Standing out from the crowd

The challenges of small business funding

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Taking Credit Where It's Due

In the absence of traditional funding, small businesses are looking for alternative means of raising finance. Crowd funding fits the bill.

Business loves jargon. It serves a purpose; in particular it flags when a new market or trend is sufficiently established to warrant its own label. Once everyone's agreed on what to call a new behaviour then it's more than just a fad, it must be serious. So it is with crowd funding: the idea that diverse individuals and consumers can invest money – debt or equity – in multiple businesses or just one business in search of funding. Crowd funding has arrived. But, just so we're clear, (it's still a young market after all!) we're talking about the crowd funding debt finance for small business.

Rising profile

If you're dimly aware of the trend but aren't persuaded, then the news last week that Funding Circle has announced a further equity funding round, raising £38m to accelerate its progress in the US, is noteworthy. Not only that, but Robert K Steel, a former under-secretary at the US Treasury and Goldman Sachs veteran, is joining its board. To date, Funding Circle, set up in 2010, has lent £317m to UK businesses from 30,625 UK investors.

SMEs are looking to the crowd for alternative finance

One of a growing number of peer to peer lenders to small business, which include Zopa, Rate Setter and Wellesley, this new lending market for small business is not only established but growing rapidly. The emergence of peer to peer lending platforms is a direct response not only to the general failure of the traditional UK clearing banks to support SME businesses adequately with suitable finance – but also to the greater credit tightening these banks have experienced since 2008. The banks position broadly paraphrases as "We're willing to lend," say the banks, "but no-one's applying!" (More accurately perhaps, SMEs value economy of effort and see little point in applying for finance they don't believe the bank has any real desire to provide.)

Whatever messaging the banks and their advocates at the British Bankers Association advance, and however much the banks try to restore their tarnished brands in the eyes of their consumer and business customers, it's clear that something is broken in small business lending. On Friday of last week the Competition and Markets Authority confirmed it is minded to launch a full scale competition enquiry that includes business banking. Even the Treasury has consulted this year on requiring the banks to refer SME applications for credit to alternative funders where the applicant bank declines to provide credit, as well as a further consultation requiring the banks to share credit information on SME customers to allow new entrants to assess prospective lending to such businesses with the same information as the banks have access to.

A new direction?

So does peer to peer lending herald the start of fundamental shift in business lending? It's still a little too early to be certain. But take note, the US's two biggest P2P lenders, LendingClub and Prosper expect to close 2013 with loan origination of \$2 billion and \$350 million respectively, compared

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with a combined $871 million in 2012. Critics point to the fact that investors do not benefit from the automatic protection of their deposits, uncertain risk and reward and that peer to peer lending represents the emergence of a shadow banking system. But isn’t that the point? This is a market response to the failure of the traditional bank lenders.

A real alternative?

In a recent article in the national press, Telegraph business editor Jeremy Warner, observed that what is really needed in UK small business banking is more fundamental competition, not simply more of the same, noting that “newcomers – Tesco, Metro Bank, Virgin Money, and so on … are basically just conventional banks dressing themselves up as something fresh. They are mere parasites on the pig’s belly, which don’t fundamentally challenge the present system.” It is an insightful view which is echoed by Andy Haldane, the Bank of England’s chief economist, who anticipates that the use of technology will bring about a revolution in finance.

What is clear certainly is that there is a long way to go. The sheer size and incumbency of the big UK banks will take time to unwind. It’s possible that the peer to peer providers will yet be absorbed by the banks themselves as the easiest way for the banks to reinvent their business lending operations – Funding Circle themselves have already partnered with Santander for referral business. But don’t be surprised if peer to peer lending contributes significantly to the new, changing landscape of business banking. As we have commented before, consumer markets are showing just how quickly user practice and behaviour can change in mobile payments and technology makes it easy to stand out from the crowd.

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