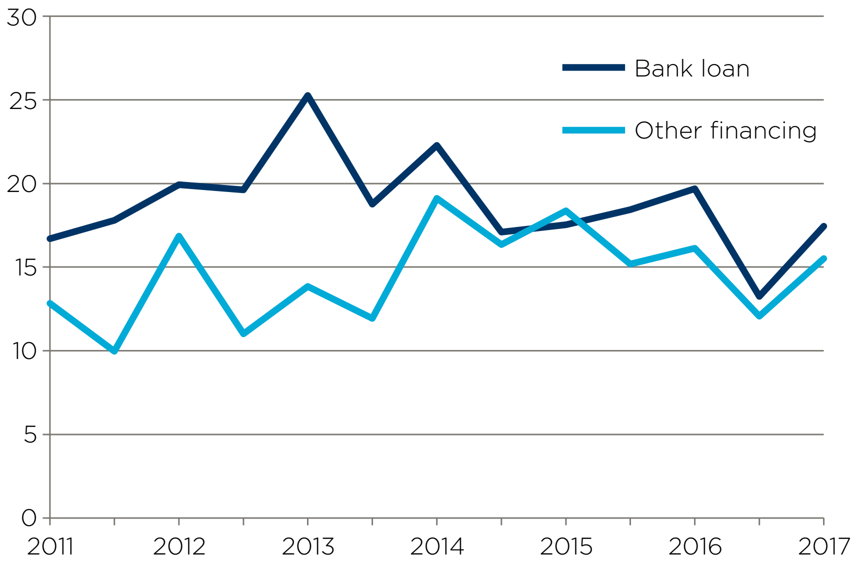


Source: DNB

There is evidence that demand for non-bank sources of finance among small firms in particular has expanded. The ECB's SAFE found the proportion of firms using non-traditional types of financing, including online lending, has been increasing, albeit with large fluctuations in each period (Fig. 58). Almost 16 percent of small firms reported using "other financing" in the first six months of 2017, compared to around 13 percent in the first half of 2011.

Fig. 58: Types of loan sought by SMEs in the Netherlands in the past six months[52]

Percentage of SMEs



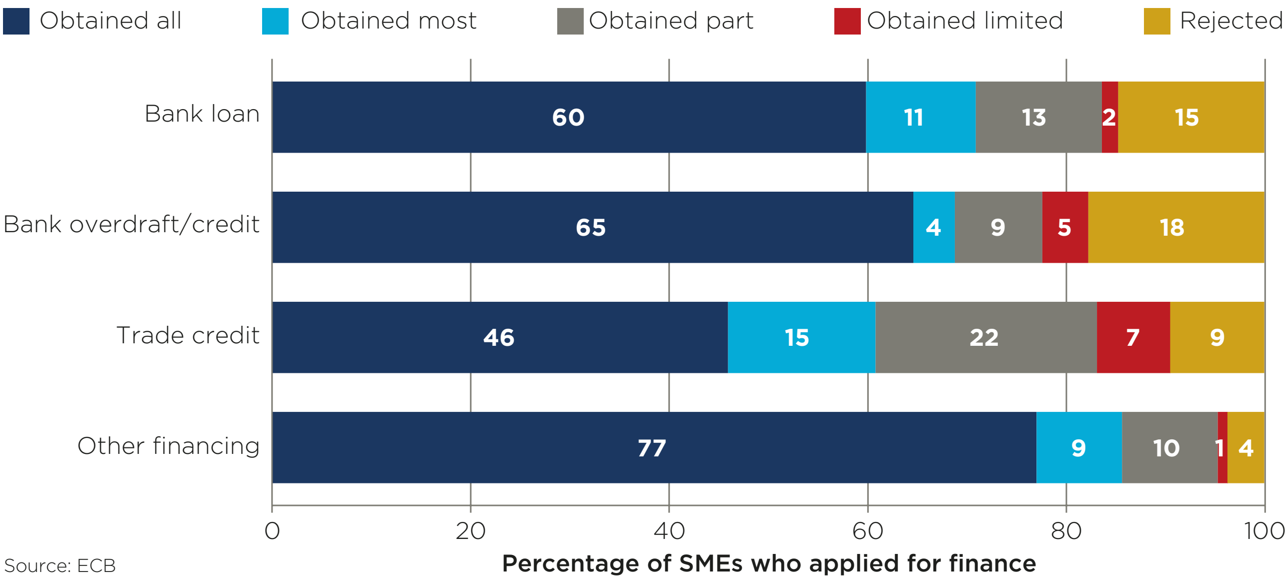
Source: ECB

[52] Other financing here includes peer-to-peer lending, crowdfunding, participating loans, subordinated debt instruments, loans from a related company, shareholders or family and friends, leasing, factoring, grants and issuance of equity and debt securities.

The ECB survey also showed small businesses were more likely to receive all of the funding when they applied for non-traditional types of credits. Some 77 percent of firms who applied for "other financing", including online lending, reported they received all that they applied for in 2017 (Fig. 59). This compares to an average of 62 percent of firms applying for any type of finance, and 60 percent of firms who applied for a bank loan.

The corresponding percentages of small firms who obtained at least some of the finance applied for were 96 percent, 89 percent and 85 percent. This suggests that firms going to non-bank sources of finance are finding it easier to access funds than those going to the traditional sources of credit.

Fig. 59: Outcome of SMEs' funding applications in 2017[53]



Source: ECB

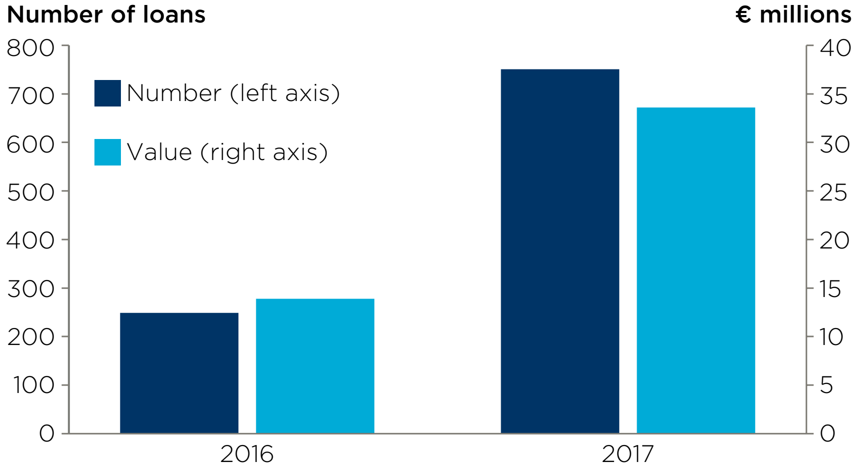
[53] The results cited here have been adjusted by Oxford Economics to exclude 'pending', 'don't know' and 'refuse to answer' options. Other financing here includes peer-to-peer lending, crowdfunding, participating loans, subordinated debt instruments, loans from a related company, shareholders or family and friends, leasing, factoring, grants and issuance of equity and debt securities.

5.2 FUNDING CIRCLE'S NETHERLANDS LENDING PROFILE

Lending through Funding Circle in the Netherlands, although the smallest of its markets, has again been growing rapidly. More than 750 new loans were issued in 2017, three times as many as in 2016 (Fig. 60).

In value terms, the new loans issued in 2017 totalled some €33.6 million; this was almost two-and-a-half times greater than in 2016. The average loan issued in 2017 was for a value just under €45,000, significantly larger than the median loan value of €30,000.

Fig. 60: New Funding Circle business loans issued, by year

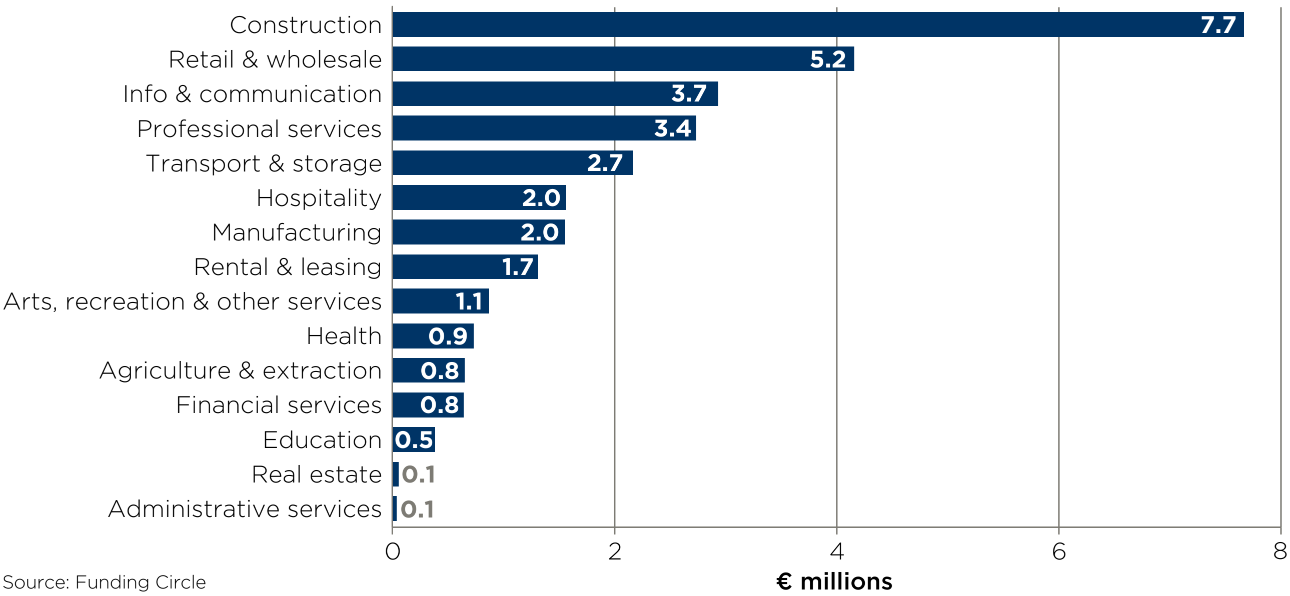


Source: Funding Circle

The portfolio of new loans issued through Funding Circle in 2017 was spread across a range of industrial sectors. The largest value of loans was extended to the construction sector at €7.7 million, followed by retail and wholesale at €5.2 million, and information and communications, which received €3.7 million (Fig. 61). Combined, the businesses in these three sectors were the recipients of just over half of the value of new loans in 2017.

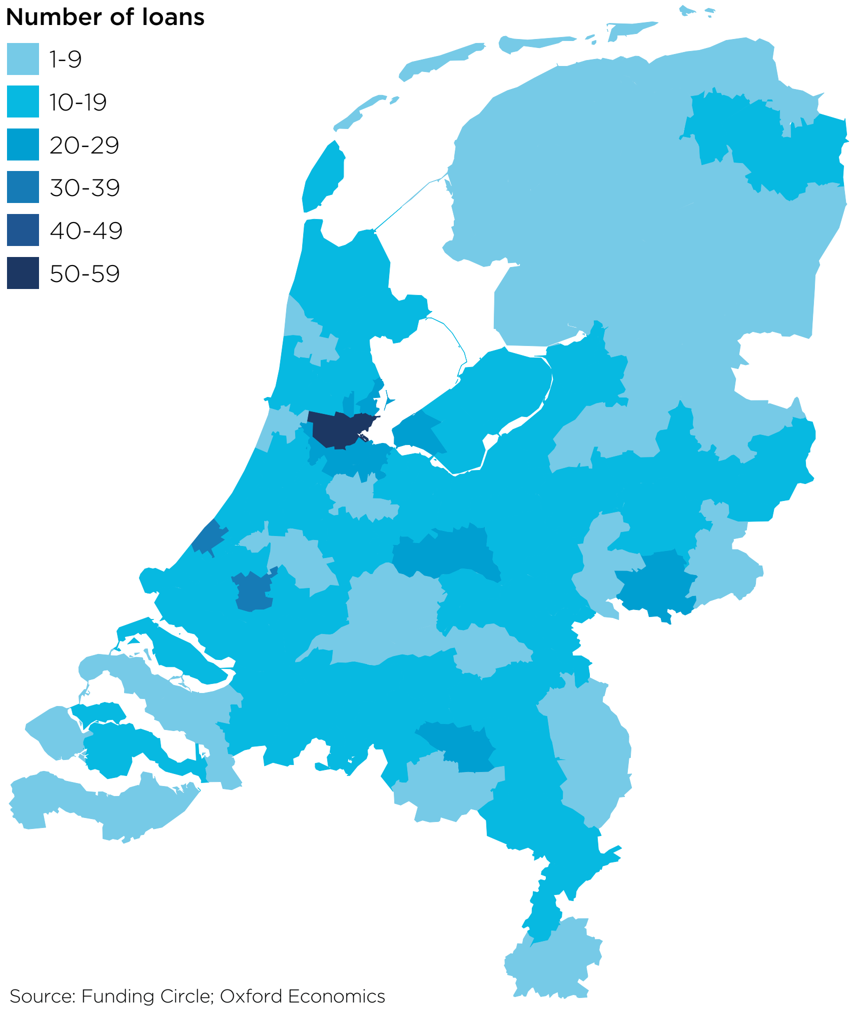
The platform's customers are widely spread across the Netherlands, with the cities of Amsterdam and Rotterdam having the highest concentration of customers (Fig. 62).

Fig. 61: Value of new lending through Funding Circle in 2017, by sector



Source: Funding Circle

Fig. 62: Loans issued through Funding Circle, end 2017, by geography



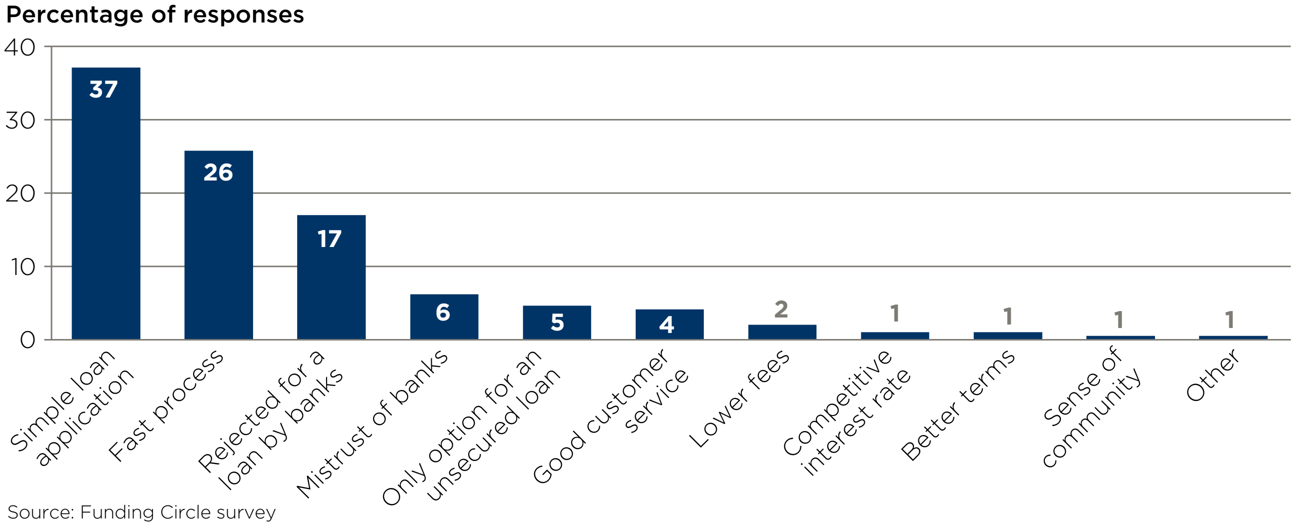
Source: Funding Circle; Oxford Economics

5.3 WHY DO SMALL BUSINESSES USE FUNDING CIRCLE?

To understand what motivated businesses to take out loans through Funding Circle, almost 200 customers were surveyed in the Netherlands. This section details the survey's most significant results.

As in the other three markets, customers value speed and simplicity when applying. Some 37 percent of customers that responded to the survey cited simplicity of the loan application as the main reason for choosing Funding Circle (Fig. 63). The speed of the application process ranked second, chosen by 26 percent of customers as their main motivation for opting for Funding Circle.

Fig. 63: The reasons small businesses borrow through Funding Circle



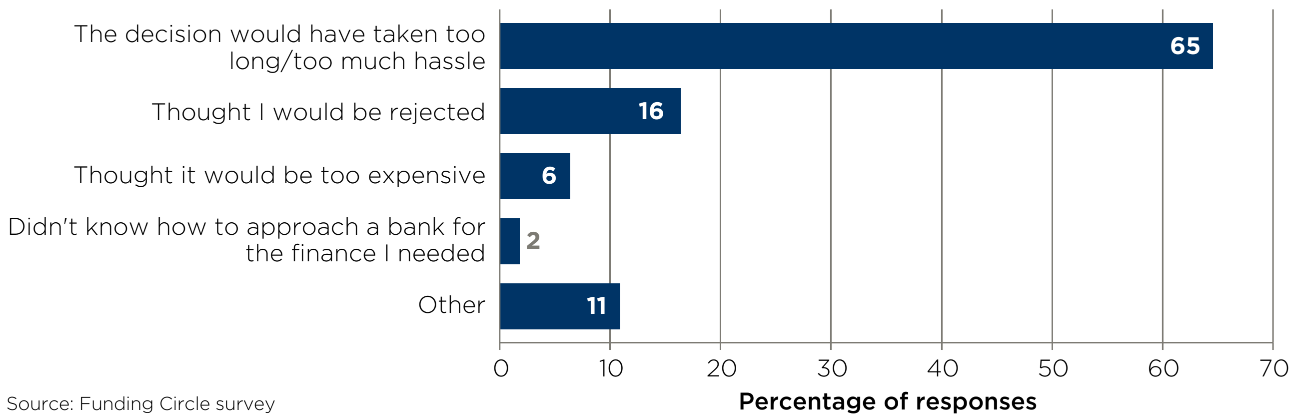
Source: Funding Circle survey

Many customers had tried and failed to get bank loans.

Compared to Funding Circle's other markets, a larger proportion of customers in the Netherlands had tried to access finance through more traditional channels before turning to online lending. Some 40 percent said they had attempted to secure a bank loan prior to applying to Funding Circle.

With regard to those who did not apply for a bank loan first, the time and hassle involved was the most common reason given—cited by 65 percent of these firms. However, market conditions also play a clear role in discouraging businesses in the Netherlands from seeking external finance: fear of rejection and a belief it would be too expensive were given as the main reasons for not applying by, respectively, 16 percent and six percent of firms.

Fig. 64: The main reason Funding Circle borrowers did not request a bank loan[54]



Source: Funding Circle survey

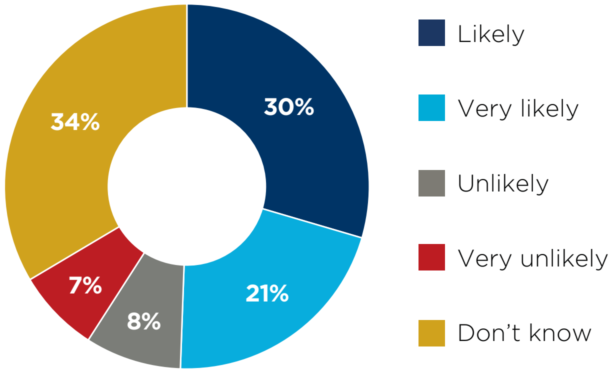
[54] Note: this excludes businesses who did attempt to secure a bank loan before applying to Funding Circle.

Some businesses were uncertain they could access external finance from elsewhere.

The survey evidence indicates Funding Circle's customers in the Netherlands were not confident about securing external financing from other sources. Some 34 percent responded that they did not know, reflecting uncertainty surrounding credit conditions (Fig. 65). Just 51 percent of firms thought it "likely" or "very likely" that they could secure funding through non-bank sources; of these, 54 percent would have turned to bank loans, and a further 19 percent to other online business finance providers.

Fig. 65: Businesses' expectations of receiving external finance if Funding Circle did not exist

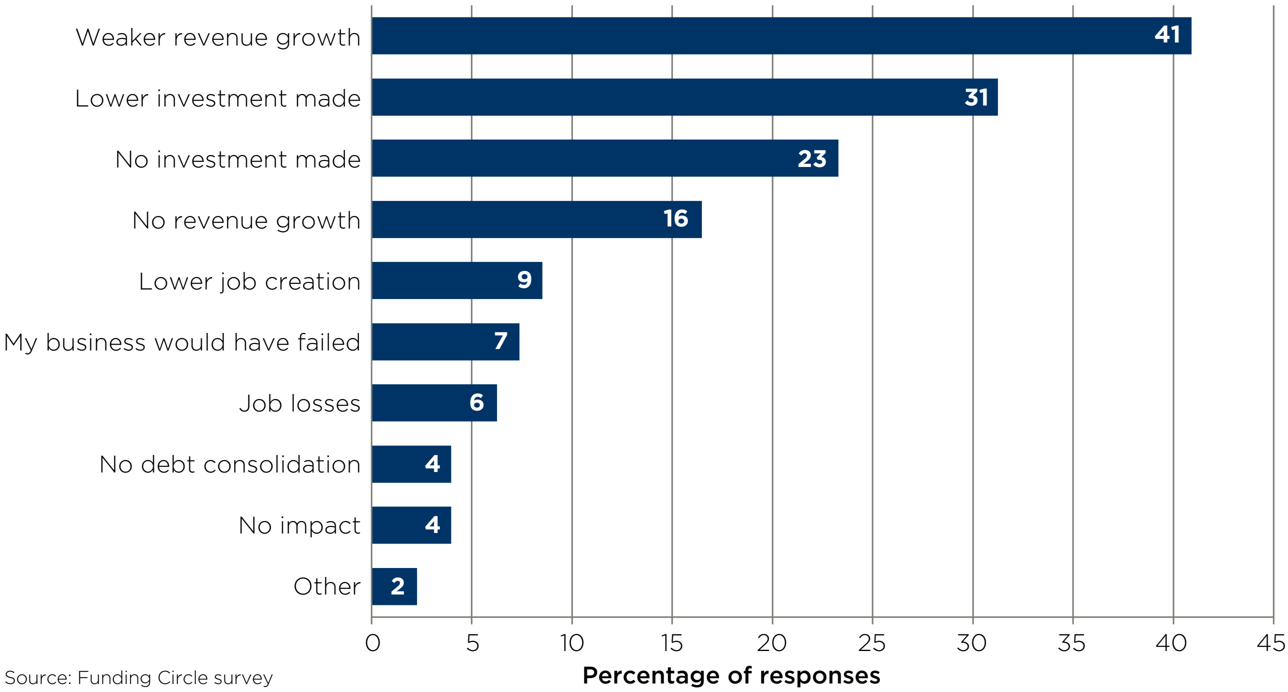
Percentage of responses



Source: Funding Circle survey

Without funding, firms would have lost revenue or lowered investment. A considerable portion of Funding Circle customers in the Netherlands—some 41 percent—indicated their revenue growth would have been weaker without their loan, while 16 percent believed their revenue may not have grown at all (Fig. 66). In addition, almost a quarter of the businesses surveyed said that no investment would have been made had they not received their loan.

Fig. 66: What would have happened if businesses had not received their required financing?



Source: Funding Circle survey

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

As part of the survey, Funding Circle customers were asked for details of their revenues, employments, procurement of inputs of goods and services, imports and tax payments. This information, in conjunction with the platform's total loan book, was used to estimate its total impact on the Netherlands economy.

Lending through Funding Circle directly contributes an estimated €38 million per annum to GDP in the Netherlands, and 600 jobs.

At the end of 2017, the platform had €40 million in outstanding loans with more than 992 SMEs in the Netherlands. In 2017, these companies generated some €589 million in gross value added contributions to the country's GDP. Using Funding Circle's share of the companies' total liabilities (around six percent), the direct gross value added contribution attributable to Funding Circle was €38 million per annum.

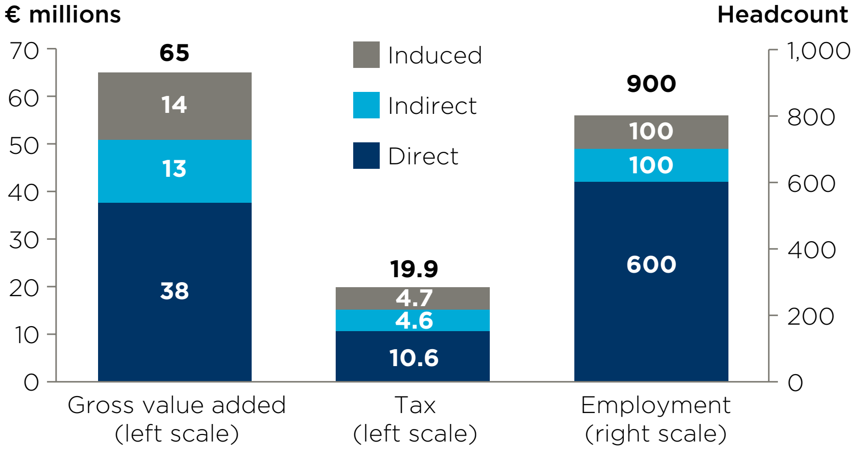
Outstanding loans originated through Funding Circle are estimated to have directly supported 600 employees in a variety of industries across the Netherlands' economy in 2017. This economic activity and employment sustained around €11 million in annual tax revenues.

But Funding Circle's impact in the Netherlands does not stop with the activity of its customers. The loans also help to fund spending on inputs of goods and services, and payment of wages to staff. This spending generates further economic impact through the "indirect" (supply chain) and "induced" (wage-financed consumption) channels.

The indirect channel captures the economic activity stimulated by the small business borrowers' spending on inputs of goods and services from Netherlands-based suppliers. Lending through Funding Circle is estimated to support €17 million in domestic procurement per year. This spending sustained a €13 million gross value added contribution to GDP, 100 jobs, and €5 million in taxes per annum.

Funding Circle's borrowers, and companies in their domestic supply chains, pay their staff wages. In turn, these employees spend a portion of their wages in the Netherlands' economy, supporting more economic output, employment and taxes. Through this induced channel, Funding Circle supported a further €14 million gross value added, 100 jobs and €5 million in tax revenues annually.

Fig. 67: Funding Circle's total contribution to the Netherlands' economy in 2017[55]



Source: Oxford Economics

In total, Funding Circle is estimated to have supported a €65 million gross value added contribution to the Netherlands' GDP in 2017, and enabled 900 jobs. Funding Circle's total economic impact in the Netherlands is the sum of these three channels of impact. Through its outstanding loans at the end of 2017, Funding Circle supported an annual total gross value added contribution to the Netherlands' GDP of €65 million (Fig. 67). It further sustained some 900 jobs, and €20 million in tax revenues per year.

[55] The three channels employment numbers do not sum to 900 in the chart, as they have been rounded to the nearest 100 people.


cotton ball lights
the original

CASE STUDY: COTTON BALL LIGHTS

Netherlands-based Cotton Ball Lights sells handmade, Fairtrade-certified lights in Europe, South America and Australia. Founded almost eight years ago, the company has grown from just five employees to more than 80 staff based in the Netherlands and Thailand. The company produces 10 million cotton ball lights a year that are sold in 16 countries—with customers having the choice of buying pre-designed strings of balls, or creating their own unique products.

Two years ago, founder Luc Clement was keen to extend his company's offering to include lightboxes sourced from China. However, a problem arose when the supplier said it required 30 percent of the payment on placement of the order, with the remaining 70 percent due when the stock arrived in Rotterdam. This meant Luc would need to pre-finance the purchase of stock fully five months before his firm was likely to recoup any money from its sale to customers.

Luc compared a large range of credit suppliers before choosing to apply for a loan through Funding Circle. Within days, he had the funds in his account which enabled him to purchase a large quantity of lightboxes in one order (setting up a sister-company, LEDR, in the process). By purchasing in bulk, Luc was able to negotiate a better price and save on shipping costs, boosting his profit margins.

When asked about the benefits of Funding Circle, Luc praises the speed with which the company was able to secure finance, and the favourable interest rates compared with traditional sources of finance. But beyond the financial terms of the loan, he particularly appreciated the human aspect of Funding Circle. Cotton Ball Lights was sent a list of every person who had invested in the business, prompting Luc to comment: "There are real people behind it, which is nice to see."

6. CONCLUSION

Almost a decade after Lehman Brothers collapsed and the financial crisis took hold, small firms are still struggling to access credit in many industrialised countries. Business surveys repeatedly point to relatively high bank loan rejection rates for SMEs, as well as financing shortfalls for those small firms whose applications are accepted. Lending data and credit condition surveys suggest banks have treated larger corporate customers more favourably in the volumes they lend, and the terms and conditions they impose, since 2007/08.

However, technology and other factors have triggered growth in a number of other providers of credit, offering small businesses an alternative to their traditional dependence on bank loans. Online lending is at the forefront of this trend.

This report has sought to quantify the full economic impact of loans extended to small businesses through one such online lending platform, Funding Circle, in the four countries in which it operates. In total, Funding Circle's outstanding loans to small businesses at December 2017 supported an annual gross value added contribution to GDP across the four markets of £3.9 billion. These loans are also found to have supported over 75,000 jobs, and some £1.3 billion in annual tax receipts.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APPENDIX 1

ESTIMATING THE ECONOMIC IMPACTS

Survey respondents in each of the four countries were asked about their company's latest annual revenue, purchases from other firms, the share of imports in those purchases, and business tax payments, as well as employment levels. Respondents who had repaid their loan through Funding Circle, or who took out a loan in early 2018, were removed from the dataset for these purposes, leaving only those respondents with outstanding loans at December 2017.

The direct gross value added of these respondents was taken to be the difference between revenues and purchases from other firms, while their direct employment was taken straight from the survey answers.

The "Funding Circle share" of those values then had to be calculated. Each company in the sample was matched with its record in the entire loan book, as adjusted to capture only loans under management and not in default at the end of 2017. This enabled the company's Funding Circle loan value, 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 were then scaled up, to arrive at impacts for the entire Funding Circle loan book, based on the ratio of all outstanding loans to the survey firms' outstanding loans. Revenues, purchases from other firms, and business taxes paid were 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. Estimates for business taxes within this overall set were then checked against the business tax total derived from the survey answers, and found to be compatible.

Next, the indirect and induced impacts were worked out. The pattern of firms by industrial sector, both in the sample and across the entire loan book, was reasonably similar to that of the wider business sector, except for 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 the 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 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 the lending through Funding Circle's platform per annum. They are <u>not</u> cumulative, so do not show the economic impact of Funding Circle since its creation.

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June 2018

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