Small Business, Big Impact
The changing face of business finance
Evidence from Funding Circle
August 2016
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London, July 2016
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Increased Revenue

Neal’s Yard Remedies is a leading British retailer of organic beauty products and natural medicine. They operate a franchise network of 40 shops across the UK. Their Bath franchise borrowed £100,000 from 935 investors to support their expansion. Since then, Neal’s Yard have seen a 30% increase in revenue.
Foreword

It has been six years since Funding Circle launched with a big idea - to revolutionise the way small businesses access finance. In that time, more than 15,000 UK businesses have borrowed over £1.4 billion from a wide range of investors including 50,000 people, local and national government, and a range of financial institutions such as pension funds. Globally, investors have lent $2.5 billion across the UK, US, Germany, Spain and the Netherlands.

For too long, UK small businesses could only access the funds they needed to grow from a small number of high street banks. In the wake of the financial crisis, we saw just how fragile this ecosystem was. Indeed, this report shows the extent to which banks moved away from small business lending and how it is still yet to recover.

When we were first thinking about how to better help small businesses, we considered how larger businesses had multiple ways to raise finance and wondered why small businesses didn’t have the same choice. What we wanted to create was the infrastructure - similar to a stock exchange or bond market - where any investor, be they individuals, financial institutions or even governments, could lend to small businesses.

I’m pleased and humbled to say that at Funding Circle, this is the case today. This report demonstrates the impact direct lending is having on small businesses and the economy at large. We must remember small business isn’t small - it accounts for half of the UK’s GDP and 60% of private sector employment. Fast, flexible, fair cost finance is absolutely critical, especially as we find ourselves in increasingly uncertain times.

We are particularly proud of the large number of jobs (~40,000) that have been created by lending through Funding Circle. Businesses are leaving banks to enjoy faster, and often lower cost finance - this report finds that whilst 77% of businesses initially shopped around for finance, an overwhelming 94% would come back to us first in future.

We are also expanding the small business finance market, with a fifth (21%) of borrowers telling us they would have been unable to access finance without Funding Circle. That, and the fact that we are able to direct significant funds to areas of the country like the North East where the traditional finance system has withdrawn through branch closures and restrictive lending policies, is hugely rewarding.

Direct lending platforms, like Funding Circle, only exist because of the huge value they create for customers on both sides of the marketplace. Looking ahead, we will continue to put our customers at the heart of what we do. We remain committed to helping thousands more small businesses access finance and ensuring investors earn stable, predictable returns, which as this report tells us, makes a valuable contribution to the UK economy.

Despite the economic uncertainty we face in the UK following Brexit, the future for small businesses, the engine of our economy, remains incredibly bright and direct lending platforms are increasingly becoming the first choice partner in helping them to achieve their hopes and aspirations.

Samir Desai CBE  
CEO and co-founder  
Funding Circle

James Meekings  
UK MD and co-founder  
Funding Circle
Executive summary

Using evidence from Funding Circle, this report examines how the lending landscape for small businesses has changed since 2010. It also assesses the impact direct lending, where investors lend directly to borrowers through an online platform¹, is having on the economy in terms of contributions to economic output and job creation. In addition, this report examines the extent to which direct lending is helping small construction companies in the UK to resolve the country’s longstanding housing crisis.

The business lending landscape in the UK is changing rapidly. Direct lending to businesses at the beginning of 2016 was 50% higher than the same period a year ago and is accounting for a growing proportion of capital raised by businesses. In the second quarter of this year, close to one in ten small firms applying for credit applied for funds from a direct lending platform.

These trends look set to continue further over the coming years, especially if an economic slowdown over the next couple of years translates into traditional channels being less willing to lend to creditworthy businesses due to their own sectoral or regional credit limits. Some time ago this would have meant that these businesses would have nowhere to turn, but now, direct lending is filling this gap, giving small business owners more choice and enhancing competition in the market.

By facilitating direct lending between investors and borrowers, platforms have also opened up pools of capital that were not previously available to small businesses, including retail, institutional and government money. Direct lending is thus facilitating a wide range of economic activity that would not have taken place in its absence – something we explore and quantify in this report.

Transforming the way small businesses access finance

Net lending to small and medium sized businesses through traditional channels has fallen by a fifth in the last five years.

The interest rate spread for small business loans has risen at banks since the financial crisis – in part to cover high branch overheads and capital costs.

Eight years on from the crisis, companies continue to report an environment in which access to capital is constrained, though there are signs of improvement in recent quarters. This is at least partly driven by increasing awareness and usage of direct lending, which has filled a gap.

Direct loans accounted for 6% of all new loans granted by the main high street banks and direct lending platforms to small and medium sized businesses in the last quarter of 2015 - up from 3% for the same period in 2014. This rise in popularity can be partially attributed to their high quality of service. Based on evidence from Funding Circle, 72% of borrowers found the experience of obtaining a loan faster than other providers they considered. Whilst 77% of borrowers initially shopped around for a loan, 94% would come back to Funding Circle first in the future. These platforms are becoming a first choice for business finance.

¹ A term commonly used to describe this activity is peer-to-peer lending. As the sector has evolved, participation from a wider range of investors, other than individuals, has increased. Investors at Funding Circle include 50,000 people, local and national government and financial institutions. The rest of this report will therefore refer to the activity of investors lending directly to borrowers through an online platform, as ‘direct lending’.
On the other hand, there is also a portion of businesses that turned to direct lending platforms because, despite their creditworthiness, they found themselves unable to obtain a loan through traditional channels. A fifth (21%) of borrowers believe they would not have been able to secure external finance in the absence of Funding Circle.

The fact that creditworthy businesses find themselves unable to obtain a loan suggests a gap exists in the market. One possible reason that banks are unable to approve certain loans is that the applicant does not hold enough assets to take security against, or alternatively, the bank is already over-exposed in a certain region or sector. Direct lending platforms have stepped in to fill this gap, and Funding Circle’s partnerships with some of the high street banks, where businesses that the bank cannot help are referred to the platform, is further evidence of this.

Potential future retrenchment by banks in a period of uncertainty may actually provide an opportunity for platforms to gain market share. We expect platforms will be able to continue to facilitate credit partly because of lower overhead and capital costs, but also because of the diverse capital base that has been built up at some platforms over the last period. The range of different investors now lending through platforms means small businesses are able to access pools of capital that were not previously available to them.

Government can play a major role in facilitating lending to businesses, and indeed has achieved success in this area through the British Business Bank. Further lending through platforms could prove to be a faster, more targeted way of providing liquidity in times of economic hardship. Given the fast loan processing times offered by platforms, direct lending could be used as a macroeconomic tool to inject money into the real economy.

Small business, big impact

Investment facilitated through direct lending platforms supports individual businesses, but also the economy as a whole. Lending boosts growth and employment for industries of the loan recipients, as well as those sectors along the supply chain. An additional economic benefit is realised as a result of the increased spending power of employees in these sectors.

Over three-fifths (61%) of Funding Circle borrowers saw their revenue increase as a result of the loan, while nearly half (47%) reported a rise in profits.

The total boost to the UK economy (measured by Gross Value Add) resulting from Funding Circle loans since 2010 currently stands at £2.7 billion. The GVA impact has built up over time, from £39.8 million in 2011, to £401.6 million in 2013, reaching £2.7 billion by mid-2016.

These loans have supported the creation of up to ~40,000 jobs: 17,400 jobs directly and a further 21,100 jobs through the benefits realised along the businesses’ supply chains and due to the increased spending power of employees.

Finance generated through direct lending platforms is also supporting small businesses in the North – a region that has faced economic hardship and that the Government is trying to target with a set of growth-boosting initiatives. A tenth (10%) of Funding Circle loans go to businesses in the North East, a region which accounts for just 3% of all UK businesses.

Investors are also lending to high growth sectors which are crucial for future economic performance. Out of the 10 sectors that account for the highest share of Funding Circle loans, five have grown faster than the UK business population as a whole in the 2008 to 2015 period. These sectors include computer programming and construction. This suggests that Funding Circle is playing an important role in
supporting sectors that account for an increasing share of economic activity and are going to be driving growth in the future.

**Unleashing the potential of small housebuilders**

One of the most commonly discussed policy areas in the UK over the past several years has been the ongoing housing crisis. **Since 2006 the UK has accumulated a housing shortfall of 264,000 dwellings.** On their own, large housebuilders have been unable to keep up with rising demand, which means that smaller housebuilders play a crucial role in meeting the supply gap the country faces.

In the years since the crisis, small developers have found it especially difficult to access bank finance due to banks restricting their lending to the sector. **In 2014, the National House Building Council conducted a survey which found that half of small builders find banks’ reluctance to lend a serious problem.**

Direct lending is helping to alleviate this crisis by supporting these smaller companies in the housing sector. **As of June 2016, 742 loans with a cumulative value of £183 million have been granted for residential property development through Funding Circle.** We estimate that lending through the platform has already **contributed to approximately 2,200 homes being built across the country.**
1 Transforming the way small businesses access finance

- Net lending to small and medium sized businesses through traditional channels has fallen by a fifth in the last five years.
- The interest rate spread for small business loans has risen at banks since the financial crisis – in part to cover high branch network and capital costs.
- Non-bank financing options have led to a rapidly improved lending picture for small and medium sized businesses. Direct loans accounted for 6% of all new loans granted by the main high street banks and direct lending platforms to small and medium sized businesses in the last quarter of 2015 - up from 3% for the same period in 2014.
- Businesses are drawn to these types of platforms by the speed and simplicity of the loan application process - 72% of Funding Circle borrowers found the experience of obtaining a loan faster than for other providers they considered. This helps to explain why 77% initially shopped around for finance, but 94% would come back to Funding Circle first in future.

The global financial crisis took a significant toll on the UK economy and the business community. In 2008 and 2009, GDP fell, the labour market deteriorated and policymakers were forced to take extraordinary measures – such as cutting central bank interest rates to record low levels.

Banks retrenched their lending to small businesses and smaller companies failed to benefit as much as larger ones from declining interest rates, as shown in official Bank of England data illustrated later in this section of the report. In part, this is likely to reflect high overhead costs (the costs of the branch network) and high capital requirements which are then reflected in the cost of lending and indeed the willingness of banks to lend to small businesses.

It costs the banks about the same amount to underwrite and process a £50,000 loan as it does a £3 million loan, meaning financial institutions are incentivised to focus relatively more on high value lending which yields a greater profit – particularly given high overhead costs.

Against this backdrop, consumer trust with incumbent financial services providers is low, with research by PwC showing that under a third (32%) trust retail banks.

Unlike in the previous UK economic downturn in the early 1990s, the economic recovery since the global financial crisis has been fraught with weaknesses, including weak productivity, subdued employee earnings growth and a lack of significant expansion in exports despite a sharp decline in the value of sterling against the US dollar and other currencies.

Yet there is some light at the end of the tunnel - the lending picture is gradually improving with a strong increase in the role of non-bank finance, such as direct lending, which in enabling businesses to access the capital that they need to expand. Facilitating lending, particularly to businesses in fast-growing industries such as technology, can play a crucial role in generating significant economic growth going forward.

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3 PwC, How financial services lost its mojo – and how it can get it back, 2014
1.1 The total UK small and medium sized business loanbook has declined by a fifth over the past five years

Looking at total lending by financial institutions, mainly banks, net lending to businesses has declined significantly in recent years, having a knock-on economic impact in terms of lower levels of business investment and economic growth. Bank of England data show that, over the five years between May 2011 and May 2016, the total value of outstanding loans to small and medium-sized enterprises declined by 18%, as repayment of existing loans exceeded issuance of new loans.

*Figure 1 – Amount outstanding of monetary financial institutions loans to businesses, £ billions*

*Source: Bank of England*
Companies continue to report an environment in which access to capital is constrained. Data produced by the Federation of Small Businesses show that more small businesses believe credit availability is ‘poor’ than ‘good’, though there are signs of improvement in recent quarters. This is at least partly driven by rising awareness and usage of non-bank finance (which we examine later in this section).

*Figure 2 – Business ratings of credit availability*

*Source: FSB*
1.2 Among traditional sources of finance, interest rate spreads have risen for small and medium sized businesses since the financial crisis

Part of the picture of relatively unfavourable credit conditions for small businesses can be seen in interest rate data, which show a widening in the interest rate spread between smaller and larger companies since the financial crisis at traditional lending institutions - as shown in Figure 3 below. In December 2004, the average interest rate charged on small loans (<=£1m) was 0.4 percentage points higher than that charged on large loans (>
£20m). At the end of 2015, average interest rates charged on smaller loans were 1.1 percentage points higher, meaning that smaller businesses have failed to benefit as much from declining interest rates compared to larger businesses.

Figure 3 – Difference between the average interest rate offered by traditional lending institutions for small (<= £1m) and large (>£20m) new business loans

Source: Bank of England, Cebr analysis. Graph shows a 12 month rolling average of the interest rate spread

1.3 Businesses are increasingly turning to direct lending

Businesses in the UK are increasingly turning to direct lending to raise the capital they need to expand, invest, and cope with cashflow issues, as well as to serve a number of other purposes.

The size of business lending through platforms is poorly captured by official data sources produced by the Office for National Statistics and Bank of England, so Cebr has considered a range of data sources produced by the Federation of Small Businesses, British Bankers’ Association (BBA) and Peer-to-Peer Finance Association (P2PFA). A comparison of datasets shows a similar picture for the likely size of the direct lending market in the UK, suggesting that the orders of magnitude described below are robust.
We have compared lending trends shown in BBA and P2PFA statistics. The BBA database on lending to small and medium sized businesses covers business loans granted by many of the UK’s largest banks – Barclays, HSBC, Lloyds Banking Group (including HBOS), Clydesdale (including Yorkshire Bank), Royal Bank of Scotland Group (including Natwest), Santander and Co-operative Bank. The P2PFA dataset captures loans granted through Funding Circle, Landbay, LendInvest, MarketInvoice, RateSetter, and ThinCats.

Our analysis of the collated data suggests that in the last quarter of 2015, out of all new small and medium sized business loans\(^4\) granted by the main high street banks and direct lending platforms, **direct loans accounted for 6% of the total in value terms.**

*Figure 4 – New direct loans\(^5\) as a share of new high street bank and direct loans to small and medium sized businesses*

These findings appear to be broadly consistent with other sources. The FSB Small Business Index dataset suggests that, of small businesses applying for credit in a given quarter, the share applying for direct loans stood at 6% in Q4 2015, but had risen to 9% by the second quarter of 2016. This is shown in *Figure 5* on page 13.

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\(^4\) The calculations are made on the basis that the overwhelming majority of direct lending goes to small and medium sized businesses rather than large companies.

\(^5\) The P2PFA dataset uses the term peer-to-peer lenders to describe the set of businesses that in this report are referred to as direct lending platforms. As in this instance the two terms refer to the same set of finance providers, we have used the term direct lending platforms for the sake of consistency.
Figure 5 – Share of small businesses seeking credit that applied at direct lending platforms

Cumulatively, since 2010 the P2PFA reports close to £3 billion in lending to businesses. The number of business borrowers is also rising at a significant rate. In the first quarter of this year 22,123 businesses had an outstanding loan with a P2PFA member. This is nearly double the number of businesses with an outstanding loan in the same period a year ago.

Figure 6 – New direct lending to businesses

Source: FSB

Source: P2PFA
1.4 Businesses are drawn to direct lending platforms by the speed and simplicity of the loan application process

Businesses choose to seek finance through direct lending platforms for a number of reasons and not only because they are unable to access loans through conventional channels. In fact, just a fifth (21%) of the Funding Circle borrowers surveyed as part of this research⁶ said they would not have been unable to secure external finance in the absence of Funding Circle, suggesting businesses generally turned to Funding Circle for reasons other than having ‘nowhere else to go’. The average Experian Delphi score (a typical measure of a company’s creditworthiness) for businesses given an ‘E band’ rating following Funding Circle’s credit assessment process is higher than the average Delphi score for a UK small business. Given that all of these businesses were therefore creditworthy, their inability to secure a loan elsewhere is not a result of their performance but of the bank lending environment. For instance, banks have exposure limits on the amount of lending to a particular region or sector.

Still, the majority of Funding Circle borrowers had multiple finance options available to them. The two most common factors that influenced borrowers to obtain a loan through Funding Circle specifically were speed and simplicity of the process. Competitive interest rate was the third most commonly cited reason. That is to say, non-bank finance can bring a range of benefits to borrowers.

*Figure 7 – The main influencing factor in a business’ decision to obtain a loan through Funding Circle*

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⁶ One of the sources cited in this report is a survey of over 500 Funding Circle borrowers. The survey was conducted online and took place during the week of June 20, 2016. For full details please see Appendix I of this report.
Among the survey respondents, 72% found the experience of obtaining a loan through Funding Circle faster than other providers they considered. 23% did not consider another financing option. For the 72% of respondents that found Funding Circle the fastest loan provider, nearly three quarters (74%) expressed that the process was at least a month faster. In 2016, successful Funding Circle applicants had the funding they applied for within two weeks on average.

**Figure 8 – How did the speed of the Funding Circle loan application experience compare to other providers? NB excludes those firms that did not consider any other provider**

When the businesses surveyed were considering obtaining their Funding Circle loan, only a fifth (20%) first attempted to secure a bank loan. This is well below the 60% figure that a report produced by Nesta in April 2013\(^7\) presented, suggesting businesses are increasingly aware of the choice they now have when searching for external finance.

The primary reason for not completing an application with a bank was that the process took too long, suggesting that businesses are increasingly turning to direct lending platforms because of the speed of the service they provide.

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\(^7\) Nesta; Banking on Each Other: The rise of peer-to-peer lending to businesses; 2013
Among the group of borrowers that did not try to secure a bank loan first, the length of the process was also the main concern, closely followed by a mistrust of banks.

**Figure 9 – Main reason Funding Circle borrowers did not attempt to secure a bank loan first**

NB excludes borrowers that did try securing a bank loan first

Whilst 77% of businesses initially shop around before taking a Funding Circle loan, the overwhelming majority (94%) of borrowers say they would come back to Funding Circle first in future. This suggests high levels of satisfaction with the service provided by the company. Satisfaction and loyalty are also evident from the fact that nearly a quarter (23%) of all Funding Circle loans are granted to repeat customers.

1.5 Direct lending is filling a gap to play an increasing role in the lending landscape

As already discussed, there is a portion of businesses that turned to direct lending platforms because, despite their creditworthiness, they found themselves unable to obtain a loan through traditional channels. A fifth (21%) of Funding Circle borrowers believe they would not have been able to access finance through a bank. Further to this, 4% of Funding Circle borrowers believe that in the absence of the loan their businesses would have failed.

The fact that creditworthy businesses find themselves unable to obtain a loan suggests a gap exists in the market, and some creditworthy businesses were unable to obtain adequate financing before the development of direct lending. One possible reason that banks are unable to approve certain loans is that the applicant does not hold enough assets to take security against or, alternatively, the bank is already over-exposed in a certain region or sector. Direct lending platforms have stepped in to fill this gap. Some banks such as Royal Bank of Scotland have acknowledged this issue, and have begun formally referring small business customers to direct lending platforms including Funding Circle.
### 1.6 Direct lending to play an increasing role in the lending landscape

The current economic climate, in which the UK faces significant uncertainty following the decision by the British electorate to leave the European Union (‘Brexit’), means that whilst traditional small business lending had begun to recover somewhat earlier this year, it may now fall again.

Having examined the above evidence which shows businesses are increasingly turning to direct lending platforms, future retrenchment by banks may actually provide an opportunity for platforms to gain market share. We expect that platforms will be able to continue to facilitate credit despite an increase in uncertainty, partly because of lower overhead and capital costs, but also because of the diverse capital base that has been built up at some platforms over the last period – where investors include individuals, financial institutions and governments. Direct lending platforms will therefore at least partially offset the negative impact of a possible economic slowdown over the coming years.

The range of different investors now lending through platforms means small businesses are able to access pools of capital that were not previously available to them. This means small businesses are no longer reliant on a small number of high street banks, and ensures the small business lending ecosystem is more sustainable than it was in the aftermath of the financial crisis.

Government can play a major role in facilitating lending to businesses, and indeed has achieved success in this area. The British Business Bank was first announced by the government in 2012 with the aim of addressing long-standing, structural gaps in the supply of finance and bringing government finance support for small businesses together in one place. Its 2015/16 annual results showed it supporting more than 48,000 businesses with a total stock of finance of £7.5 billion which has been delivered through 90 finance partners.

Government involvement can be especially useful in times of economic downturn. Given the fast loan processing times offered by platforms, they can be used by government bodies as a macroeconomic tool to directly inject money into the real economy. Supporting these direct lending platforms could prove to be a faster and more targeted way of providing liquidity in times of economic hardship than programmes such as Funding for Lending.

The economic gains from increased direct lending to businesses are significant. This is in part because the rise of direct lending platforms has increased competition among all loan providers. An increase in the number of competitors will continue to drive innovation in the offering of loan products and services as more firms compete for customers. As direct lending platforms continue to play an increasing role in the small business lending ecosystem, traditional lenders such as banks may begin to consider how they can better address the concerns expressed by borrowers who no longer consider banks when looking for a loan. For example, increased transparency in terms of fees structures may attract businesses who currently cite lack of trust towards banks as a primary reason for turning to other sources of finance. The following section considers an additional set of economic gains resulting from the rise in non-bank lending.

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8 The Bank of England *Money and Credit* data series shows that the value of the total UK SME loanbook was 1.7% higher in June 2016 than the same month a year ago.
10 British Business Bank, 2015/16 annual accounts.
2 Small business, big impact

- Over three fifths (61%) of Funding Circle borrowers saw their revenue increase as a result of the loan, while nearly half (47%) reported a rise in profits.
- Lending facilitated by Funding Circle has boosted annual economic output by £2.7 billion (measured via GVA).
- These loans have also supported the creation of up to ~40,000 jobs across numerous industries including high growth areas such as technology.
- Lending is helping businesses in parts of the UK that have been faced with economic challenges, such as the northern regions. Businesses in the North East make up just 2.7% of all business in the UK. However, 10.2% of loans facilitated by Funding Circle go to the North East.

This section quantifies the benefits of investment facilitated through Funding Circle. We divide the benefits into three categories: direct, indirect, and induced. Direct benefits are enjoyed by the loan recipients that receive additional funding. Indirect benefits result from increases in employment and economic activity experienced along supply chains associated with a given investment. Finally, induced benefits are generated through the increased spending power of employees. We measure these benefits in terms of employment and economic output (measured as gross value added, GVA\textsuperscript{11}).

2.1 Funding Circle loans have boosted the economy with a £2.7 billion GVA contribution

Loans obtained through direct lending platforms are having a positive impact on economic activity. Over three fifths (61%) of Funding Circle borrowers said their business revenue increased as a result of the loan. For those recipients that saw their revenue increase, the average increase is 17%. Furthermore, 47% of borrowers saw their profits rise as a result of the loan. Among loan recipients whose profits increased, the average rise was 15%.

GVA measures the economic contribution made by a particular economic unit such as a region, business or industry. It is used as one of the factors when calculating gross domestic product (GDP) and, in this report, is a measure of the relative economic importance of a business. The GVA benefit can be divided into three categories: direct, indirect, and induced.\textsuperscript{12}

We have estimated that the direct annual GVA impact of Funding Circle loans is £1.2 billion. Yet the added economic activity generated by Funding Circle loans benefits not only the recipients, but also those companies along the recipients’ supply chains. These indirect economic benefits provide a further GVA boost of £752 million. Additionally, the added spending power of employees in jobs supported as a result of the Funding Circle loans generates a £709 million GVA boost (the induced economic activity).

This means that the total (direct, indirect, and induced) GVA boost resulting from Funding Circle loans currently stands at an estimated £2.7 billion.

\textsuperscript{11} GVA is an indicator of economic performance and measures the value of goods and services produced in an area.
\textsuperscript{12} For businesses that say they would have failed in the absence of a Funding Circle loan, the analysis in this report does not only consider the added turnover resulting from the loan as an economic gain, but the entire turnover of the business.
If we assume that the share of businesses which increase their revenue as a result of the loan as well as the share of businesses that would have failed without the loan has stayed the same in each year, then we can estimate how the £2.7 billion GVA boost has built up over time. This is shown in the below table.

**Table 1 – Total GVA boost resulting from Funding Circle loans, by year**

<table>
<thead>
<tr>
<th>Year</th>
<th>Boost to annual GVA (£ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>4.5</td>
</tr>
<tr>
<td>2011</td>
<td>39.8</td>
</tr>
<tr>
<td>2012</td>
<td>139.6</td>
</tr>
<tr>
<td>2013</td>
<td>401.6</td>
</tr>
<tr>
<td>2014</td>
<td>966.4</td>
</tr>
<tr>
<td>2015</td>
<td>2,042.2</td>
</tr>
<tr>
<td>2016 (Jan to mid-June)</td>
<td>2,664.2</td>
</tr>
</tbody>
</table>

**Source: Funding Circle loanbook, Office for National Statistics, Cebr analysis**

Funding Circle projects that by 2025, the total amount of UK lending through the platform will stand at $20 billion per year. If we assume that the current lending to GVA boost ratio persists, this means that in 2025 the GVA boost resulting from Funding Circle loans will equal $2.8 billion or £2.1 billion per year\(^\text{13}\).

\(^\text{13}\) Based on exchange rate at 3 August 2016
2.2 Funding Circle loans have supported the creation of ~40,000 jobs

The survey conducted as a part of this report found that 47% of borrowers increased their headcount as a result of the loan while 52% kept the same headcount.

The average headcount increase was 2.5, so between two and three people. Given that 14,931 unique companies received a Funding Circle loan between August 2010 and June 2016, the survey results suggest that approximately 7,000 companies across the UK increased employment as a result of their loan. Keeping in mind that the average number of added employees is between 2 and 3 (2.48), the direct employment boost generated by Funding Circle loans is 17,400.

*Figure 11 – Direct employment boost resulting from Funding Circle loans, by sector NB only the top 10 sectors are shown*

In addition to these jobs which are all in companies that have received a Funding Circle loan, there is also a number of jobs supported in companies that make up the loan recipients’ supply chains. Additionally, due to the added jobs that Funding Circle loans support at the recipients’ firms and in companies along their supply chain, employees that hold these extra roles enjoy an increase in their spending power.

This means that overall, Funding Circle loans originated between August 2010 and June 2016 have contributed to the creation of up approximately 40,000 jobs. 17,400 of these jobs were created directly with a further 21,100 jobs supported via indirect and induced channels.
Increased Headcount

Spartan Motor Factors are the fastest growing vehicle parts supplier in South Wales, with branches in Newport, Cardiff and Bridgend. Their loan of £75,000 from 1,251 investors enabled the business to open a new branch at short notice and build a mezzanine floor in their Cardiff branch, doubling their stock and workforce, creating more than 20 new jobs.
2.3 Recipients of Funding Circle loans are varied and loans are used for a range of purposes

The diversity of the Funding Circle loanbook means that there is not necessarily a ‘typical’ Funding Circle borrower. This is especially true given the growth that Funding Circle has seen in recent years. Between 2014 and 2015 the number of loans obtained through Funding Circle has increased by 66%.

*Figure 12 – Number of Funding Circle loans granted*

Still, considering some basic business characteristics does help us form a picture of what kind of company is most likely to seek a loan via Funding Circle.

*Table 1 – Characteristics of Funding Circle borrowers*

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan amount</td>
<td>£67,500</td>
</tr>
<tr>
<td>Monthly payment</td>
<td>£2,100</td>
</tr>
<tr>
<td>Loan term (months)</td>
<td>45</td>
</tr>
<tr>
<td>Turnover at time of loan application</td>
<td>£1,340,800</td>
</tr>
<tr>
<td>Profit at time of loan application</td>
<td>£72,655</td>
</tr>
</tbody>
</table>

*Source: Funding Circle loanbook, Cebr analysis*

As the above table shows, the average Funding Circle borrower takes out a loan of roughly £67,500 which the business repays over 45 months on average. Compared to most business loans granted through banks, this is a relatively small loan amount and is the lending segment that many banks have moved away from. This is one of the reasons that smaller businesses looking for a relatively small loan are increasingly turn to direct lending platforms as they find that fewer banks offer attractive loan options at their end of the scale.
Given that the Funding Circle loan application process allows for a flexible variety of loan purposes, borrowers use the loans they receive for a wide range of purposes. The most common uses are to supplement cashflow and for equipment purchase.

**Figure 13 – Primary way in which Funding Circle borrowers use the obtained funds**

Source: Funding Circle survey, Cebr analysis
2.4 Funding Circle loans are supporting high growth industries

Some of the sectors that account for a high concentration of Funding Circle loans are among the high growth industries that play a crucial role in powering the UK economy. Out of the 10 sectors that account for the highest share of Funding Circle loans (see Figure 14 below), five have grown faster than the UK business population as a whole in the 2008 to 2015 period. If we consider growth in terms of the number of businesses, the total UK business population increased by 11% between 2008 and 2015. However, office administration expanded by 61%, personal services by 21%, computer programming by 18%, construction of buildings by 16%, and food and beverage services by 13%.

All of these sectors account for a relatively high share of Funding Circle loans. Therefore, there is evidence that Funding Circle is playing an important role in supporting sectors which account for an increasing share of economic activity and are going to be driving growth in the future.

*Figure 14 – Share of Funding Circle loans, by sector NB only the ten most popular sectors are shown*

![Graph showing sector distribution of Funding Circle loans](image)

*Source: Funding Circle loanbook, Cebr analysis*

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14 Calculations based on data from the *Annual Business Inquiry – Workplace analysis by Industry* compiled by the Office for National Statistics and published by NOMIS in December 2015.
2.5 Funding Circle helps businesses in the North to access capital

Nearly a quarter (23%) of Funding Circle loans go to businesses in the South East – a higher share than for any other region. This is to be expected as the South East has the highest proportion of businesses in the country.

However, Funding Circle loans are also popular among businesses in parts of the UK that have faced greater economic challenges, such as the North. As the below graph shows the North East has the country’s second lowest gross value added (GVA). It also has the second lowest GVA per head after Wales.

Figure 15 – Total gross value added (GVA\(^1\)) by region in 2013, current prices, £ billions

![Bar chart showing total gross value added (GVA) by region in 2013](image)

Source: Office for National Statistics

Partially due to this economic underperformance, businesses in the North East make up just 3% of all businesses in the country. However, 10% of Funding Circle loans go to the North East. This is shown in Figure 16 on page 26.
The overrepresentation of the North East and the North West among Funding Circle loan recipients shows that its activities are supporting efforts to balance economic growth across the country by supporting underperforming regions. The Government’s ‘Northern Powerhouse’ agenda aims to spread wealth and job opportunities to the northern regions. Funding Circle supports this mission by facilitating loans to local businesses in these areas.

Source: House of Commons business statistics, Funding Circle loanbook, Cebr analysis
Funding Circle loans further support the Northern Powerhouse agenda by creating jobs. Across the North West 50% of Funding Circle loan recipients said that their headcount increased as a result of the loan, while the figure for the North East stood at 47%. This job creation in the private sector helps curtail public sector dependence, which is higher in the Northern regions than in the South (see Figure 17).

Limiting public sector dependence is also a crucial step in boosting regions’ abilities to handle any future economic crisis. Because an economic downturn is often followed by public spending cuts, a high dependence on public sector employment makes regions dependent on the public sector more vulnerable. Therefore creating more jobs in the private sector enhances a region’s ability to weather economic crises.

Figure 17 – Public sector employment as share of total

Source: Office for National Statistics
North East

Ambic Ltd, a long-established UK manufacturer of educational furniture based in County Durham, have benefited from two loans to the sum of £161,800 – spread across 1,277 Funding Circle investors.
3  Unleashing the potential of small housebuilders

- Since 2006 the UK has accumulated a housing shortfall of 264,000 dwellings; on their own large housebuilders have been unable to keep up with rising demand
- In order to provide the necessary homes in the future it is necessary to ensure adequate access to finance for small housebuilders, yet these developers continue to struggle to access finance through traditional sources.
- Through Funding Circle 742 loans with a cumulative value of £183 million have been granted for residential property development.
- These loans have already helped address the housing crisis by contributing to the construction of approximately 2,200 homes across the country.

The following section considers how direct lending platforms can play a role in addressing the housing crisis - one of the most commonly discussed policy areas in the UK over the past several years.

3.1 Over the past decade the UK has accumulated a housing shortfall of 264,000 dwellings

Although pockets of unaffordability exist around the country due to sharp price rises, London and the South East have been the most impacted regions. Between 2006 and 2016, average house prices have risen by 97% in London and by 52% in the South East. The comparable figure for the UK as a whole is 45%.  

The housing crisis impacts not only those trying to get onto the property ladder, but renters too. Based on data from the Office for National Statistics, average London rents have increased by 20% over the five years to 2015. Median gross employee earnings have risen by just a quarter of that (5%) over the same five year period, meaning that the cost of housing has become far less affordable for many.

The drivers behind the price increases have come from both the supply and demand side. London and the South East both have high-achieving economies that have drawn in new residents therefore boosting housing demand. Additionally, due to its strong performance over the past years and resilience to economic shocks (prices recovered very quickly after the 2008/09 financial crisis) London property has drawn in many international investors.

On the supply side, the level of housebuilding has constantly underperformed compared to the growth in the number of households. One of the reasons behind this is that many builders (both small and large) were forced to shut down as a result of the financial crisis. In the years since the crisis, small developers have found it especially difficult to access bank finance due to banks restricting their lending to the sector. In 2014, the National House Building Council conducted a survey that found that half of small builders find banks’ reluctance to lend a serious problem.  

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15 Based on the UK House Price Index compiled and published by the Land Registry
The graph below compares the annual increase in the number of households with changes in the dwelling stock. For every year in which the red line dips below the bar level there is a shortfall in supply. Cumulatively, the UK-wide building shortfall is currently estimated at 264,000 dwellings.

**Figure 18 – Annual increase in UK households and the dwelling stock**

![Graph comparing annual increase in UK households and the dwelling stock](image)

*Source: DCLG, Cebr analysis*

### 3.2 Funding Circle loans have helped to build as many as ~2,200 homes

Direct lending platforms such as Funding Circle are helping to alleviate this housing crisis by supporting those small companies in the housing sector that have struggled to access finance since the crisis. Based on the Funding Circle loanbook from August 2010 to June 2016, the platform granted 742 loans for residential property development. The cumulative value of the 742 loans for residential property development is £183 million.

Using data from the Office for National Statistics and the census we have estimated the average size of a home in various UK regions. We then applied this data to a building costs estimator produced by Jewson\(^\text{17}\) assuming a one storey home with standard building quality contracted to builders and subcontractors and arrive at the average per home building costs presented on the following page.

Table 2 – Number of homes built with investment from Funding Circle, by region

<table>
<thead>
<tr>
<th>Region</th>
<th>Amount of borrowing through Funding Circle for residential property development (£)</th>
<th>Average home size (m²)</th>
<th>Average building cost (£)</th>
<th>Homes built as result of finance through Funding Circle</th>
</tr>
</thead>
<tbody>
<tr>
<td>London</td>
<td>£69,000,000</td>
<td>72.4</td>
<td>£86,112</td>
<td>800</td>
</tr>
<tr>
<td>South East</td>
<td>£61,000,000</td>
<td>82.9</td>
<td>£87,067</td>
<td>700</td>
</tr>
<tr>
<td>South West</td>
<td>£16,000,000</td>
<td>82.5</td>
<td>£79,182</td>
<td>200</td>
</tr>
<tr>
<td>North West</td>
<td>£15,000,000</td>
<td>80.9</td>
<td>£77,274</td>
<td>190</td>
</tr>
<tr>
<td>Midlands</td>
<td>£12,000,000</td>
<td>82.9</td>
<td>£75,696</td>
<td>160</td>
</tr>
<tr>
<td>North East</td>
<td>£7,000,000</td>
<td>80.0</td>
<td>£72,960</td>
<td>90</td>
</tr>
<tr>
<td>East Anglia</td>
<td>£3,000,000</td>
<td>83.1</td>
<td>£79,182</td>
<td>40</td>
</tr>
<tr>
<td>Total</td>
<td>£183,000,000</td>
<td></td>
<td></td>
<td>2,190</td>
</tr>
</tbody>
</table>

Source: Office for National Statistics, Nomis, Cebr analysis

Based on the average cost of building a home in each region and the scale of Funding Circle loans throughout the country, finance taken by smaller property developers through Funding Circle could have already contributed to approximately 2,200 homes being built.

Given the scale of the housing crisis (264,000 dwelling shortfall), there is great potential for direct lending platforms to facilitate lending to the construction sector that can then use that funding to boost supply and alleviate affordability pressures on UK residents. This potential stems from the fact that many small builders have access to the supplies and labour necessary for homebuilding but have found banks reluctant to lend in the aftermath of the financial crisis. Direct lending platforms can match up these small builders with investors who are willing to lend.

Another reason why it is essential to support small builders is that many large developers are working at or near capacity and are only expanding capacity at a very measured rate. This presents a need and an opportunity for smaller builders to boost output and contribute towards a sustainable level of new homes.

Given the current housing shortfall of hundreds of thousands of homes and the country-wide per home building cost of £79,514, the total amount of money that needs to be raised to address the crisis is £21 billion.

Funding Circle and other direct lending platforms can play an important role in helping to raise this finance by facilitating lending to small developers, which the banking sector has been less focused on serving. Partially as a result of the lack of finance, the pace of building has continuously dragged behind the rise in demand, pushing up property prices and rents, thereby putting added financial pressure on many families. Given that many prospective investors are looking to diversify their portfolios with high performing asset classes such as property, direct lending platforms can play a crucial role in raising the £21 billion needed to boost the housing supply.

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House Building

Since borrowing £3.2 million from over 14,000 Funding Circle investors, Forth Homes has built 32 new family homes in the North West, helping to address the current housing shortage we face. Looking ahead, they plan to build 60 houses in 2016 and hundreds more over the coming years.
4 Appendix

4.1 Appendix 1

One of the sources cited in this report is a survey of Funding Circle borrowers. The survey link was emailed to Funding Circle borrowers and participation was voluntary. It took place online during the week of June 20, 2016. The total number of survey responses was 531.

Questions asked in the survey were as follows:

<table>
<thead>
<tr>
<th>Question</th>
<th>Options</th>
</tr>
</thead>
<tbody>
<tr>
<td>How long ago did you take a loan through Funding Circle?</td>
<td></td>
</tr>
<tr>
<td>What was the main influencing factor in your decision to borrow through Funding Circle?</td>
<td></td>
</tr>
<tr>
<td>How important were the following factors when you borrowed through Funding Circle?</td>
<td></td>
</tr>
<tr>
<td>Thinking about the last loan you took with Funding Circle, did you attempt to secure a bank loan first?</td>
<td></td>
</tr>
<tr>
<td>• What was the main reason that your application for credit was not completed?</td>
<td></td>
</tr>
<tr>
<td>• What was the main reason why you didn’t attempt to secure a bank loan first?</td>
<td></td>
</tr>
<tr>
<td>How did your experience of taking a loan through Funding Circle compare to other providers you considered?</td>
<td></td>
</tr>
<tr>
<td>• How much faster?</td>
<td></td>
</tr>
<tr>
<td>• How much slower?</td>
<td></td>
</tr>
<tr>
<td>How likely was it that without Funding Circle, you would not have received external finance?</td>
<td></td>
</tr>
<tr>
<td>• Which source of finance would you have used?</td>
<td></td>
</tr>
<tr>
<td>• What would have been the impact on your business of not securing finance?</td>
<td></td>
</tr>
<tr>
<td>How did the last loan taken through Funding Circle affect employment at your business?</td>
<td></td>
</tr>
<tr>
<td>• By how many people did it increase?</td>
<td></td>
</tr>
<tr>
<td>Were the people you hired predominantly skilled/semi-skilled/apprentices?</td>
<td></td>
</tr>
<tr>
<td>And were they predominantly from your business’ local area/recruited from outside of the local area but from within the UK/recruited from outside the UK</td>
<td></td>
</tr>
<tr>
<td>What is the primary way in which you have used your last Funding Circle loan?</td>
<td></td>
</tr>
<tr>
<td>How did your last Funding Circle loan impact your business’ revenue?</td>
<td></td>
</tr>
<tr>
<td>• How much has your revenue increased by?</td>
<td></td>
</tr>
<tr>
<td>How did your last Funding Circle loan impact your business’ profit?</td>
<td></td>
</tr>
<tr>
<td>• How much have your profit increased by?</td>
<td></td>
</tr>
<tr>
<td>Should your business require further external funding, what are you most likely to do?</td>
<td></td>
</tr>
<tr>
<td>What would be your one request for greater support from the Government?</td>
<td></td>
</tr>
</tbody>
</table>
4.2 Appendix 2

The following note elaborates on the methodology used in Section 2 of this report.

Cebr used a combination of national statistical sources and data provided by Funding Circle related to the businesses that it facilitates lending to.

To establish the contributions and impacts of Funding Circle, we adopted the framework provided by ONS’ supply-use tables, the most detailed official record of how the industries of the economy interact with other industries, with consumers and with international markets in producing the nation’s GDP and national income.

Making use of the supply-use framework for such purposes is one of the best means of ensuring consistency with the national accounting framework. The process of embedding a specific company or sub-sector, or a specific group of companies like those that borrow through Funding Circle, within this framework involves assigning them an explicit role within the models. Once this embedding process is completed, we have the foundation for establishing:

- The economic contribution (or direct impact) of the Funding Circle-funded businesses, using standard measures of GVA and employment.

- The wider economic impact of these businesses on the UK economy, using Leontief input-output modelling to estimate a full set of (matrix) multipliers, capturing direct, indirect and induced impacts on GVA and employment.

We used the multipliers in conjunction with the direct impacts to calculate the absolute values of the impacts of Funding Circle-funded businesses through their supply chains (indirect impacts) and through the businesses in the wider economy in which the direct and indirect employees of Funding Circle-funded businesses spend their wages and salaries (induced impacts).