British Business Bank

Small Business Finance Markets 2024/25

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CEO foreword

Since the British Business Bank's inception, an important part of its remit has been to analyse and understand the functioning of the UK's smaller business finance markets, examining both smaller business demand and finance providers' supply. This has always been essential in informing and shaping work between policy makers and market participants, and in the design of our programmes which address those markets' needs.

Now in its eleventh year, our flagship annual Small Business Finance Markets report is a key part of our output, providing an in-depth analysis of the markets for smaller business finance in the UK and acting as a trusted source of information about how they operate and deliver for smaller businesses.

The case for business investment

This year, as well as reporting on market trends over the last year, we examine in greater depth the role of access to finance in supporting business investment.

If we are to achieve the growth we all want in the UK economy, it is important that we continue to make the case for business investment which can help drive economic growth, lift wages and improve living standards. By investing, businesses can profit in many ways – including through better productivity, increased efficiency, greater innovation or simply having greater production capability for their products and services.

These investments can include, anything from upgrading or buying new vehicles and equipment, to innovating and investing in new technologies, intellectual property, software, research and development or new premises.

When businesses benefit, the wider economy benefits too through job creation, increased GDP and higher living standards. Investing in the right areas of the economy can also help achieve other important policy goals, such as meeting the country's net zero ambitions through both adoption and development of new and more efficient technologies, and supporting the key sectors identified in 'Invest 2035' the UK's modern industrial strategy.

A failure to invest, more than anything, simply represents a missed opportunity for the businesses and the UK economy.

A mixed market picture, but with some encouraging signs

Although the global environment and some domestic uncertainty meant some businesses were less willing to invest with confidence in 2024, our market analysis shows some encouraging signs are beginning to emerge.

The overall flow of bank lending increased last year, albeit with indicators that much of the increase has been to support working capital and cashflow rather than investment for growth. It is positive, however, to see asset finance growing for the fourth year in a row.

Equity investment in 2024 is similar to 2019 and 2020 levels. Growth and seed stage equity finance rebounded in the first half of the year, but Q3 was challenging for all stages.

The diversity of finance on offer, in terms of both product and provider, continues to be a strong fundamental in the UK's markets and is an important factor in meeting the diverse needs of the UK's highly varied smaller business community. Challenger banks' share of bank lending edged up to 60% of total bank lending, their highest ever. The British Business Bank has played a key role in catalysing the development and success of the market for challenger banks, as well as crowdfunding, debt funds and asset finance amongst others, helping to achieve a diverse range of lenders to smaller businesses that didn't exist before.

Unlocking potential

Across the UK's Nations and regions, entrepreneurialism and high growth potential businesses have historically been more widespread than access to the finance that can enable them to thrive. However, half of the UK's Nations and regions are seeing investment growth.

Although our analysis this year shows that geographical imbalances remain, especially in equity markets focused on high growth, the British Business Bank is playing a key role in tackling these, with 84% of the businesses it has supported being located outside London, well in excess of the 66% of the wider UK small business population. Our new generation of Nations and Regions Investment Funds are a key contributor to helping us address this market weakness, with an additional £1.6 billion of funding available.

Similarly, imbalances are found in provision to underrepresented groups, with ethnic minority and female-led businesses in particular finding difficulties in accessing the finance they need to meet their ambitions. A crucial part of the market to address these imbalances is the Community Development Finance sector, and as well as supporting this through our Start Up Loans programme, we have recently introduced a new Community ENABLE Funding programme, which has the potential to be a game-changer for the provision of such finance.

Growing our support for business investment

Since its formation 10 years ago, the British Business Bank has continually increased its support across the market, supporting greater access to both debt and equity finance for smaller businesses.

Two recent developments have meant that we will be able to utilise the skillsets in the Bank to increase our provision still further. We expect the new British Growth Partnership to have a transformative effect once it is fully established, subject to regulatory approval. It will help UK pension funds to capture the full commercial potential of our world class breakthrough technology companies, generating economic growth and providing a legacy for future generations of pensioners. Recent reforms to our financial framework have also made £7.9bn of capital in our commercial programmes permanent for the first time, meaning we can flexibly re-invest our returns over the long term and allocate our resources to where they can produce the best and most effective outcomes for smaller businesses.

Access to a diverse range of finance is central to increasing investment by smaller UK businesses, and we look forward to playing an ever more active role in supporting them as they grow and thrive.

Louis Taylor
CEO, British Business Bank

Executive summary

2024 posed significant challenges for the UK's smaller businesses, set against the backdrop of a turbulent global economic environment. Over the year UK GDP grew by 0.9%, faster than 2023 (0.4%) but below its G7 peers the US (2.8%), Canada (1.3%) and France (1.1%).

Smaller business finance markets have been resilient, but improving smaller businesses' growth performance will require more investment and finance.

1

Fewer smaller businesses are using external finance, but value of finance edged up in 2024

The proportion of smaller businesses using finance declined from 50% in the third quarter of 2023 to 43% in the second quarter of 2024, stabilising at that level in Q3 2024. Despite that fall in use of finance, aggregate flows of finance held up, at least in nominal terms.

Specifically, gross bank lending totalled £62bn, up 4.5% on 2023, with the annual rise in bank lending exceeding that of asset finance for the first time since 2020. Challenger banks' share of bank lending edged up to 60% of total bank lending.

Equity investment in 2024 is similar to 2019 and 2020 levels. Deal values were up 7% in the first three quarters compared to the same period in 2023, driven by a buoyant Q2, but Q3 was particularly weak. Deal numbers were down 24% over the same period, again with a challenging third quarter.

2

Business investment is central to improving long-term growth and often requires finance

Business investment helps drive economic growth by expanding businesses' production capabilities, enhancing their efficiency and enabling their development or adoption of innovation. This can in turn drive economic growth further, helping to lift wages and living standards.

The UK has historically had low business investment compared to G7 counterparts, with business investment growth slower post the Global Financial Crisis. Evidence shows that the lack of investment in capital is a key reason for the UK's productivity gap with countries such as France and Germany.

Experimental research from the Department for Business and Trade shows that smaller businesses are less likely to invest, and at relatively lower levels, than larger businesses. Improving business investment in smaller businesses will therefore be vital to improving productivity, growth and living standards in the future.

Investment is more difficult for smaller businesses. They often have less capital and investors have less information and certainty about these businesses. This can lead to lower access to capital for smaller businesses and more expensive borrowing costs due to perceptions of higher risk, hampering potential business growth and consequent positive economic effects.

3

Finance markets are evolving to reach entrepreneurs from different backgrounds and in more places

When the British Business Bank was founded in 2014 its aim was improving general access to finance post global financial crisis, including increasing the diversity of finance available to smaller businesses. As we reported in last year's Small Business Finance Markets report, access to finance has evolved and smaller businesses in the UK have never had more options than they have now.

This improvement in diversity of finance is a positive for business investment, as it helps serve a wider range of smaller businesses' funding needs.

For many smaller businesses, however, the access to finance challenges can be more varied or nuanced than simply the types of finance available. Willingness to use finance to grow fluctuated in 2024, falling to 33% in the second quarter, but rebounding to 41% in the third quarter. Furthermore, less than four in ten smaller businesses considered more than one provider.

Underrepresented groups of entrepreneurs often face particular challenges in obtaining finance. Our analysis this year highlights, for example, that ethnic minority-led business are more willing to use finance to grow but are more likely to be discouraged from applying.

Place also matters for those seeking business finance, with ambitious entrepreneurs in deprived areas, who could benefit greatly from better access to external finance, held back by barriers such as low awareness of finance options.

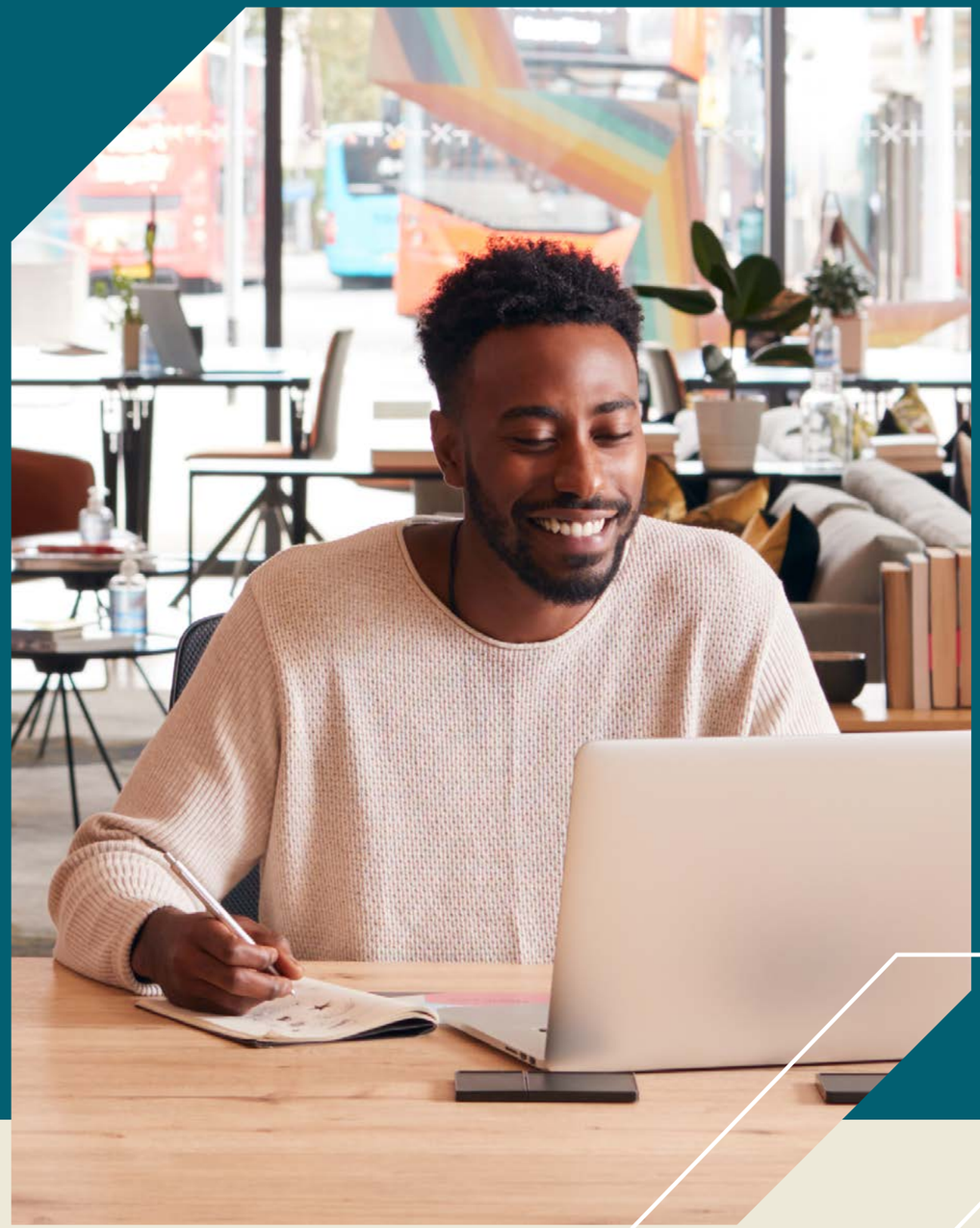
To combat these inequalities of access, the launch of our Community ENABLE Funding (CEF) programme is designed to increase the availability of funding to social impact sector lenders and the smaller businesses they serve in local communities across the UK's Nations and regions.

4

More investment is needed in the UK's fastest-growing and most innovative companies

Innovative companies often depend on finance to fund their business investment plans. They have the potential to drive productivity and living standards disproportionately, as well as to support the UK to be internationally competitive in the industries of the future. Many of these companies also help address societal challenges, including the transition to net zero and global health.

Existing British Business Bank programmes support both early and late-stage equity investment as well as private debt. The Bank is also creating a new vehicle, the British Growth Partnership, subject to regulatory approval, to crowd-in UK pension fund and other institutional investment into venture capital funds and innovative businesses.



Introduction

This is the eleventh annual British Business Bank Small Business Finance Markets report. The latest report assesses the importance of business investment and the role of access to finance, as well as assessing more recent trends in smaller business finance markets.

The British Business Bank has the mission to drive sustainable growth and prosperity across the UK, and to enable the transition to a net zero economy by improving access to finance for smaller businesses. Delivering this mandate requires an understanding of the current state of smaller business finance markets.

This report provides insight into the latest market developments and trends, allowing the Bank to constructively engage with market providers and stakeholders to benefit smaller UK businesses.

New evidence and analysis

The British Business Bank has continued to refine and improve the evidence and analysis used in this report.

- We have updated our Business Finance Survey and combined it with our updated survey of market intermediaries and Devolved Nations to provide new market insights.
- We continue to make use of the Bank's management information and feedback from market contacts.
- This report also references a wide range of evidence drawn from academic, government and market research, as well as drawing on credible international databases. We are keen to increase the range of researchers we work with.

Structure of the report

The report is split into two sections to allow consideration of both longer-term market issues and developments, and more recent trends in smaller business finance, including the latest position.

Part A of this year's report is dedicated to the importance of business investment and the role of access to finance. Business investment in the UK has been low against international comparators for decades and has been stifling productivity gains which could lead to an improvement in living standards. This chapter explores business investment from the angle of UK small businesses, recent macroeconomic developments that have led to a challenging environment for business investment, the structural issues that remain and how policy is evolving to support investment. We then highlight some examples of Bank programmes that have evolved to address these challenges.

Part B examines recent trends in small business finance markets. The section starts off by reviewing the small business population and smaller business demand for external finance. It then explores DEI and finance for female, Ethnic Minority and disabled entrepreneurs and finance for environmental sustainability. Part B of the report then considers recent trends in the availability of different types of debt and equity finance most widely used by small businesses, before exploring bank lending, alternative lending and debt products.

Aggregate flow and stock of smaller business finance

- The flow of bank lending increased in 2024 but remained lower than in 2020 and 2022
- Asset finance grew for the fourth year in a row
- Equity investment in 2024 is similar to 2019 and 2020 levels

This section brings together the latest data from a range of sources on the number and value of various types of external finance provided to smaller businesses in the UK.

Consistent and comprehensive data outlining the number and value of the aggregate stock and flows of all types of external finance to smaller businesses is not available. However, the summary table provides a good estimate. The table has been revised from previous years to include a breakdown of total bank stock by lending and overdrafts. While flows of different types of finance are not directly comparable, the data shows that bank lending is still the single largest form of external finance for smaller businesses.

Figure 1

Estimates of the nominal flow & stock of external finance for UK smaller businesses (a)

Finance type		2020	2021	2022	2023	2024	YTD change on previous year	As of
Bank lending flows £bn Source: Bank of England	Gross flows (b)	104.9	57.7	65.1	59.2	**62.1**	**4.9%**	**Dec-24**
Bank loan stock £bn Source: Bank of England	Outstanding amount (c)	205	200	188	175	**171**	**-2.5%**	**Dec-24**
Bank overdraft stock £bn Source: Bank of England	Outstanding amount (c)	8.3	8.7	8.9	8.6	**8.3**	**-2.5%**	**Dec-24**
Total bank stock £bn Source: Bank of England	Outstanding amount (c)	213	209	197	184	**179**	**-2.5%**	**Dec-24**
Asset finance flows £bn Source: FLA (d)		16.0	19.6	21.8	23.3	**23.5**	**0.9%**	**Dec-24**
Other gross flows of SME Finance								
Private external equity investments £bn		10.2	20.3	17.0	8.8	**6.9 (Sep)**	**+6.6%**	**Sep-24**
Source Beauhurst (e)	No. of reported deals	2465	3036	2868	2152	**1303 (Sep)**	**-24.3%**	**Sep-24**

(a) The information contained in this table should be viewed as indicative as data and definitions are not directly comparable across different sources. There can be some double counting across estimates in different parts of the table. Flows data are cumulative totals for the year or to the date stated. Non-seasonally adjusted.
(b) Data exclude overdrafts and covers loans in both sterling and foreign currency, expressed in sterling. The total may not equal the sum of its components due to rounding.
(c) Movements in amounts outstanding can reflect breaks in data series as well as changes in the underlying flow.
(d) The Finance & Leasing Association (FLA) whose members make up 90-95% of the market.
(e) Beauhurst is a data provider that records announced equity deals including crowdfunding deals.

The flow of bank lending increased in 2024 but remained lower than in 2020 and 2022

Gross lending (excluding overdrafts) to small and medium-sized businesses (SMEs) by banks was £62.1bn in 2024. This was 4.9% higher in nominal terms than in 2023 and was the third highest since records began in 2012. It remained below the record high of 2020 (£104.9bn), which was largely driven by government-guaranteed Covid-19 loans, and it also remained below the level observed in 2022 (£65.1bn).

The stock of bank lending in 2024 was £171bn, down 2.5% from £175bn in 2023. This is the fourth consecutive annual drop, as it has fallen each year since 2020; however, it remained above the level observed in 2019 (£156bn). Additionally, the stock of bank overdrafts fell in 2024 to £8.3bn, which is down 2.5% from £8.6bn in 2023 and is the lowest level observed since 2020 (£8.3bn). Consequently, total bank stock (lending and overdrafts) in 2024 was £179bn, down 2.5% from £184bn in 2023. This is the fourth consecutive annual drop for total bank stock (lending and overdrafts), as it has fallen each year since 2020; however, it remained above the level observed in 2019 (£168bn).

Asset finance grew for the fourth year in a row

SME asset finance new business increased 0.9% in 2024 to £23.5bn, according to Financing & Leasing Association data. Albeit slight, this was the fourth increase in a row and the highest level on record, £0.2bn above the 2023 total. It followed a rise of 7% in 2023 and 11% in 2022.

Growth in new business has been uneven across the year as economic conditions and interest rate expectations ebbed and flowed.

Equity investment in 2024 is similar to 2019 and 2020 levels

Smaller businesses raised £6.89bn of equity finance over the first three quarters of 2024, which was 7% higher than the amount raised during the same period in 2023 , and in line with 2019 and 2020 levels. The rise in the level of investment was driven by a buoyant Q2, which amounted to £3.45bn, the highest quarterly value since early 2022 and more than both Q1 and Q3 combined.

In terms of deal numbers, there were 1,303 UK SME equity deals announced over the first three quarters of 2024, 24% fewer than during the same period in 2023. This was the lowest Q1-Q3 total since 2016, highlighting subdued activity across the year on this basis. The decrease can be attributed to a particularly weak Q3, marked by uncertainty, where the number of deals fell to 288, the lowest since 2013Q2. Nonetheless, the number of deals in the first half of 2024 was greater than 2023H2.

Later stages of the UK market have experienced a notable improvement, with growth stage companies raising a total of £2.95bn in the first three quarters of 2024, representing a 30% increase on the same period in 2023. Investment into seed stage companies also recovered during the first three quarters of the year, with the total of £1.26bn signifying an 8% annual increase. Venture stage investment fell by 12% to £2.68bn during the same period in 2024, although this decline was smaller than the 43% contraction that occurred in 2023.

Macroeconomic developments

- During another year of uncertainty growth remained subdued but positive
- Business investment grew but remains below the pre–2008 trend
- Rates of inflation dropped markedly during the year
- Job vacancies fell but real regular pay increased
- Official forecasts predict Budget policies will boost UK economic growth

During another year of uncertainty, growth remained subdued but positive

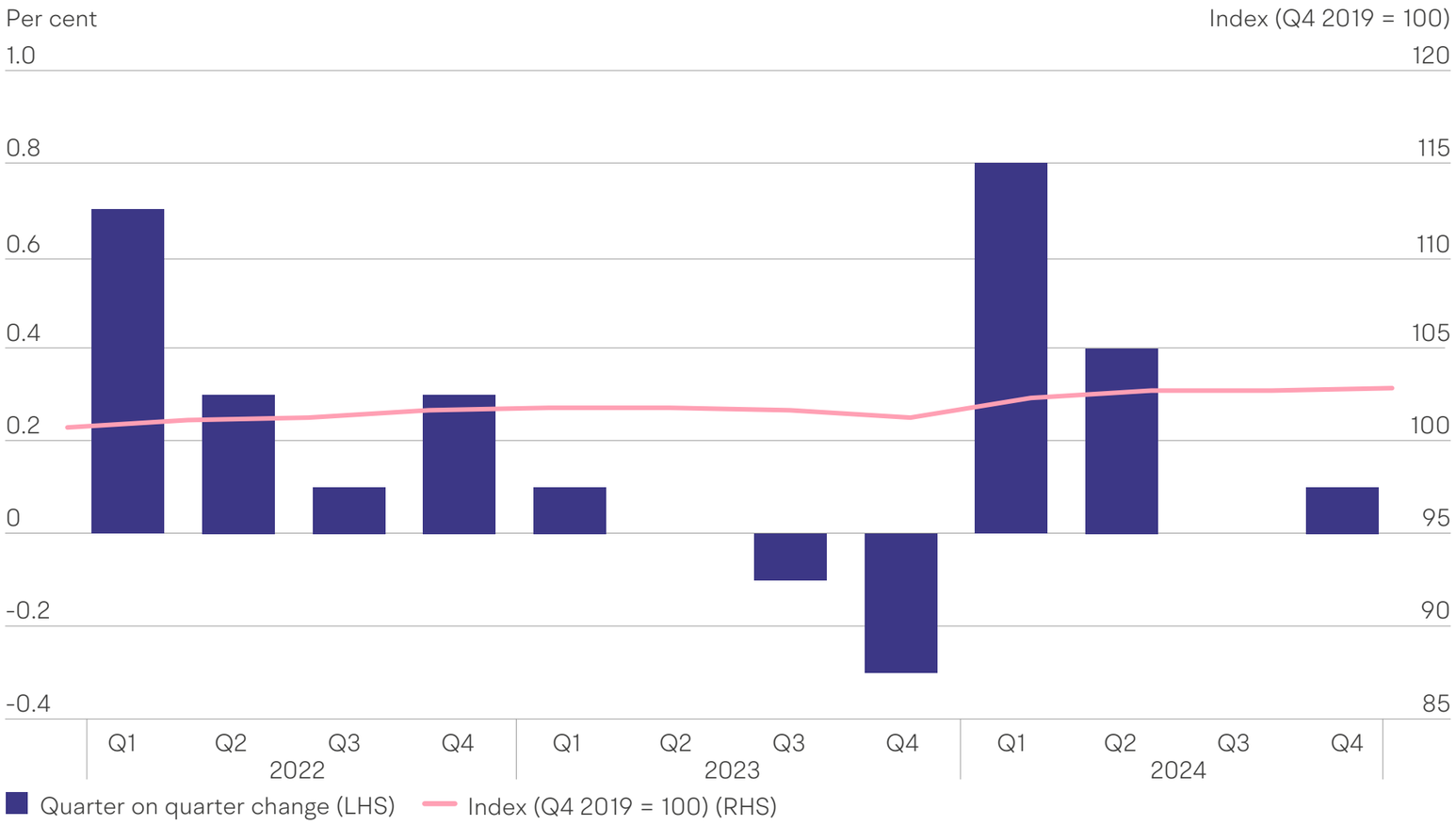
2024 posed significant challenges for the UK economy, with economic and political uncertainty, and a turbulent global economic environment. Following a brief technical recession in the second half of 2023, the UK economy showed signs of recovery, growing by 0.8% in Q1 2024 (figure 2). Growth across the rest of the year, however, was relatively subdued leaving annual GDP for 2024 just 0.9% above 2023. This rate of growth was faster than that in 2023 (0.4%) but comfortably below the average annual growth of 1.5% between 2013 and 2023.

UK GDP growth in 2024 was also below several G7 peers with the US (2.8%), Canada (1.3%) and France (1.1%) reporting stronger growth over the year. Longer-term comparisons with the G7 are also unfavourable with the UK's 3.2% growth since Q4 2019 lower than the US (12.1%), Canada (7.7%), Italy (5.6%), France (4.0%) and Japan (3.9%).

Figure 2

Real GDP, seasonally adjusted

Source: ONS



Business investment grew, but remains below the pre–2008 trend

Business investment across 2024 was 0.8% up on the level seen in 2023. Within the year, there was considerable volatility with a decline in Q1 followed by two consecutive quarters of growth while the year ended with a 3.2% decline in the final quarter (figure 3).

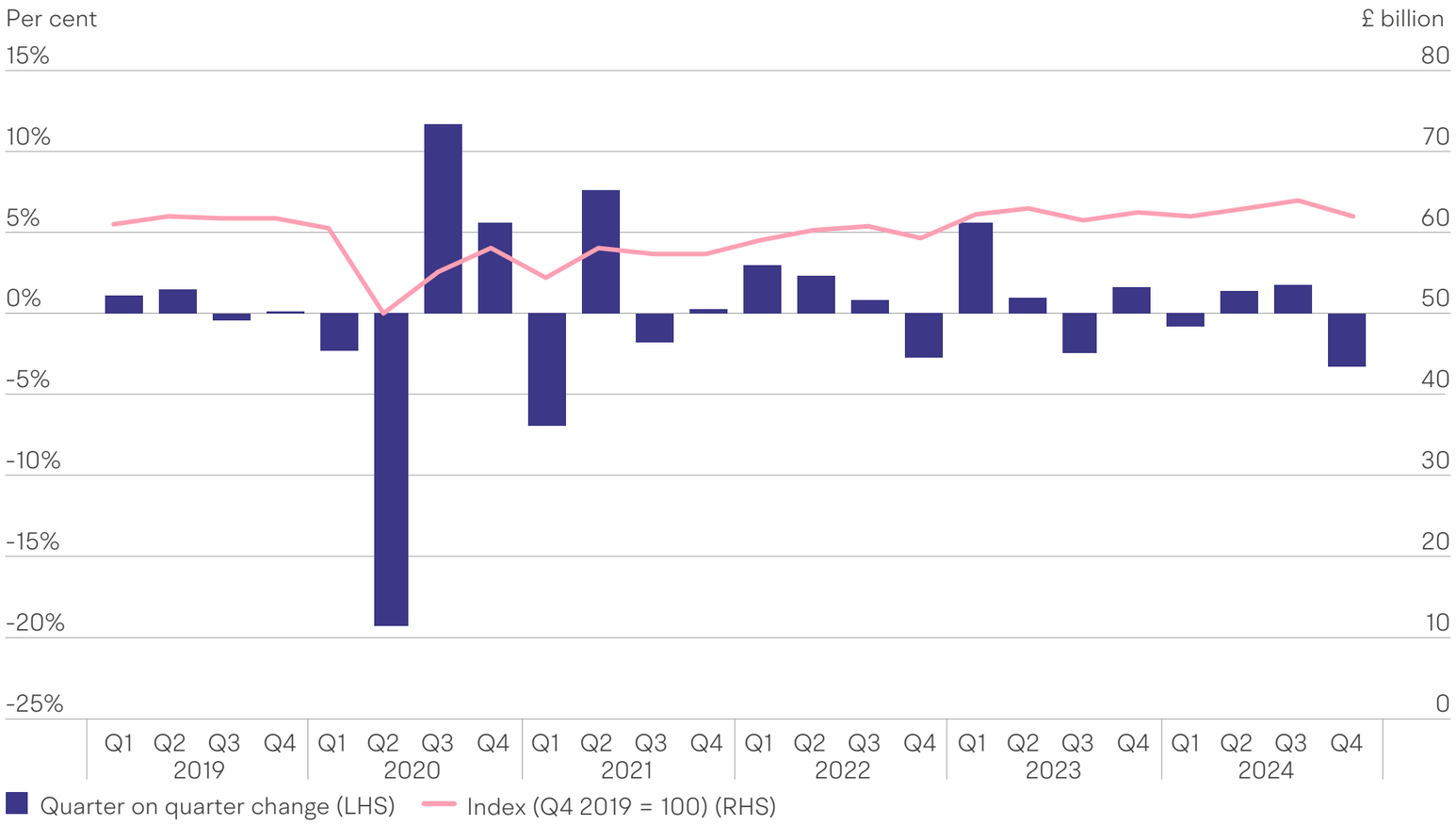
One explanation for the growth over the year is the stabilisation of Bank rate in the early part of the year followed by reductions starting in August. The latest cut brought the current rate to 4.50%, after the hike from 0.10% in December 2021 to 5.25% in August 2023. Furthermore, the introduction of full expensing which allows companies to claim 100% of qualifying machinery and plant investments may have also contributed to increased business investment.[1] However, business investment in the UK remains largely subdued and below the pre-global financial crisis trend, a topic discussed in Part A of this report.

Business confidence remained weak in 2024. The Federation of Small Businesses (FSB) small business confidence index rose in Q1 2024 recording the first and only positive response since Q1 2022.

Figure 3

Business investment, seasonally adjusted

Source: ONS



However, overall confidence remained low, as it was followed by declines in the next three consecutive quarters, reaching the lowest value since the Covid-19 pandemic in Q4 (figure 4). This decline followed the slow economic growth observed in the second half of the year. Additionally, the FSB suggests that expectations regarding increased taxes and employment costs, may have contributed to the pessimism observed in Q4.

The British Chambers of Commerce (BCC) Quarterly Economic Survey showed a slightly more positive outlook in the first half of the year, with an increase in the net balance of businesses expecting turnover growth. However, similar to the FSB results, this optimism was followed by a significant decline in Q3, and especially in Q4 (figure 5).

This trend also mirrors the Institute of Directors' Economic Confidence Index, where business optimism for the next 12 months rose in the first half of the year, peaking in July, which coincided with the election of the new Labour government.[2] However, optimism sharply dropped in December, reaching the second-lowest level since June 2020, with 63% of BCC members identifying taxation as their primary worry. Overall, business confidence measures do seem to fluctuate from quarter to quarter, amid an uncertain economic environment.

Figure 4

Voice of small business confidence index

Source: Federation of Small Businesses

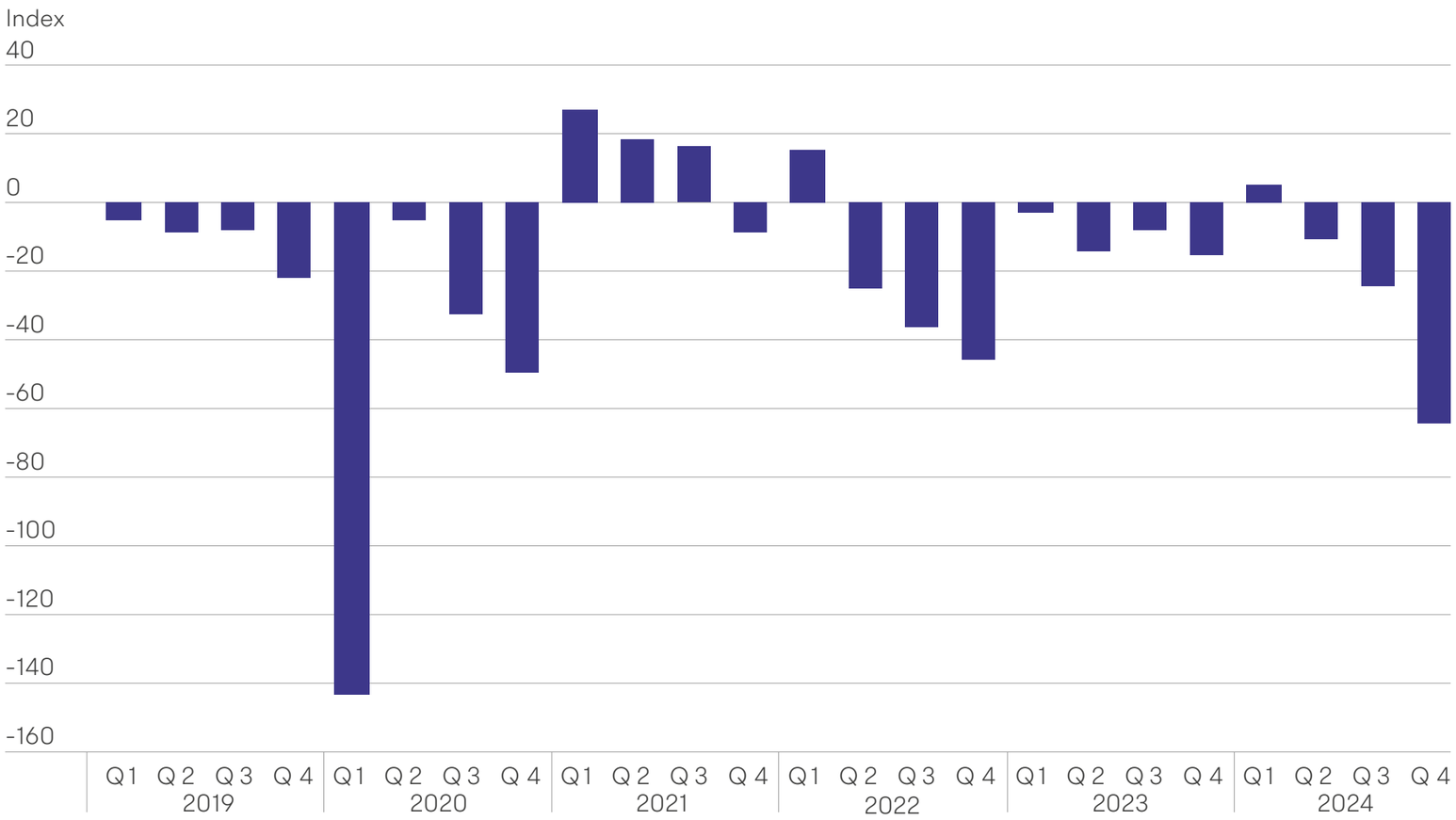
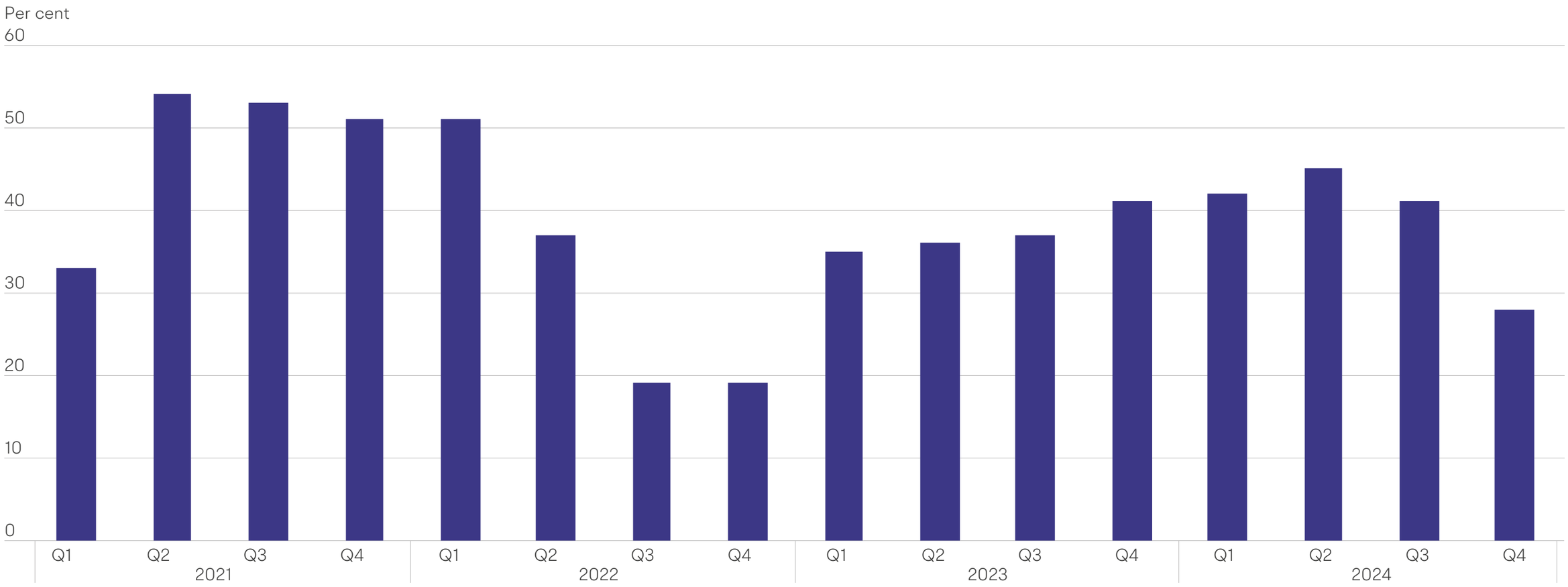


Figure 5

Expect turnover to increase over next 12 months, net balance

Source: British Chambers of Commerce



Rates of inflation dropped markedly during the year

The rate of inflation measured by the consumer price index (CPI) continued to fall in 2024, ending the year at 2.5%, down from 4% in December 2023 and well below the peak of 9.1% in 2022 (figure 6). CPI inflation was as low as 1.7% in the 12 months to September before rising slightly in the last quarter of the year.

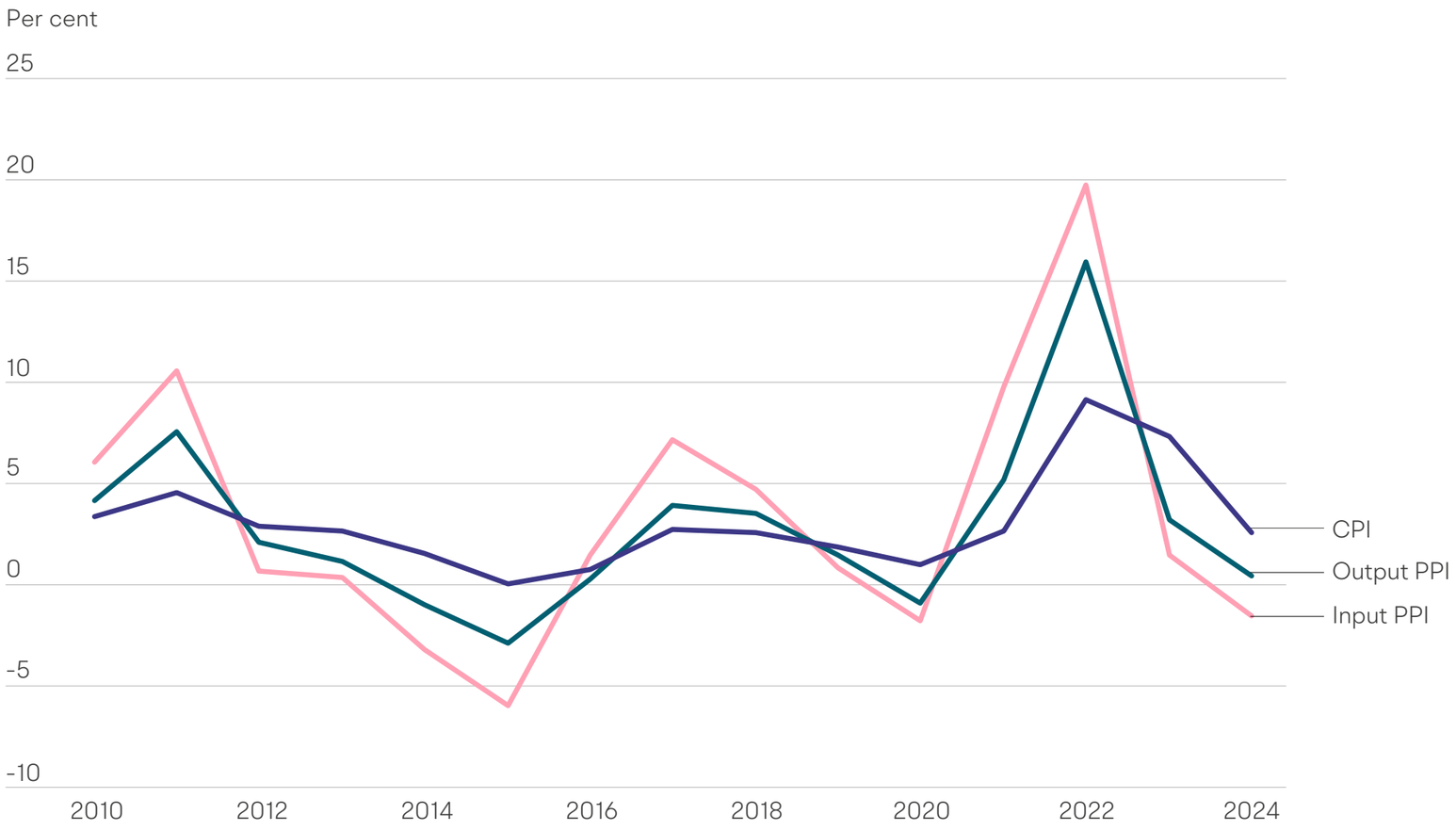
The drop in inflation during the first half of the year was largely driven by the continued recovery of the global supply chain, which led to a decrease in the prices of key global commodities, including natural gas. However, in the last quarter of 2024, uncertainty, along with rising oil and gas prices, contributed to an increase in CPI inflation over the 12 months to November 2024 to 2.6%.

Core and services inflation remain a little higher, suggesting underlying domestic pressures persist. The annual rate of core inflation, which excludes the volatile energy and food components of the CPI, was 3.2% in December 2024, down from 5.1% in December 2023. Similarly, services inflation was 4.4% in December 2024, down from 6.4% at the end of 2023 and the lowest rate since March 2022.

Figure 6

Consumer and producer price inflation

Source: ONS



As the global and UK economies recovered, the cost of business inputs also dropped in calendar year 2024. For the first time since 2020, the producer price index for inputs annual average shrank by 1.6% in 2024. Subsequently, the producer price index annual average for manufacturing outputs rose by just 0.4% in 2024. This is the lowest increase since 2020 (-1%) and down from 4.4% in 2023.

Job vacancies fell, but real regular pay increased

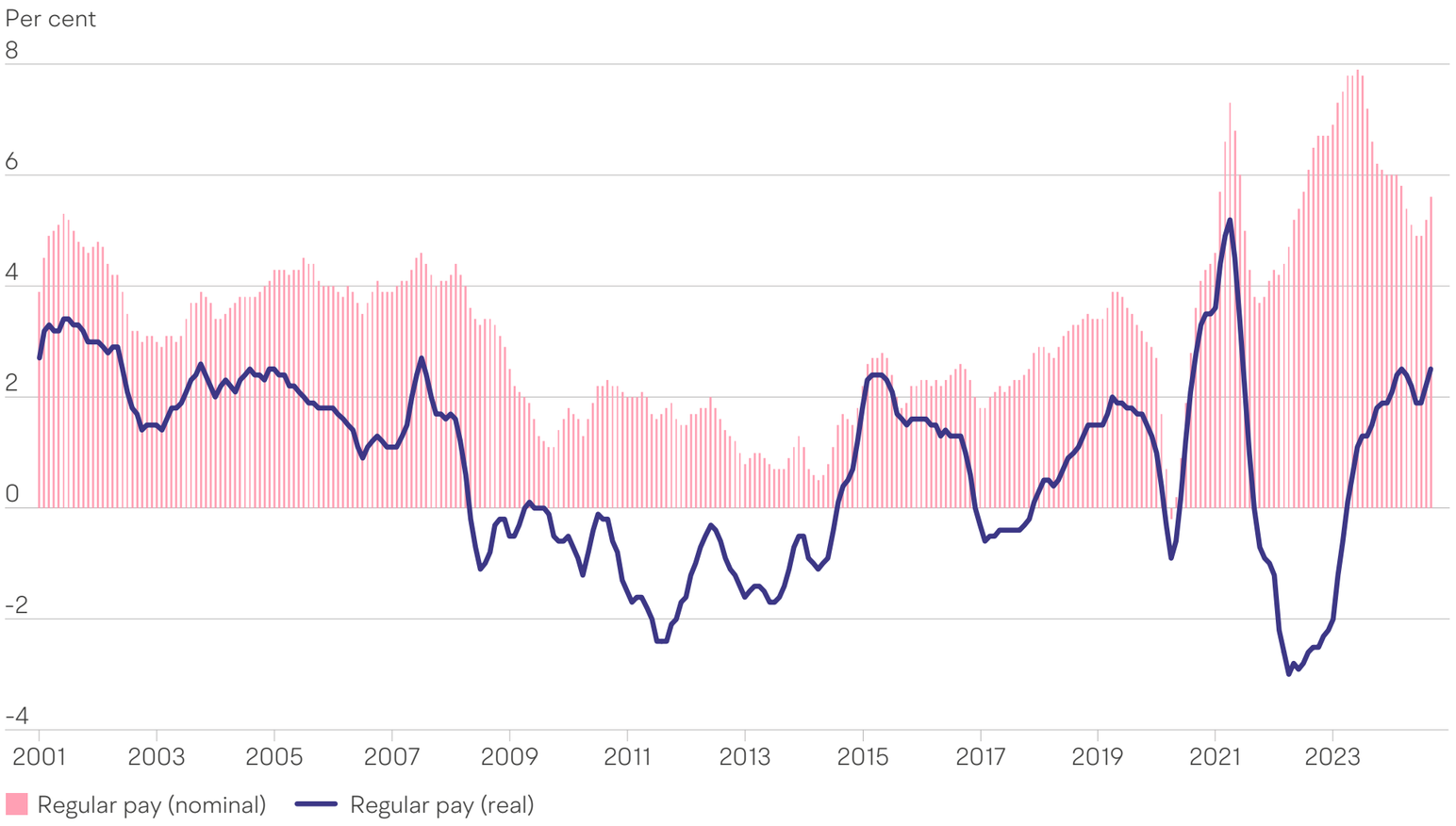
The number of vacancies continued to fall in 2024, reaching 812,000 in the three months to December, the lowest level since the quarter to June 2021, and in line with pre-COVID levels. However, the drop in vacancies did not cause an increase in the unemployment rate for people aged 16 and over, which remained relatively flat at 4.3% in 2024.[3]

Nominal regular pay growth gradually fell in 2024 before picking up in the three months to October. This was the first increase in over a year and was followed by further growth in the 3 months to November (figure 7). Despite falling for most of the year it remained above inflation,

Figure 7

Nominal and real regular pay, annual change in 3-month average

Source: ONS



leading real regular pay to continue to grow. Indeed, growth of real regular pay rose to 2.5% in the three months to November 2024, the highest since August 2021.

Official forecasts predict Budget policies will boost the UK economy

The latest forecasts from the Bank of England, published in February 2025, predict that the UK economy will continue to grow, particularly in the medium term. This growth is expected, in part, to result from the combined effect of the Budget policies. In 2025, growth is projected at 0.75%, with an increase to 1.5% in the medium term (figure 8). The forecast also takes into account monetary policy easing during the period, including anticipated interest rate cuts to 4% by the end of 2027, along with a £100 billion reduction in asset purchases in 2025.

On the other hand, the Office for Budget Responsibility (OBR) forecasts that the economy will temporarily benefit from fiscal loosening in the short term. The OBR expects output to be boosted above its estimated potential level in 2025 and early 2026, with growth rates of 2% and 1.8% respectively, before falling back from 2027 onwards.[4] The independent forecast consensus is slightly more conservative, predicting 1.2% growth in 2025.[5]

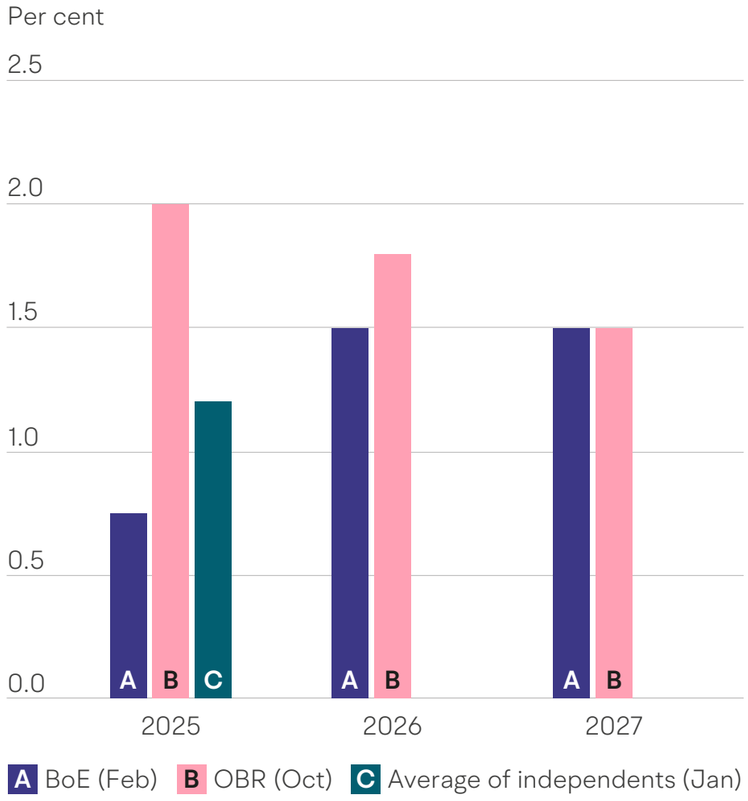
The BoE forecasts inflation to rise to 3.5% in 2025 before dropping to the 2% target in 2027 (figure 9). This decline in CPI inflation in the medium term reflects the emergence of economic slack as a result of fiscal tightening. The OBR also predicts a slight rise in inflation to 2.6% in 2025, driven by energy price volatility and the direct effects of the Budget policies, which temporarily result in a positive output gap. In the medium term, inflation is expected to drop to around 2% as energy prices stabilise and the domestic positive output gap normalises. This is consistent with the Oxford Economics forecast of 3% in 2025, with a slight decline in the medium term.

The BoE forecasts business investment growth of 3% in 2025, followed by a decline that aligns with OBR estimates in the longer term. Meanwhile, the independent forecast consensus predicts growth in 2025, but at a lower rate of 1.4%. The OBR, however, takes a significantly different view, forecasting a contraction in business investment of 1.2% in 2025 (figure 10).

Figure 8

Official and independent forecasts of change in real GDP

Source: BoE, OBR, and HMT comparison of independent forecasts



The BoE's short-term forecast is driven by increased public investment and infrastructure spending, which is expected to complement private investment and boost business activity. Additionally, the anticipated easing of monetary policy is seen as encouraging borrowing for investment.

In contrast, the OBR's forecast of a decline in business investment is attributed to squeezed profits resulting from higher taxes. Over time, firms are expected to gradually rebuild their margins and pass on the rising cost of employer National Insurance Contributions (NICs) to consumers, leading to long-term growth.

Looking further ahead, the forecast for long-term growth in business investment could drive increased demand for finance from businesses. This aligns with the Department for Business and Trade's Green Paper, released in November 2024, which outlines a modern industrial strategy designed to provide businesses with the stability and certainty needed to invest in high-growth sectors (see Part A for more details).

Figure 9

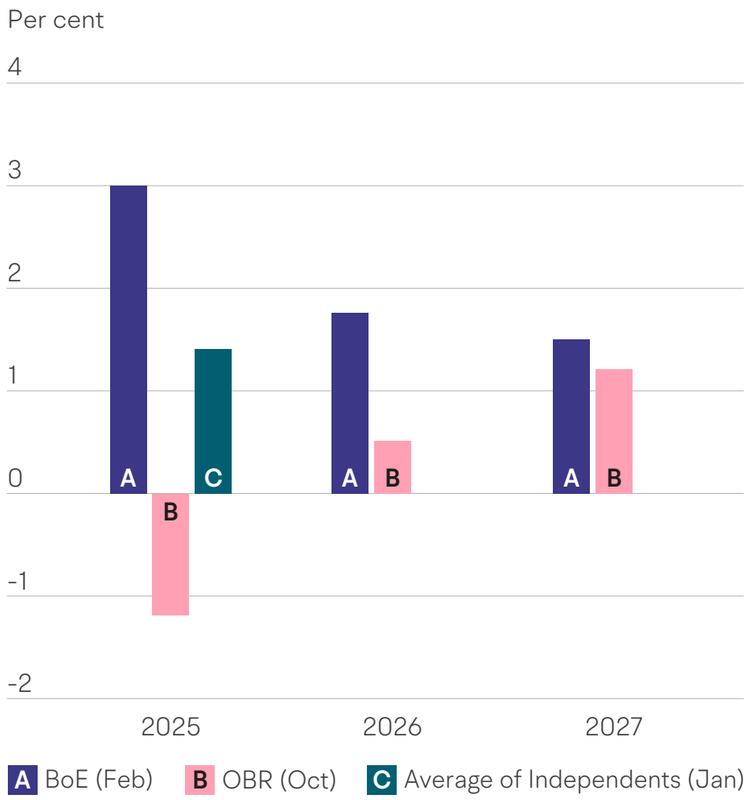
Official and independent forecasts of change in CPI

Sources: BoE, OBR and Oxford Economics

Figure 10

Official and independent forecasts of business investment

Sources: BoE, OBR and HMT Comparison of Independent Forecasts



Part A:
The importance of business investment and the role of access to finance

1.1

Business investment

Low business investment in the UK has contributed to low productivity

Smaller businesses tend to invest relatively less than larger businesses

Challenging economic conditions have impacted investment in recent years

Structural issues remain but policy is evolving to support investment

The Bank's programmes have matured to address the varied challenges

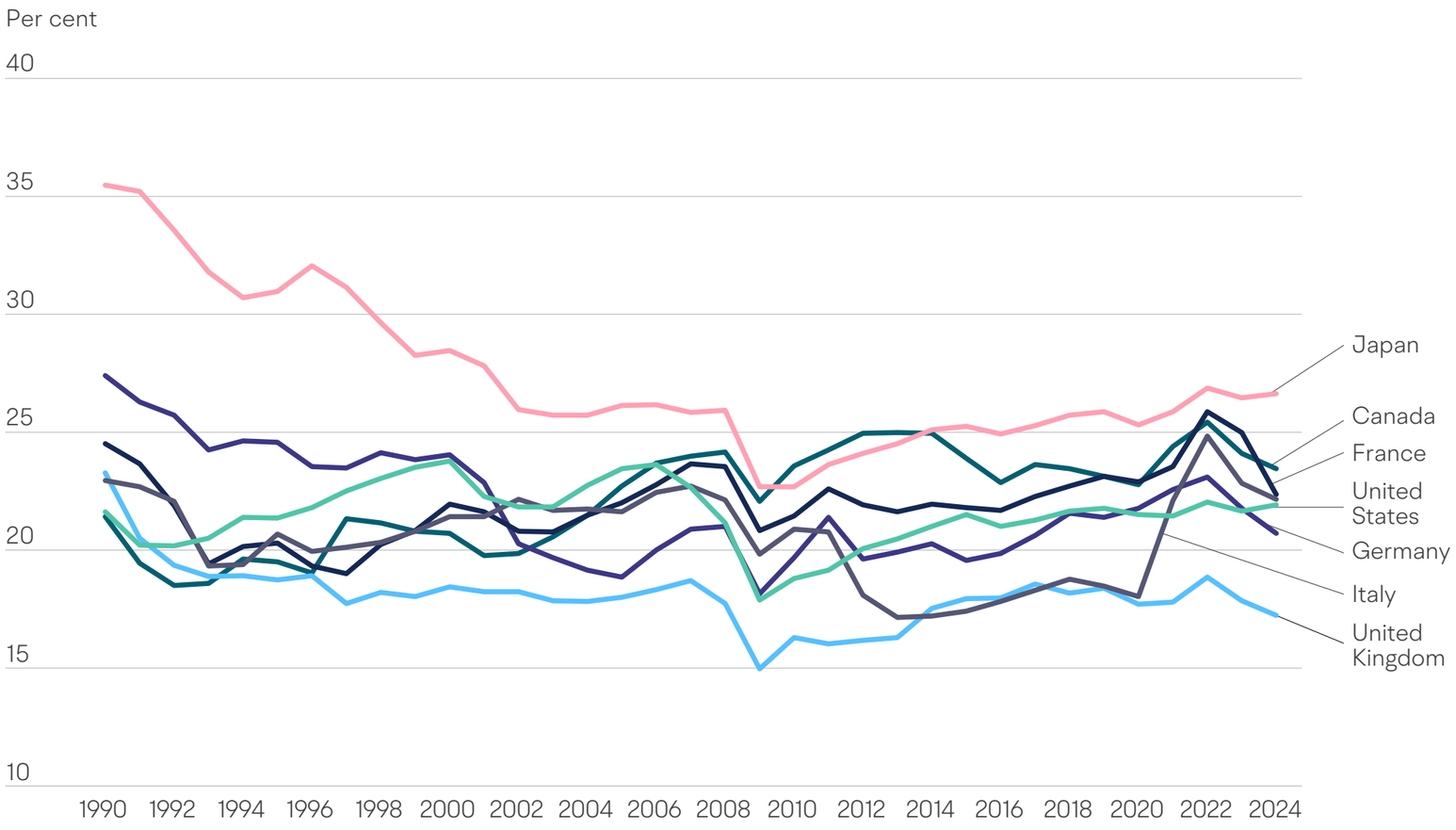
Business investment includes any expenditure by firms on assets used in their production process. It is typically the largest of the core components of the investment function in GDP, which also includes components such as dwellings and government investment. It also tends to be one of the most cyclical components of GDP and consequently accounts for a greater share of the volatility of GDP, with low business investment often correlated with high uncertainty.[6]

Investment helps drive economic growth by expanding firms' production capabilities, enhancing their efficiency, and enabling the development or adoption of innovation. It also complements a wide range of public investments, such as those in education, infrastructure, and market frameworks. This can in turn further drive economic growth, which can help to lift wages and living standards.

Figure A.1

Total investment, percentage of GDP

Source: World Economic Outlook (WEO) database



Low business investment in the UK has contributed to low productivity

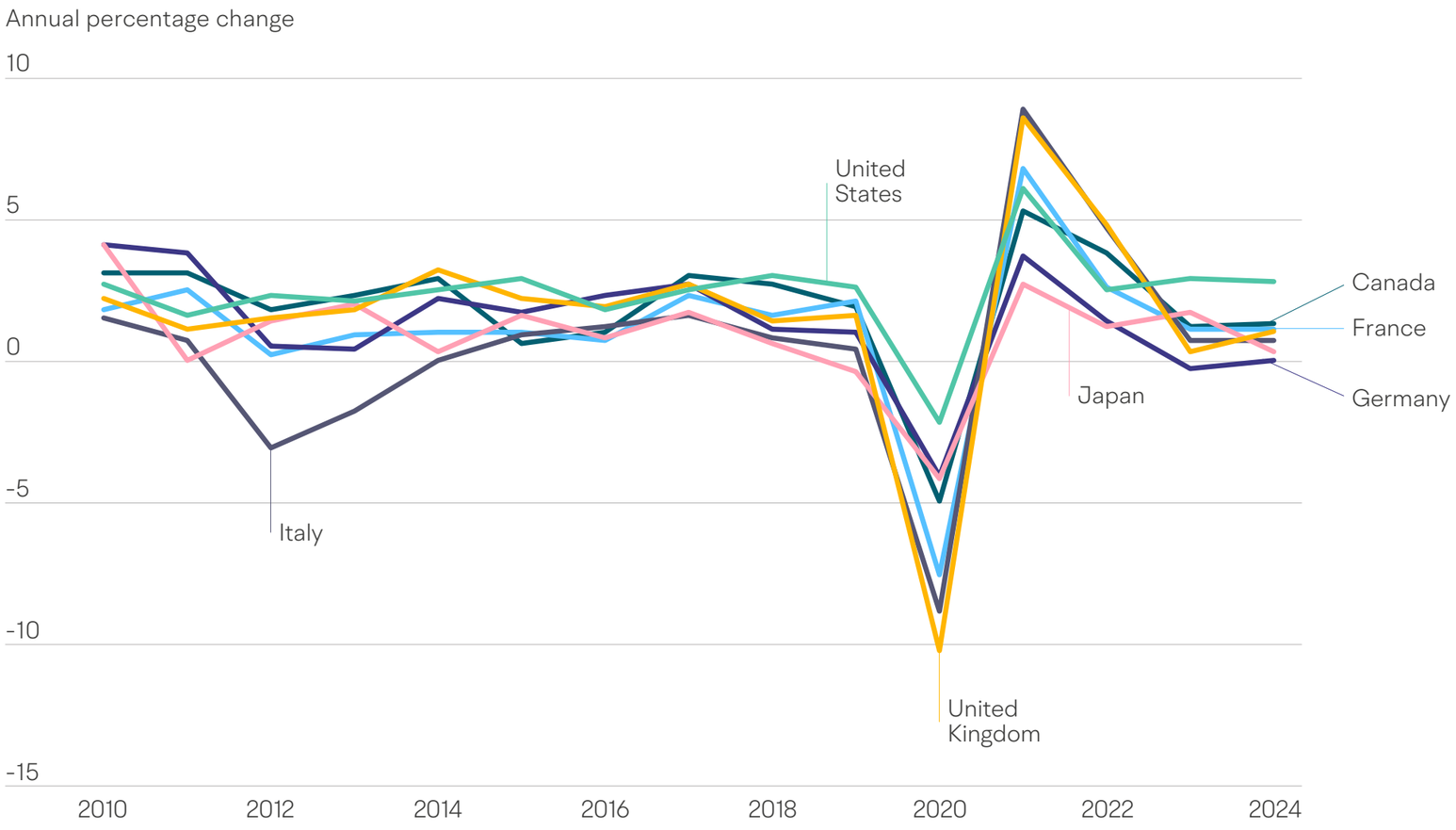
The UK has historically had low business investment compared to G7 counterparts. As figure A.1 shows, the UK has the lowest share of investment as a percentage of GDP among G7 countries for 24 out of the last 30 years. Looking further afield, the UK ranked 28 out of 31 OECD countries for investment in 2022. Evidence shows that the lack of investment in capital is a key reason for the UK's productivity gap with countries such as France and Germany.[7]

While other G7 countries generally have an investment level between 20-25% of GDP, the UK has consistently had lower than 20% investment since the early 1990's. The UK's investment as a percentage of GDP has ranged between 14.8% and 18.7% of GDP following the millennium. Over the same period, investment in Germany ranged from 18.0% to 24% and in the United States from 17.8% to 23.7%. All of the G7 apart from Italy have had higher total investment as a percentage of GDP than the UK in any given quarter during this period, with 2023 being the year where the UK had the largest

Figure A.2

Real GDP growth for G7 nations

Source: World Economic Outlook (WEO) database



investment gap with the other G7 nations. Looking forward, the OECD's investment forecast for 2025 shows the UK as the only OECD country set for a fall in investment.[8]

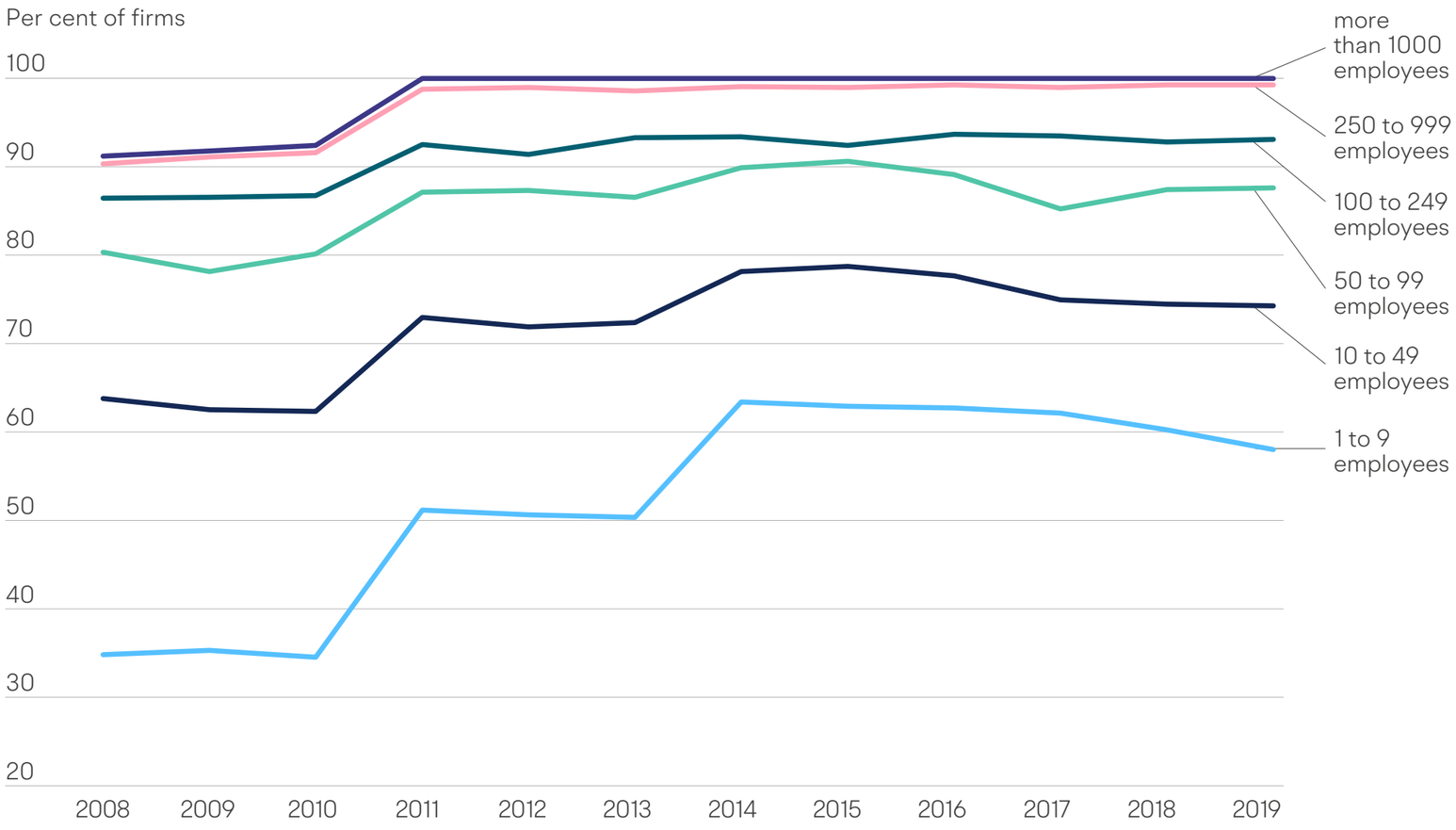
Over time, the difference in investment has a large cumulative effect. British Business Bank analysis of OECD data reveals that total cumulative investment in France, which has a lower GDP than the UK, from the period 2010 – 2019 was 32% more than the UK in this period, with the difference in total investment equivalent to the UK's spend between 2010-2013.[9] The total investment in Germany was 70% more in total over this period. During this period, the UK saw a growth in labour productivity of $2.2 per hour, while France and Germany saw increases of $5 and $5.9 respectively.[10]

Despite this, figure A.2 shows that real economic growth in the UK outperforms its level of investment compared to other G7 nations. This could suggest that investment has a larger catalytic effect in the UK and could be an opportunity to stimulate economic growth in the future.

Figure A.3

Proportion of firms that invest, by size

Source: DBT – Business Investment Analysis



Smaller businesses tend to invest relatively less than larger businesses

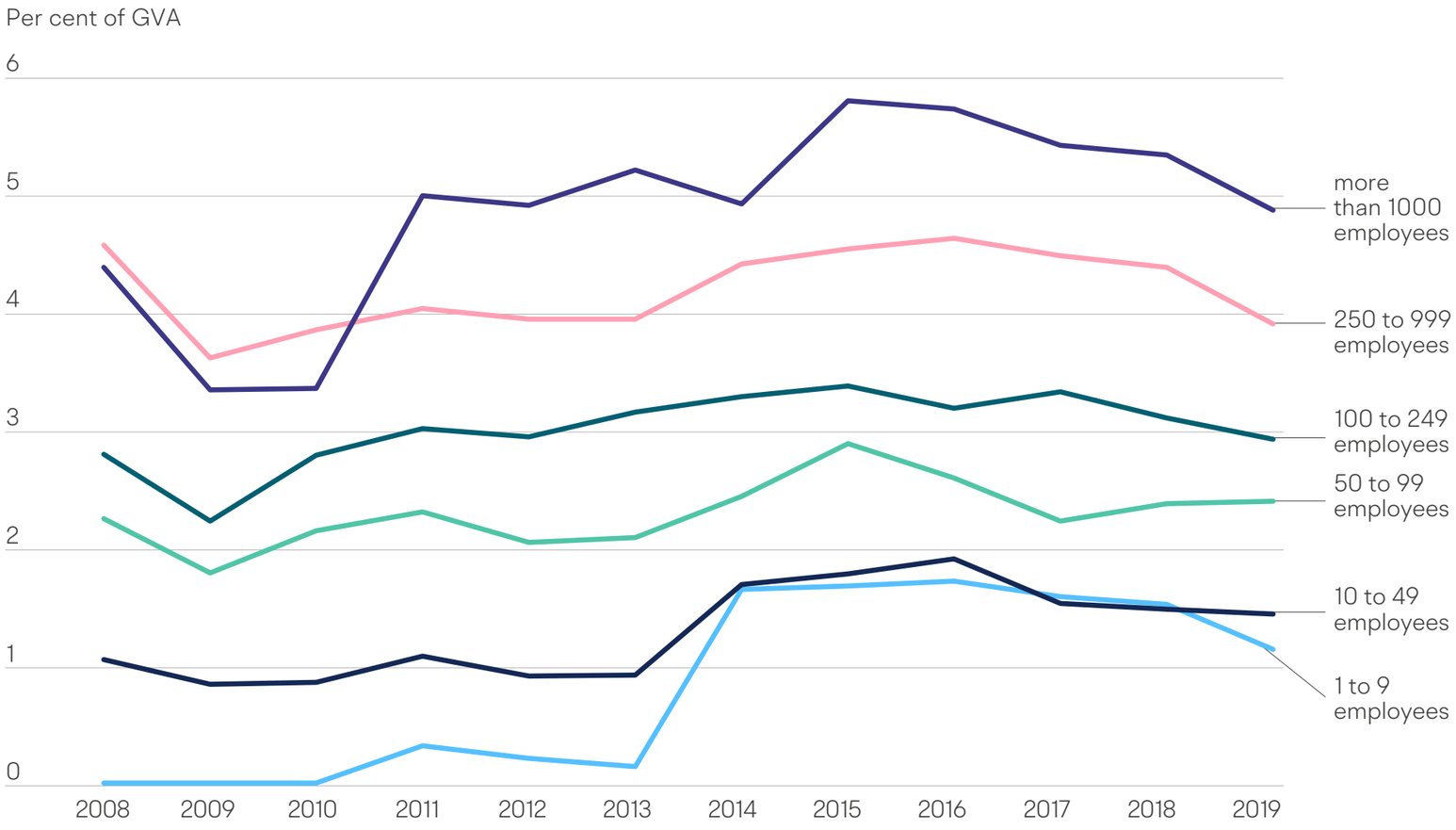
SMEs form around 99.8% of all businesses in the UK, accounting for around 60% of employment and just over half of private sector turnover. Figures A.3 and A.4 show that small businesses are less likely to invest and at relatively lower levels than larger businesses. They also show that there is a correlation with increased business size and increased likelihood to invest and at higher level.[11] Improving business investment in smaller businesses will therefore be vital to improving productivity and living standards in the future.

Smaller businesses often have less capital and investors have less information and certainty about these businesses. This can lead to lower access to capital for small businesses and more expensive borrowing costs due to what is perceived to be higher risk, thus hindering potential business growth and the positive economic effects of this.

Figure A.4

Median investment by firm size

Source: DBT – Business Investment Analysis



The latest stats before the Covid-19 pandemic show that median investment for firms with 1-9 employees had a median investment of 1.14% as a share of GVA, which rose to 1.44% for firms with ten to forty-nine employees. In comparison, firms with more than a thousand employees invested 4.88 % of GVA.

Using ONS data on the non-financial business economy, we can form an indicative indication of the contribution of non-financial SMEs to business investment in 2019 when we pair them with DBT research.[12] Using the median value, in the absence of an available mean value, of investment for business size and applying these to GVA stats in 2019, we can see in Table A that large businesses invested 2.25 times as much as SMEs (excluding the financial sector).[13] This is despite larger businesses contributing slightly less turnover (48%) to the economy than SMEs (52%).[14]

Given this method accounts for under 10% of total investment in the UK across all firm sizes, it would also suggest that investment in the UK is driven by a concentrated number of firms. This is supported by DBT evidence which suggests that 94.9% of total investment comes from the top 10% of largest investors, with a mean investment as a share of GVA for 'very large' firms of 14.95%.[15]

Despite this relatively low level of investment by smaller businesses, at least compared to larger businesses and almost certainly by international standards, Bank of England research concluded that three-quarters of SMEs believe they are investing at an appropriate level, with just one-fifth believing they are underinvesting.[16] Businesses cited boosting productivity and maintaining their business as the main motivations for undertaking investment. Considering the productivity lag and lack of business investment, this would suggest that many businesses may not be aware of the optimal level of investment, and as such are underinvesting.

Department of Business and Trade research has suggested that firms that are better managed are more likely to invest and invest more.[17] This seeming underinvestment could add credence to the Productivity Institutes' findings that there is evidence that the quality of UK management is low by international standards and that "In smaller firms, managers may be overwhelmed by the day-to-day running of the operation or preoccupied with ensuring the survival of the firm."[18] They go on to say this can lead to short-termism and lead to the strategic thinking about the long run that is needed for investment to be absent.

Table A

Indicative investment by firm size using median values

Source: British Business Bank analysis of DBT and ONS data

Firm size	GVA (£ million)	Median investment (% of GVA)	Total investment (approximate – GVA x Median) (£ million)
1 to 9	263,409	1.14%	3,687
10 to 49	199,515	1,44%	2,873
50 to 249	219,557	2.62%	5,752
SME Total			**12,312**
250 and over	630,378	4.40%	27,736

Among the businesses who believed they were underinvesting, both supply and demand-side issues were noted. The majority cited credit being too expensive (58%) and not being able to borrow at a reasonable rate (55%) as two key reasons behind the lack of investment. In addition, evidence from the Bank's SME Intermediary Survey finds that over 30% of small businesses saw credit as being too expensive as a reason to not apply for finance.[19]

Businesses that perceived themselves as having invested appropriately were less negative regarding access to finance, relative to businesses who perceived themselves to have invested too little. This highlights an important correlation between businesses' perceptions of the appropriateness of their investment levels and access to finance.

From a demand perspective, risk aversion (77%) and deleveraging (75%) were the main motives behind low demand for finance.[20] Furthermore, evidence from intermediaries showing that nearly 46% of small businesses state risk/debt aversion as a reason not to apply for finance.[21] Many smaller businesses are also discouraged as they fear they will be rejected for finance and prefer to grow more slowly than raising external funds.

Positively, small businesses' willingness to invest for the purpose of business growth has increased from last year. Meeting this demand could provide capacity to increase business investment amongst small businesses and improve future productivity in the UK. More detail about small business finance demand can be found in chapter 2.2.

Challenging economic conditions have impacted investment in recent years

Since the global financial crisis (GFC), there have been a series of one-off shocks that have impacted business investment in the UK. This includes global shocks, such as the Covid-19 pandemic and the recent wars in Ukraine and the Middle East, domestic shocks, such as Brexit, and domestic uncertainty, driven by political changes. Collectively, these shocks have weighed heavily on the UK economy.

This has been most prominent during the Brexit referendum and the following years of political upheaval which has seen an uncertain relationship with our largest trading partner and multiple changes of political leadership.

The IMF and Bank of England state that the momentum of the post-GFC recovery in business investment was disrupted by the Brexit referendum which was associated with business uncertainty with the BoE finding that anticipation of Brexit is estimated to have gradually reduced investment by about 11% over the three years following the June 2016 vote.[22] This impact is still causing uncertainty. Since 2022, 1 in 3 SMEs have felt there has been a negative impact on them from the new EU trading arrangements.[23]

Analysis by economist Tera Allas shows the relative reduction in capital accumulation in comparison to hours worked following the GFC in the UK across almost all sectors.[24] Figure A.5 below shows how from 1995-2007, multifactor productivity provided the largest contribution to annual GDP growth, whereas from 2010-2019 it was driven by an increase in the number of hours worked. Given the slowing growth in capital stock shown in figure A.6, it is not surprising to see the lack of contribution from capital to economic growth. This has led to a low capital-intensity ratio in the UK and an over-reliance on number of hours worked in the labour force to induce economic growth. The UK has been working harder, not smarter.

Structural issues remain, but policy is evolving to support investment

Of more concern to policy makers are the structural issues that continue to negatively impact business investment. As discussed in previous Small Business Finance Markets reports, the GFC exposed the concentrated, and in some cases the underdeveloped nature of the UK smaller business finance markets. For example, higher costs and stricter lending criteria for post-crisis term bank lending made it even more difficult for smaller businesses to finance growth and investment.

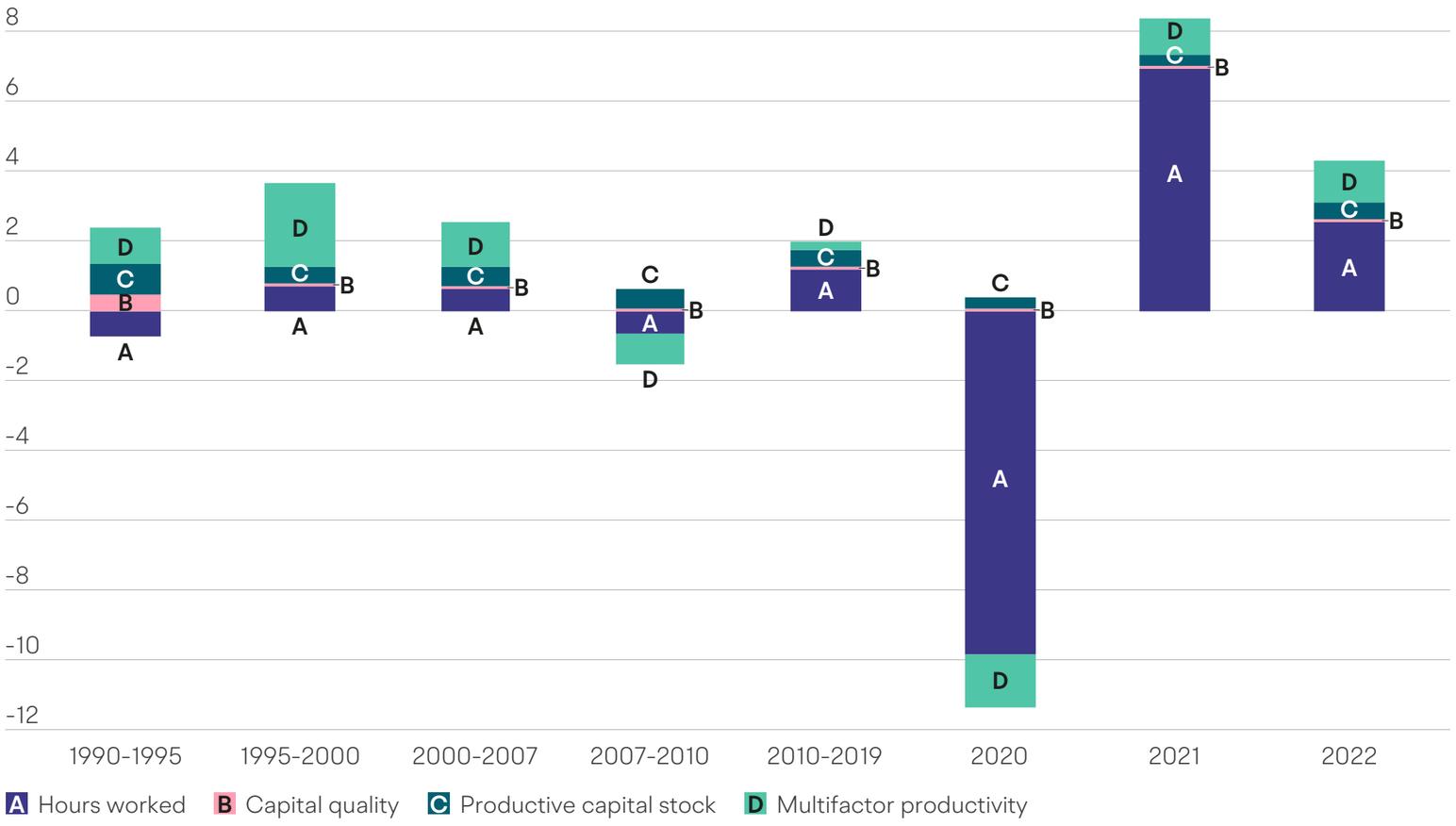
This is evidenced by the OECD and the IMF, who find that smaller firms have limited access to finance investments in intangibles and new technologies.[25,26] Intangible investments, including R&D, or investment in higher risk or unproven technologies are particularly hard to finance and firms lack the collateral that are provided by tangible assets. This is not only important as intangible investments are associated with higher productivity growth but also in the context of developing new technology to advance the green transition.[27]

While stricter banking regulation was not the preserve of the UK, though some argue the UK went further than

Figure A.5

Contributions to annual GDP growth in the UK, percentage points

Source: OECD compendium productivity indicators



many peers, smaller businesses in other countries often had alternative options to market-based bank lending in the form of government supported financial instruments. The OECD, in their 'Quantifying industrial strategies' report found that in 2021 the UK government provided financial instruments equivalent to only 0.1% of GDP when excluding export finance and grants equivalent to 0.26% of GDP. The French government by comparison provided of 1.5% of GDP in financial instruments and 1.13% in grants figure A.7.[28]

Instead, the UK preferred to utilise tax expenditure. Here the UK offered the most at 2.3% of GDP, while France provided 1.07% and Ireland equivalent to only 0.6% of GDP. While many larger businesses will have been able to take advantage of tax breaks for activities such as R&D it is likely that start-ups and scale-ups may not have the necessary profits to benefit. However, policies such as full expensing , discussed in the asset finance chapter in Part B have been welcomed by smaller businesses and their associations.

UK smaller businesses are able to claim a range of tax relief, covering a wide range of activities including business investment.[29] The UK preference for tax expenditure over financial instruments, targeted or

Figure A.6

Contributions to growth in UK net capital stock by asset, percentage points

Source: ONS Capital stocks and fixed capital consumption, UK: 2024

otherwise, may in part be due to the lack of consistent policies targeting business investment and most notably the lack of a long-term industrial strategy. Research has often suggested the lack of an enduring industrial strategy and consistent policy aims and associated tools in general in the UK has led to uncertainty for many businesses.[30] As mentioned earlier, economic and political uncertainty can negatively impact business investment intentions and when coupled with shifting policy aims can lead to businesses simply choosing not to invest.

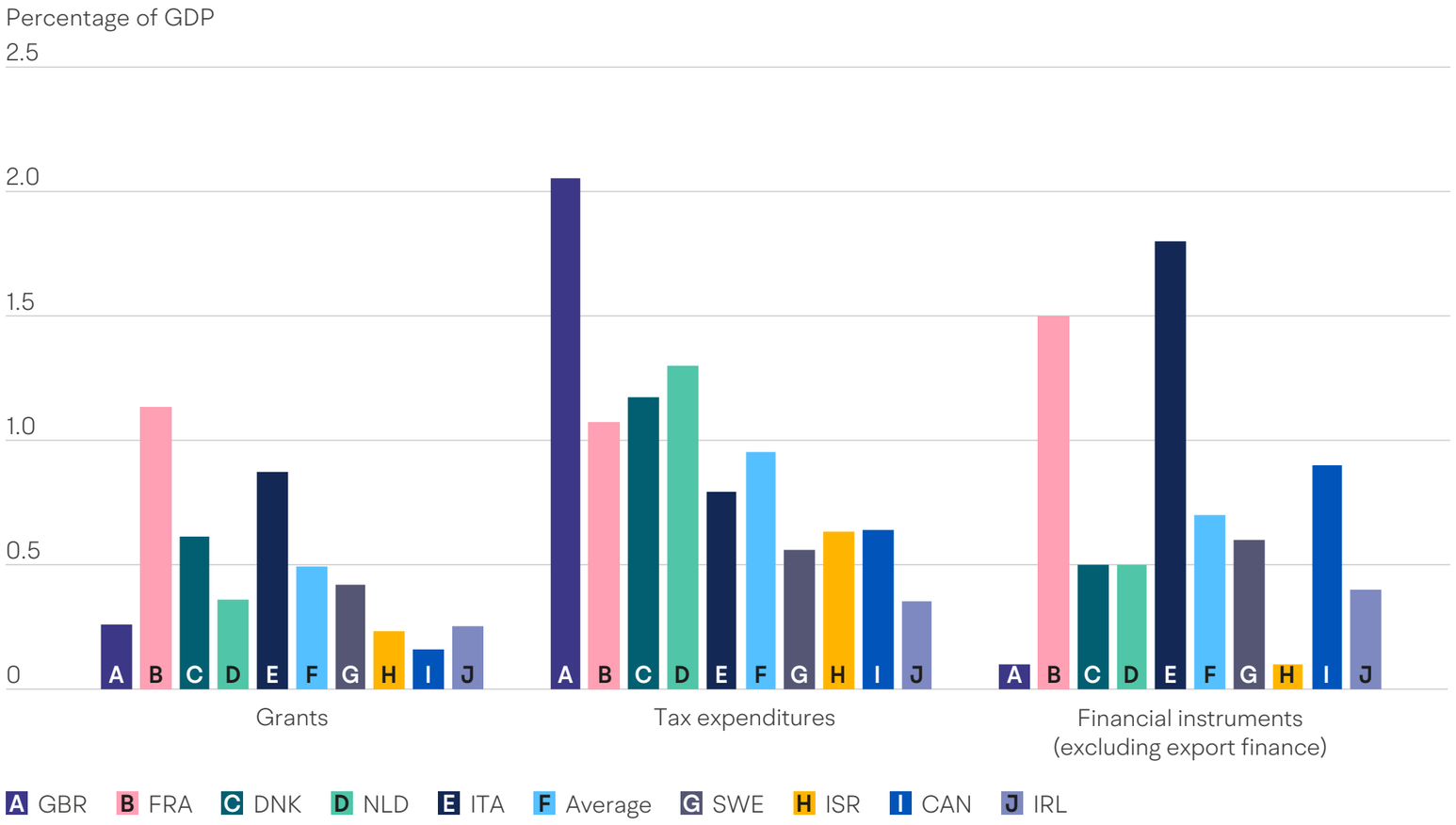
In addition, some sectors of the UK smaller business private finance markets were underdeveloped post the GFC, especially when compared to the US. Examples include private debt markets and, at least at the start of the post-GFC period, smaller business equity markets. In addition to more standardised debt products, US smaller businesses were able to get bespoke finance from debt funds. These offer flexible debt which can be well suited to a range of business investments, often much more so than a standard term loan.

When the Bank was founded in 2014 the key aims were improving general access to finance post global financial crisis and this included improving the diversity of finance

Figure A.7

Grants, tax expenditures and financial instruments separated by type in 2021

Source: Quantifying Industrial Strategies – OECD



available to smaller businesses. As we reported in last year's Small Business Finance Markets report, access to finance has evolved and smaller businesses in the UK have never had more options than they have now. For example, challenger and specialist banks now lend more than the major UK banks and alternative types of finance such asset finance, debt funds, equity and non-bank lending have grown significantly over the last decade.[31]

In general, this improvement in diversity of finance is a positive for business investment. Depending on the type of investment smaller businesses are looking to make, different types of finance are more appropriate (figure A.8). For example, should a business be looking to invest in vehicles, machinery or IT, asset finance would likely be an ideal type of finance. If they were looking to carry out research, equity or grants may be more appropriate. However, for many smaller businesses the access to finance challenges can be more varied or nuanced than simply the types of finance available, with many businesses being cautious about taking on external finance.

Figure A.8

Matching the finance type to investment goals

Source: British Business Bank

Equipment or asset purchase

Asset finance

- Through the provision of various forms of leasing and hire purchase, asset finance offers access to funds for business-critical investments, like machinery, equipment and vehicles, without the need for large up-front payments.
- Leasing allows businesses to obtain new equipment by renting it for a contracted period without owning it. This can also mitigate against obsolescence, with the flexibility to upgrade assets and technology when required, which can enhance efficiency and productivity.

Research and development

Equity

- Equity finance is generally the issue of new shares in exchange for a cash investment.
- The business receives the money it needs and the investor (generally a business angel or venture capitalist) will own a share in the company. This means the investor will benefit from the success of the business.
- This is most relevant for investments where the probability of success is highly uncertain but offers the potential for high growth.

Grants

- Business grants are payments provided by either the Government or a private organisation for a specific purpose, such as training, expansion, or research & development. These do not have to be paid back.

Term loans

- A way to fund assets over an agreed term.
- Repayment options to suit business cashflow, with variable or fixed interest rates.

Working capital for growth

Invoice finance

- A short-term loan that allows businesses to borrow money using their unpaid invoices as collateral.

Revenue-based finance

- A capital-raising method in which investors agree to provide capital to a company in exchange for a certain percentage of the company's ongoing total gross revenues.

The Bank's programmes have matured to address the varied challenges

In recent years, as the British Business Bank has matured, we have developed a greater understanding of markets and the nuanced and varied challenges smaller business face. This has been done through our programmes and our evaluations of those programmes, interactions with market participants and via research and consultations.

While the above obstacles to business investment could be considered applicable to the wider smaller business population, many of the challenges faced can be exacerbated by other factors that only impact certain segments of smaller business.

One such factor is the geographical location where a business is based. Public infrastructure spending was relatively low in the 1990s and 2000s and concentrated in London and the South East, contributing to the historical underperformance of other regions and cities.[32] London and the South East are also the two regions with the highest levels of business investment.

Our analysis in chapter 2.4 shows that London and the South East account for 72% of the value of total

Figure A.8 (continued)

Matching the finance type to investment goals

Source: British Business Bank

Property purchase or expansion

Commercial mortgage
- A loan that involves paying a deposit followed by monthly repayments with variable or fixed interest rates. Interest rates tend to be higher than for residential mortgages due to the higher risk for the lender.

Term loans
- A loan where a borrower receives a lump sum of money that they repay in instalments over a set period.

Scaling a startup

Venture capital
- A critical source of funding for startups and other businesses that want to grow quickly, providing finance to businesses that cannot sustain debt repayments.

Angels
- An angel investor is someone who invests their own money in a small business in exchange for a minority stake (usually between 10% and 25%).
- Angel investors tend to be entrepreneurs or people with extensive experience in the business world.

Debt funds
- Private debt funds generally support profit generating companies seeking finance to implement step-change growth plans.
- Private debt loans are tailored to the needs of the borrower and typically involve more flexible repayment schedules than traditional bank loans.

Sustainability or green projects

Green investment grants
- Financial awards that support businesses or projects that are environmentally friendly. They can help businesses reduce their carbon footprint and operate more sustainably. They do not need to be repaid

Green loans
- A sum of money that is borrowed and paid back in instalments over a set period of time. The borrower is charged interest on the loan, but this may be lower than other loans providing sustainability targets are met.

Note: More information is available on the Bank's 'Making business finance work for you' page.

investment in SME equity deals for the UK in 2024. Meanwhile, Wales, East Midlands, Northern Ireland and the West Midlands only account for just 3.6%.

This has contributed to a regional productivity gap, as figure A.9 shows with London and the South East the only regions with labour productivity above the UK average. For the 8 largest cities outside London combined, the gap between actual and potential productivity could be worth £47bn.[33]

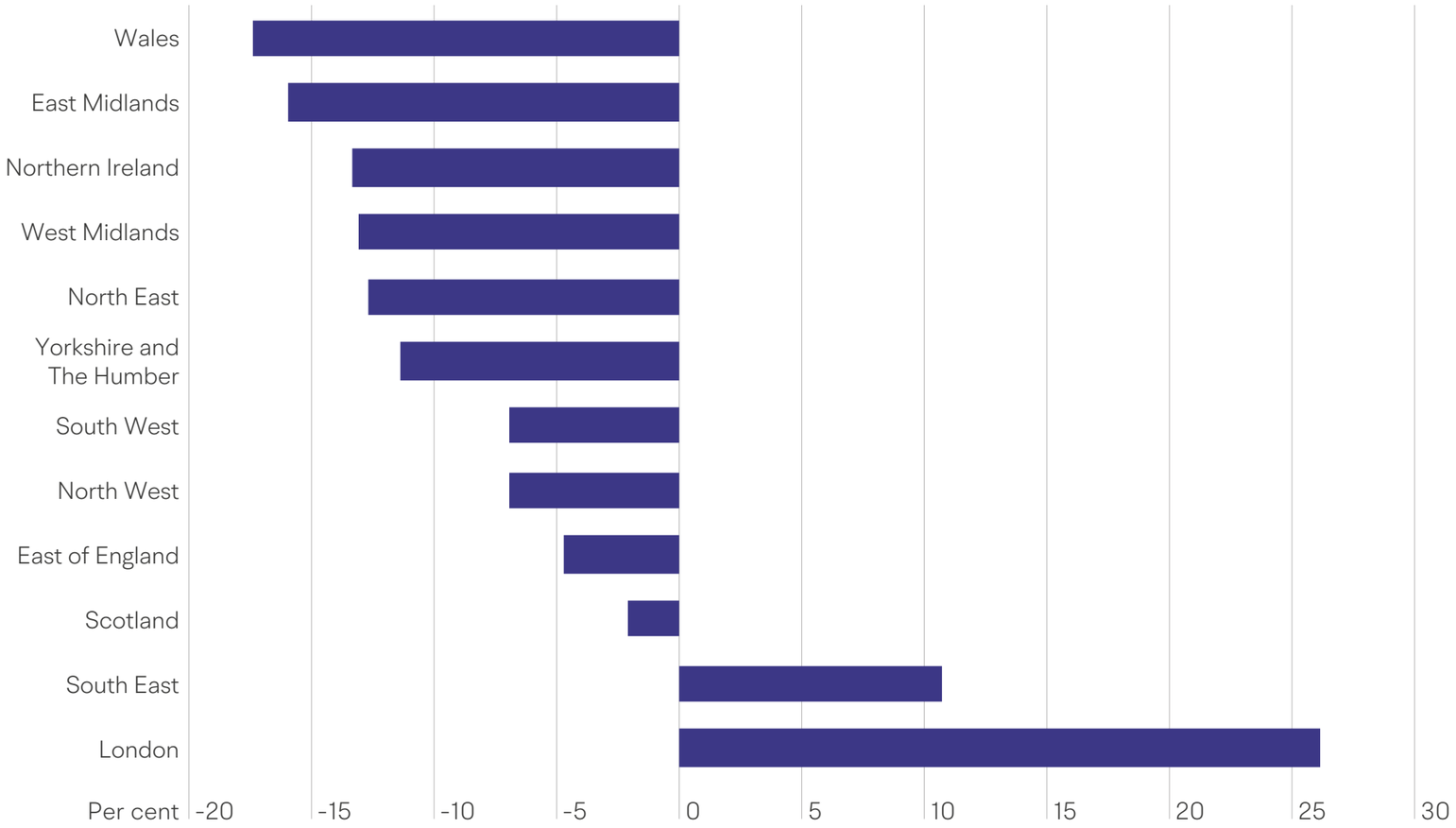
Moreover, as Chapter 2.1 on business population shows, London also has the highest proportion of large businesses of any region in the UK. These larger firms have greater access to capital and thus can invest more and at higher levels, as discussed earlier in the chapter. This shows how improved access to finance and higher investment can help improve productivity levels.

One of the Bank's objectives is to identify and help to reduce regional imbalances in access to finance for smaller businesses across the UK. This is a key component of our broader strategic objective focused on "Unlocking potential": unlocking growth by ensuring entrepreneurs can access the finance they need regardless of where and who they are. The Bank's 10-year Impact report shows that 84% of the 209,000

Figure A.9

Output per hour worked by Nation and region relative to the UK average in 2022, percentage difference

Source: ONS – Regional and subregional labour productivity, UK: 2022



small businesses supported by the Bank were outside of London, well in excess of the 66% in the wider UK small business population in 2024.[34]

The Nations and Regions Investment Funds (NRIF) make a key contribution to this objective. Their aim is to drive sustainable economic growth by supporting innovation and creating local opportunity for new and growing businesses across the UK, whatever the economic conditions, with an inclusive approach to all eligible sectors.

The Bank and government have also identified the stage and sector a business is in can impact it's access to finance. At the Spending Review 2021 the Government committed an additional £1.6bn for the British Business Bank to deliver a new generation of six geographically focused funds via the NRIF programme from 2023/24 onwards.

As part of the issues identified in the Patient Capital Review, the UK Government launched the British Patient Capital (BPC) programme in 2018: a £2.5bn VC Investment Fund to enable long-term investment in innovative UK companies. BPC invests in a way that builds the private market and patience of the wider VC ecosystem.

By focusing on the late-stage funding gap, the Bank and its commercial subsidiaries are helping to ensure high-growth UK companies have access to the right type of funding at the right time in their life cycle, supporting them as they expand, create jobs, develop products and enter new markets.

These companies have the potential to both disproportionately drive productivity and living standards and will support the UK to be internationally competitive in the industries of the future. Many of these companies also help address societal challenges, including the transition to net zero and global health.

BPC is now the largest domestic investor in UK venture and venture growth funds. Evidence shows that BPC now plays a market leadership role and has a positive signalling effect in the wider market. This is helping to improve the functioning of the VC market and strengthen the UK's innovation and enterprise ecosystem. The programme has also performed well in crowding in private sector investment ensuring that innovative companies have access to the VC they need to grow. This finance has allowed these small companies with high potential to facilitate investment and thus growth and innovation.[35]

Figure A.10 shows how far the UK VC market has come compared to the US. This represents significant progress in investment for an asset class that has potential to produce innovative and productivity enhancing companies of the future.

Moreover, the UK is home to world-leading research and development, with three of the top 10 universities globally. The UK is also home to the world's third largest tech ecosystem (by volume of VC investment, behind only the US and China). This provides fertile ground for innovation to thrive, but a lack of access to domestic patient capital continues to hold back some UK companies from scaling up and fulfilling their commercial potential here in the UK.

By financing innovative companies developing new technologies, venture capital produces spillover effects, such as knowledge transfers, that raise productivity levels of other businesses across the economy. This is particularly the case in R&D intensive deeptech sectors that are based on novel scientific breakthroughs.[36]

Supporting growth for UK innovation

The Long-term Investment for Technology and Science (LIFTS) initiative aims to establish new funds or investment structures to crowd in UK institutional investment, particularly Defined Contribution pension funds, to support the growth and ambitions of the UK's most innovative science and technology companies. This builds on the IMF's recommendation that firms' access to external finance (ideally equity capital) could be enhanced by unlocking pension savings.

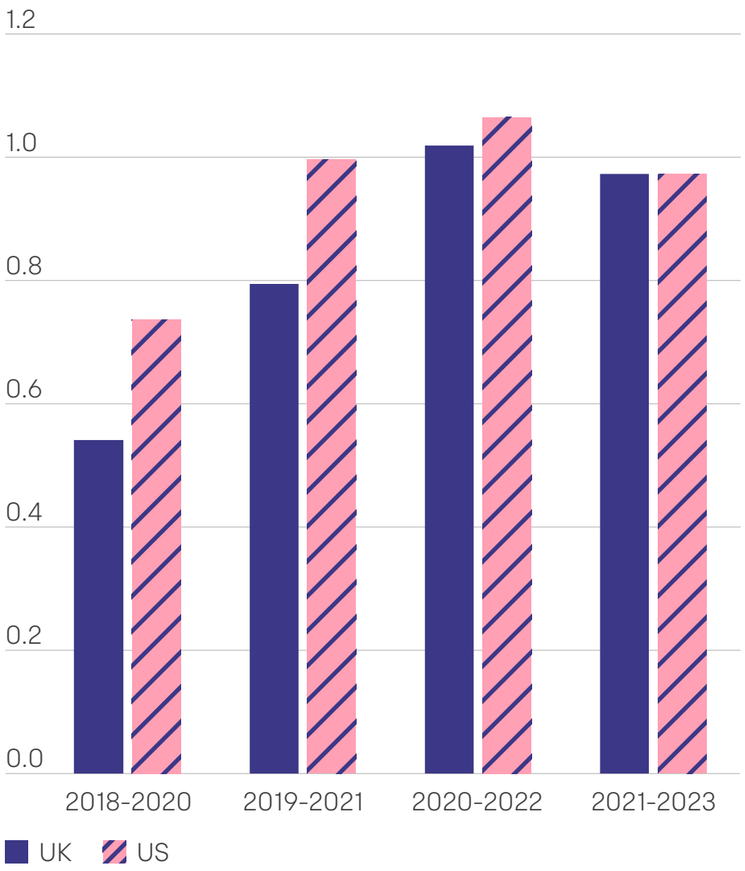
The initiative has three main objectives:

1. **Unlock UK institutional investment:** The outcome will be to support the UK's innovative businesses to accelerate their growth while delivering potentially higher returns for pension scheme members.
2. **Catalyse investment into UK science and technology:** The UK has a wealth of science and technology businesses, which could offer valuable investment opportunities for UK savers. In addition, the Bank and others have identified a funding gap for R&D-intensive businesses seeking significant rounds of capital to scale up and accelerate their growth.
3. **Stimulate the UK VC ecosystem:** Sustainably increase deal flow, develop the domestic venture landscape and nurture investment and entrepreneurial talent, and attract the best international players to the UK to enable high-potential UK businesses to scale and stay here.

Figure A.10

VC investment, percentage of GDP

Source: British Business Bank analysis of Pitchbook data



The Government and the Bank recognise that more needs to be done. The Chancellor of the Exchequer and Secretary of State for Business and Trade announced at the International Investment Summit that the British Business Bank will establish the British Growth Partnership, subject to regulatory approval, encouraging more UK pension fund investment into the UK's fastest growing, most innovative companies.

The objective of the British Growth Partnership is to crowd in private investment, primarily from UK pension funds, into high-growth UK companies. BGP will seek to raise a series of funds in the coming years. Building on the unique position of the Bank as the UK's largest LP, these funds have the potential scale, low cost and diversity needed to help to reduce the gap between the risk appetite of pension funds and the relative risk of late-stage VC investment. This will be reinforced by seeding the BGP with a sufficient level of Government capital.

BGP would provide financial support to innovative and fast-growing firms. This should allow these companies to create more jobs, improve their turnover, and deliver greater innovation to sustain long-term economic growth, encouraging them to remain in the UK for longer.

Furthermore, the direct increase in funding could create spillovers from the investment into innovative companies.

In November 2024 the Department for Business and Trade released a Green Paper for a modern industrial strategy, a 10-year plan designed to deliver the certainty and stability businesses need to invest in the high growth sectors that will drive our growth mission.[37] This will channel support to 8 growth-driving sectors. They include the services and manufacturing industries that present the greatest opportunity for output and productivity growth over the long-term.

The Bank's portfolio of programmes help to stimulate investment across regions and high-growth potential sectors and we look forward to playing an active role in delivering the industrial strategy and supporting business investment and growth for the UK's small businesses.

Part B:
Market developments

Small business characteristics

- 2.1 Small business population
- 2.2 Small business demand for finance

2.1

Small business population

The UK business population decreased in 2024

The number of registered business births exceeded closures

Small businesses provided more employment than large businesses in the devolved Nations and the South-West of England

This section reviews the current stock of UK businesses and the components of change over time incorporating insights from the Department for Business and Trade (previously Business, Energy and Industrial Strategy (BEIS)) business population estimates and Office for National Statistics (ONS) business demography.

In 2024, SMEs formed 99.8% of all businesses, accounting for around 60% of UK employment and just over half (£2.8 trillion) of private sector turnover, showing their vital contribution to the UK economy. They contribute to economic growth, job creation, and innovation. They are also a key part of local economies and communities, offering a sense of place and belonging, as well as providing unique products and services that cannot be found elsewhere.

The UK business population decreased in 2024

There were an estimated 5.5 million UK private sector businesses at the start of 2024, a 1% decrease on the total reported at the start of 2023.[38] This reversed the increase seen in 2023, when the business population had increased by 0.9%, the first increase since the Covid-19 pandemic. Overall, the stock of businesses is similar to 2022 figures, which is reflective of the lack of post-pandemic economic growth.

Figure B.11 shows the decrease in business population in 2024, as the total business population decreased by 56,000. Numbers of employing businesses decreased by 18,000 (1.2%), whilst non-employing business numbers decreased by 38,000 (0.9%). The decrease in non-employing businesses resulted from a decrease of 43,000 (1.5%) unregistered businesses, partially offset by an increase in non-employing registered businesses of 5,000 (0.4%). Numbers of registered businesses decreased by 13,000 (0.5%). This offsets the increase seen in the previous year, which was driven by a 3% rise in unregistered zero employee firms at the start of 2023 compared to the previous year.

The rate of change in the stock of firms across the UK varied substantially by geography. Regional data shows that the decrease in business numbers was only in England, with increases in private sector businesses of 1% in Wales, 19% in Scotland and 9% in Northern Ireland. Conversely, the number of private sector businesses decreased in six of the nine English regions. London was the English region with the largest numeric decrease (67,000), followed by the North West (50,000) and the East of England (41,000), whilst the largest percentage decrease was in the North West (9%).

The stock of businesses decreasing is not necessarily a problem within an economy, especially when employment is increasing as it did in the UK in 2024. For example, the reduction in unregistered businesses, which are likely to be very small businesses comprised of self-employed individuals may be due to these individuals finding contracted work for a higher wage in an established firm. This may also part-explain the reduction in percentage of total employment in SMEs.

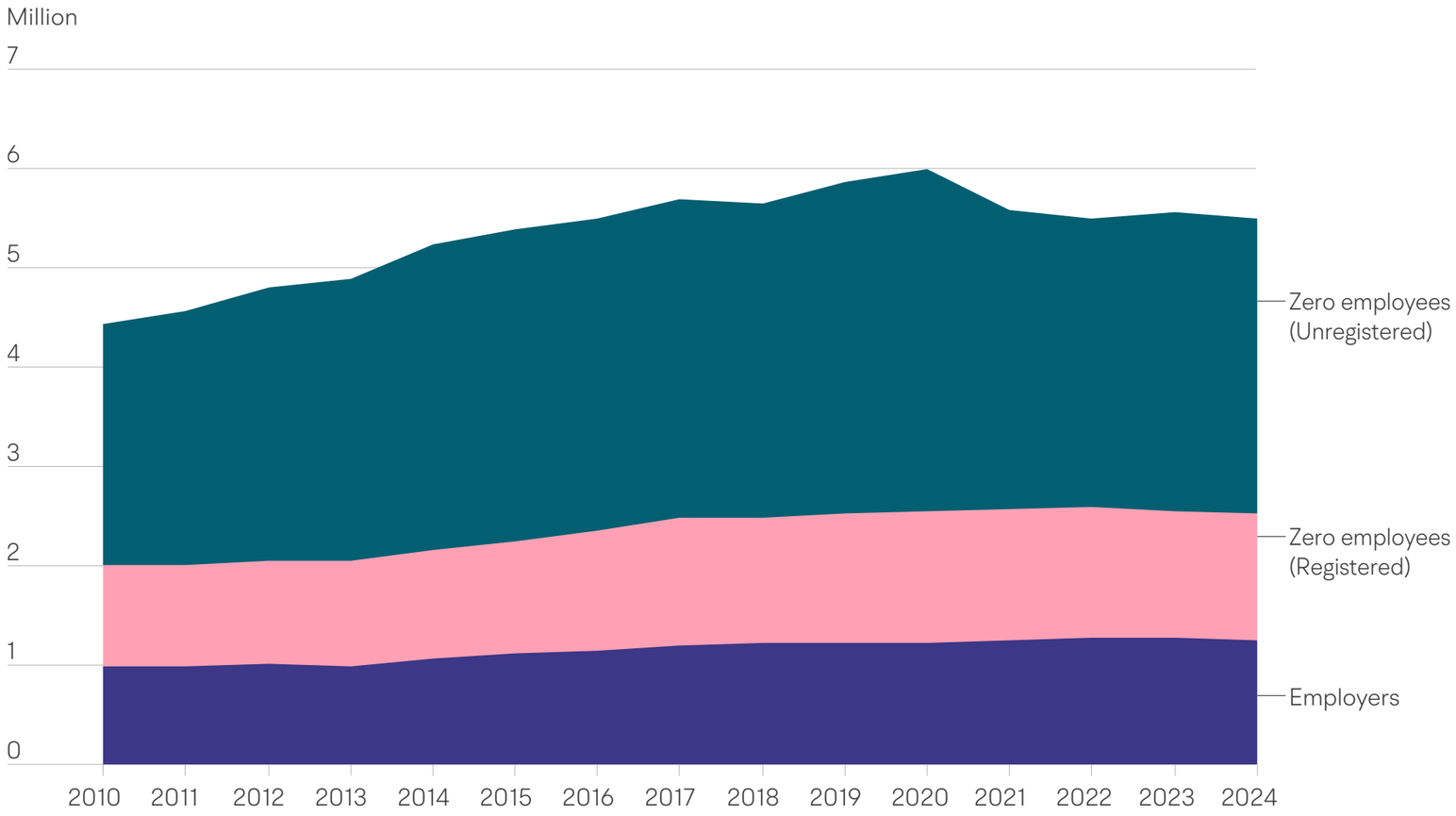
Moreover, turnover from SMEs increased from £2.35tn in 2023 to £2.75tn in 2024. This suggests that there has been a positive reallocation of resources from the businesses that have been lost. Individuals and resources may now be better utilised and more efficient, hence the improvement in turnover and employment despite the reduction in number of businesses. The death of underperforming firms and re-allocation of resources/labour can be beneficial to an economy.

However, this increase in turnover may not directly lead to a proportional increase in GVA, as the 2024 SME Finance Monitor reports that half of SMEs have either been significantly affected by increasing costs or see it as a major future barrier.[39]

Figure B.11

UK business population

Source: DBT Business population estimates 2024



The number of registered business births has exceeded closures

The overall business population is affected by the number of business start-ups and closures.[40] VAT and PAYE registrations (and de-registrations) are used as a proxy for business start-ups (and closures). In 2024 there was a net birth rate of approximately 10,000 businesses. This does not account for unregistered businesses which have decreased in number between 2023 and 2024, therefore providing only a partial landscape of business dynamism.

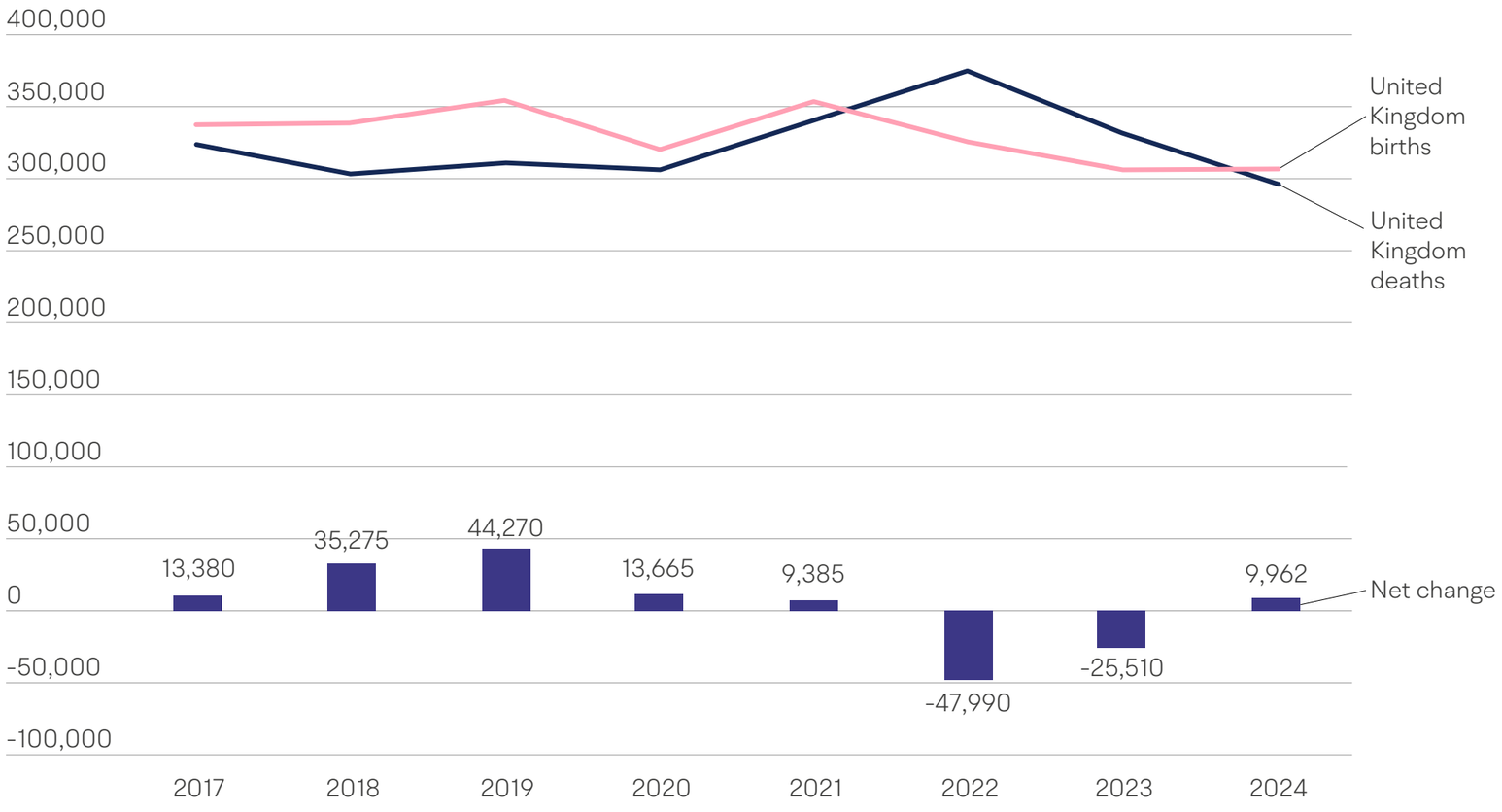
Figure B.12 shows that the UK business population had exhibited a steady increase since 2017 with the number of business births exceeding the number of business deaths each year. 2022 marked a shift, where the number of business closures (375,500), outnumbered the number of new businesses (327,510), leading to a net decline of 47,990 businesses.

This was a challenging period for UK businesses, with inflationary pressures and interest rate hikes which intensified in 2023 with a further net decline of 25,510 businesses. 2024 ends that part of the cycle, with a net positive birth of nearly 10,000 businesses. This has been

Figure B.12

Number of UK business births and deaths

Source: Business demography, quarterly, UK (Q4 2024)



caused by lower death rates for businesses in the last year, with business birth rates lower than the end of 2023.

The Bank have a Start Up Loans programme to encourage the birth of new businesses. This provides personal loans to an individual for the purpose of starting up a new business or developing an existing early stage business. In addition to the finance, the programme offers pre-application support and post-loan mentoring advice. For more information on the impact of this programme see the Evaluation of Start Up Loans that was published in December 2024.[41]

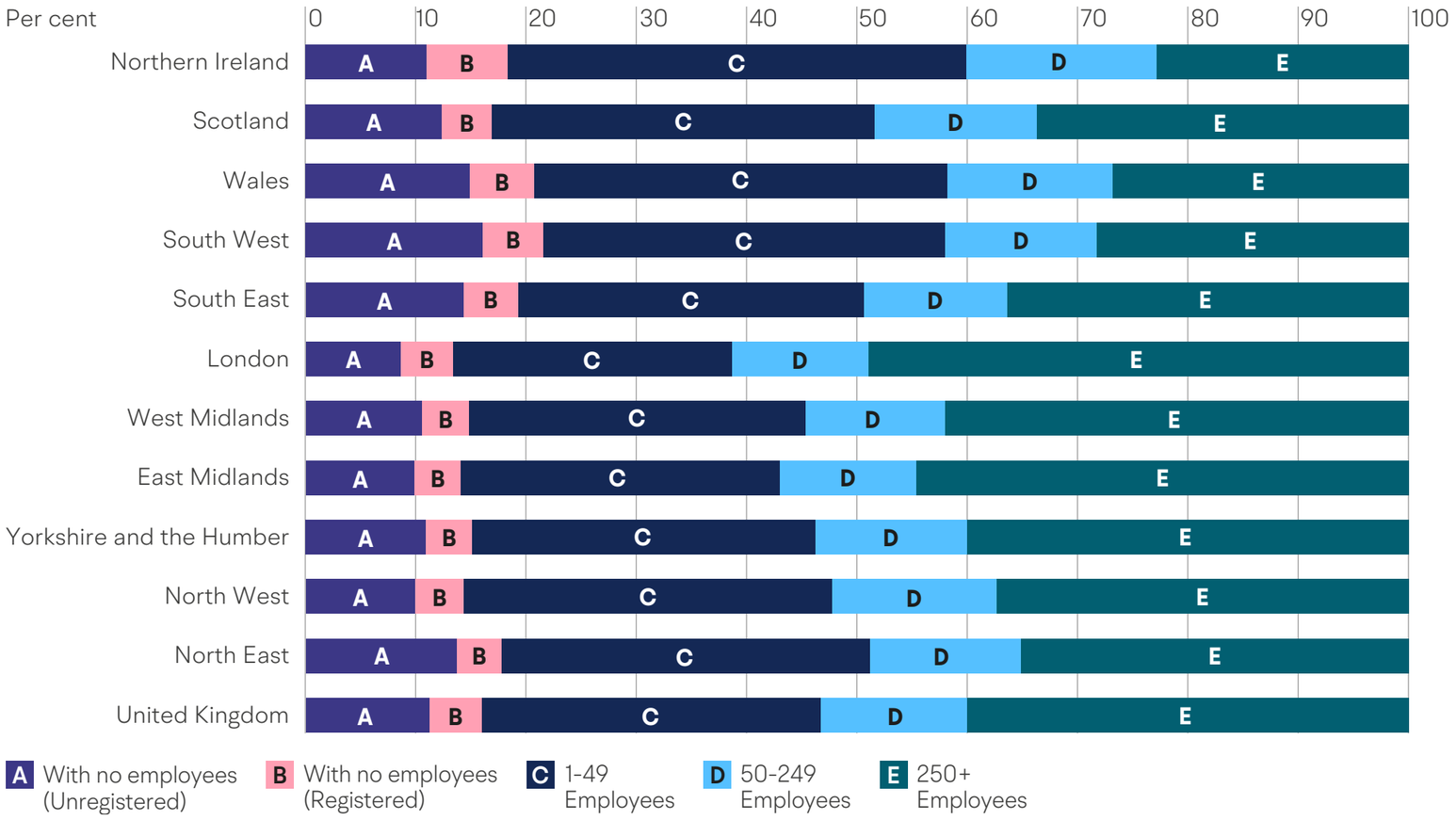
Small businesses provided more employment than large businesses in the devolved Nations and the South-West of England.

Across all regions, besides London, SME businesses provided more employment than large businesses. Figure B.13 shows the regional breakdown of employment by business size. In the South-West of England and the Devolved Nations, small businesses with 1-49 employees provided more employment than large businesses. The highest rate of employment in

Figure B.13

National and regional breakdown of employment, by business size

Source: Bank analysis of DBT population estimates 2024



small businesses is in Northern Ireland, which accounts for nearly 60% of employment. The lowest rate was in London, which also has the largest share of employment in large businesses.

Total employment in SMEs decreased by 0.1 million from 2023-24, reducing the SME share of total employment from 61% to 60%. Meanwhile, employment has increased in large businesses. This could be a result of small businesses being more vulnerable to increasing costs and macroeconomic conditions.

At the start of 2024, the 5.49 million population of SMEs had a workforce of 16.6 million. There were 5.45 million small businesses (with 0 to 49 employees), 99.2% of the total business population and 37,800 medium-sized businesses (with 50 to 249 employees), 0.7% of the total business population. 1.4 million (26%) businesses had employees and 4.1 million (74%) did not employ anyone aside from the owner(s).

These stats only tell part of the story, as SMEs are a crucial component of local communities and culture. They are more likely to recruit local labour and maintain local supply chains which helps give local communities a sense of identity.

2.2

Small business demand for finance

Smaller businesses' use of finance declined in 2024

Credit cards remained the most popular finance type

Willingness to use finance to grow fluctuated in 2024

Businesses were more likely to consider just one provider

This section highlights smaller businesses' use of and demand for external finance covering a wide range of debt, equity and grant products. It uses smaller business survey data from the UK Finance BVA BDRC SME Finance Monitor and the British Business Bank's Business Finance Survey.

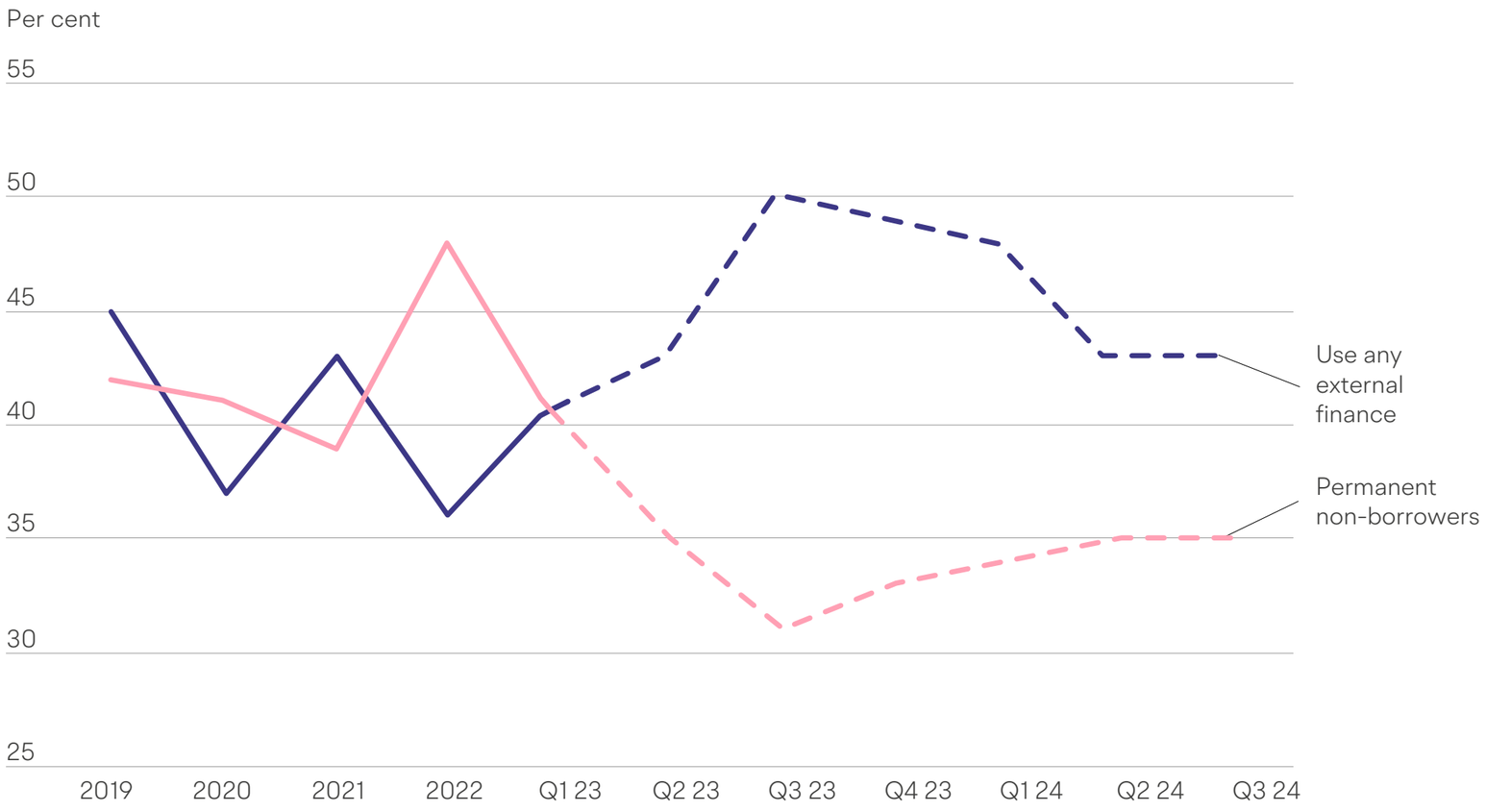
Smaller businesses' use of finance declined in 2024

The share of smaller businesses using external finance declined in 2024. UK Finance BVA BDRC SME Finance Monitor data showed this fell from 48% in Q1 to 43% in Q2, before remaining unchanged in Q3 (figure B.21). Although this represents a notable decline from Q3 2023, when usage peaked at 50%, it is still at a high level relative to historical standards. The decreased use of finance was reflected in the share of businesses identified as permanent non-borrowers, moderately rising from 31% in Q3 2023 to 35% in Q2 2024, again remaining unchanged in the third quarter.[42]

Figure B.21

Proportion of smaller businesses using external finance and permanent non-borrowers

Source: UK Finance BVA BDRC SME Finance Monitor



Working capital was the most frequently mentioned reason for seeking finance over the past three years, accounting for more than half of all demand for finance (51%), although this constituted a decline on 2023, when it was stated by 58% of smaller firms.[43] Insights from market intermediaries indicated that this prevalence may derive from a focus on survival and financial stability, owing to the impact of economic pressures such as higher utility costs.[44] In particular, sole traders were more likely to seek finance to navigate recovery compared to small and medium businesses.[45]

More positively, demand for finance for business growth and development increased in 2024. Of those reporting a need for external funding in H1 2024, 6% of all smaller businesses, over half (57%) of these needs were business development-related, well above the 2021 series low of 24%. This was primarily driven by large increases in those saying they wished to invest in new plant and machinery (24%) in H1 2024, compared to 11% in 2021.[46]

Moreover, the share saying their finance need was for cash flow purposes decreased to 45% in H1 2024, well below the 81% reported in 2021. This is further supported by the Bank's Business Finance Survey results, where the proportion of businesses seeking finance to invest in business growth over the past three years rose from 28% in 2023 to 34% in 2024.[47] Meanwhile, the survey also revealed those that were refinancing or consolidating debts during the same period fell by 7 percentage points from 17% in 2023 to 10% in 2024, pointing towards greater capacity for funding growth-oriented activities.[48]

Credit cards remained the most popular finance type

Smaller business use of different finance products can reflect changes in the economic outlook. Figure B.22 illustrates how finance use has changed over time.

Credit card financing continued to be the most popular finance type in 2024, although usage declined slightly from 15% of smaller businesses in Q1 to 13% in Q3. This represented a continued fall from its peak of 20% in Q3 2023. Bank overdrafts were the second most popular form of finance for much of this period, also experiencing a decline in usage throughout 2024, falling from 14% in Q1 to 9% in Q3. More broadly, these changes over the course of the year appear to indicate a gradual shift away from short-term, higher-interest products, possibly reflecting the aforementioned rise in the number of smaller businesses that sought capital for growth purposes.

Bank loan usage was stable in 2024, reaching 10% in Q3, which made them the second most favoured finance type in that quarter. Their take-up is largely impacted by interest rates, which were reduced in August 2024 for the first time since the onset of the Covid-19 pandemic, thereby making them a more appealing option. Such preferences are potentially indicative of businesses opting for longer term finance options, supporting the notion of a more forward-looking mindset.

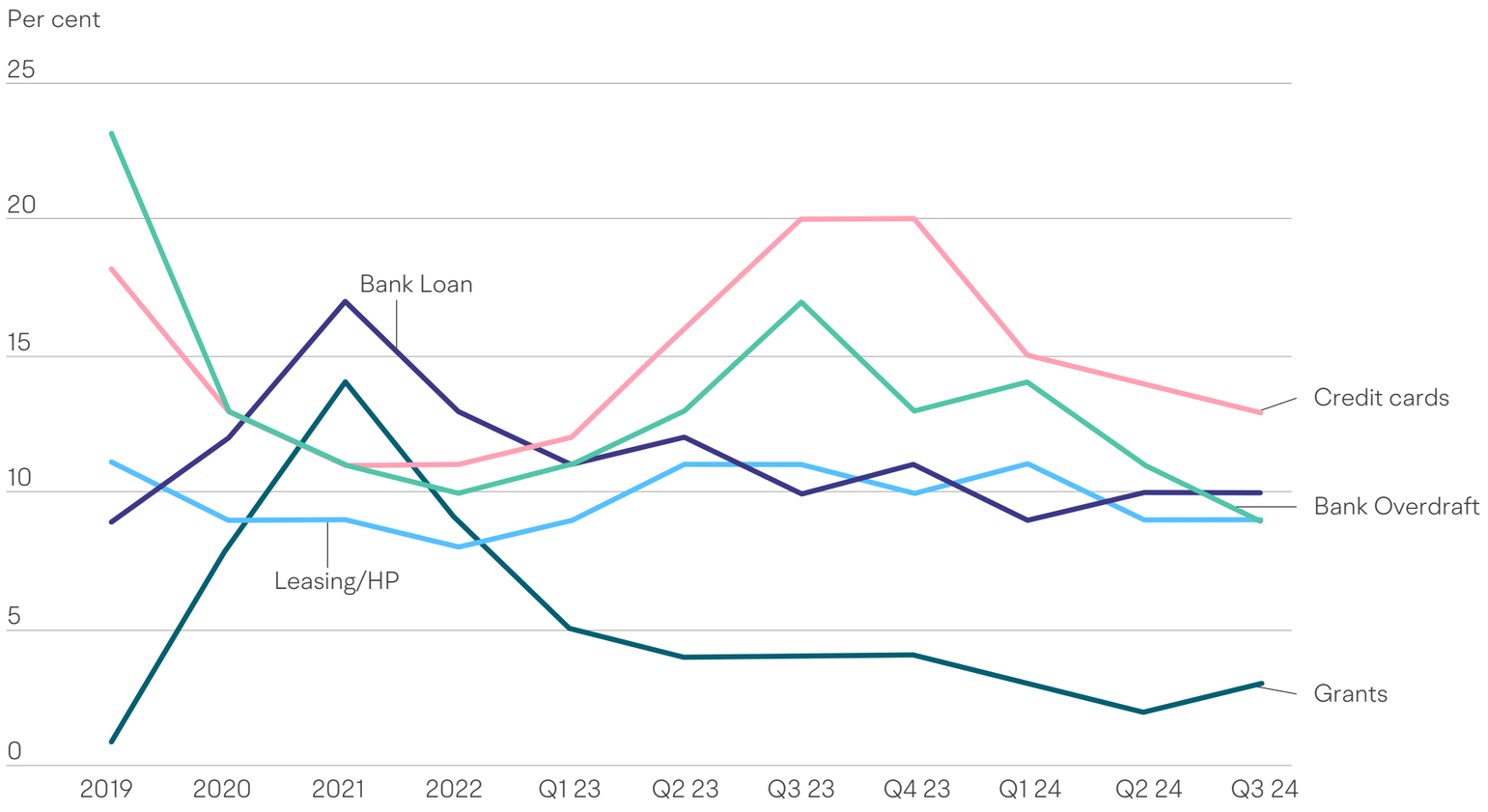
However, leasing and hire purchase arrangements, which are often used for investment in machinery, vehicles and premises were down slightly from Q3 2023 (11%). This likely reflected businesses postponing investment decisions whilst observing uncertainty and whether the Bank of England were likely to reduce Bank Rate during the year. Despite this, it remained the alternative finance type with both the highest level of awareness (83%) and usage (9%) among smaller businesses.[49,50]

Finally, the utilisation of grants was considerably lower, remaining subdued throughout 2024 and settling at 3% in Q3, in line with pre-pandemic usage rates. This followed a period of increased availability, awareness and subsequent usage during the pandemic, when it rose well above 10%.

Figure B.22

Small businesses' use of different finance types

Source: UK Finance BVA BDRC SME Finance Monitor



Willingness to use finance to grow fluctuated in 2024

The share of smaller businesses that expressed willingness to use finance to grow and develop fluctuated in 2024, falling from 38% in Q1 to 33% in Q2, before rebounding markedly to 41% in Q3 (figure B.23). Overall, this was up on 2023, when approximately 31% of firms demonstrated such willingness across the first three quarters of the year.

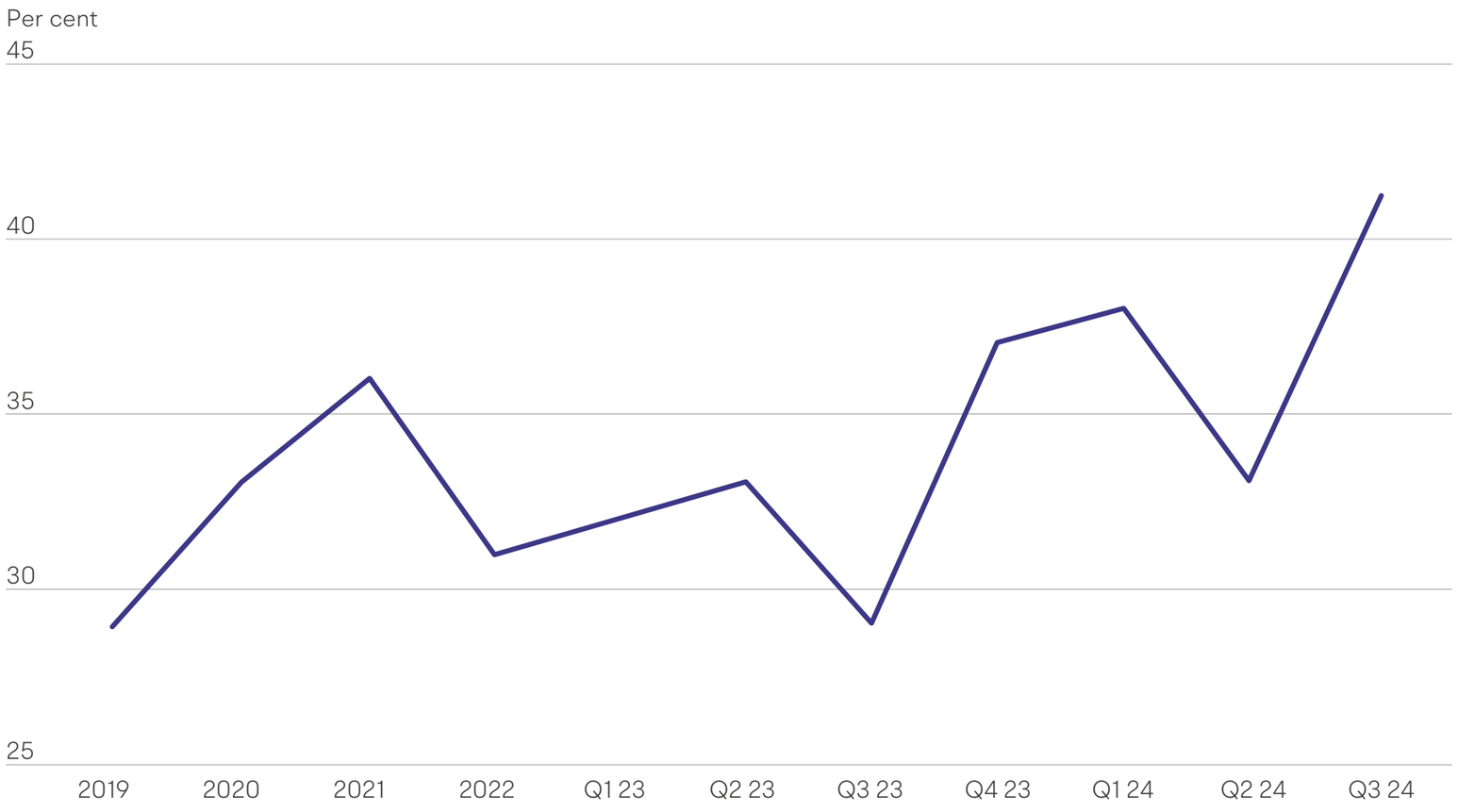
The pronounced increase that occurred in Q3 2024 may be partly attributed to inflation returning closer to the Bank of England target and a reduction in interest rates. The latter in particular may have induced greater optimism across the wider economy, with further potential cuts signalled at the time, improving the affordability of finance for smaller businesses. The share of firms with no employees that were happy to borrow to grow was up to 40% in Q3, its highest level since 2016, highlighting an increased willingness towards finance from the smallest businesses.[51]

An overarching openness towards using finance to support growth and development is also evident in the share of smaller businesses that are either prepared to

Figure B.23

Proportion of smaller businesses happy to use external finance to grow and develop

Source: UK Finance BVA BDRC SME Finance Monitor



take risks to become more successful or have a long-term ambition to be significantly bigger (figure B.24). The proportion of risk-takers rose by 4 percentage points, from 44% in H2 2023 to 48% in H1 2024. Those with long-term growth ambitions also increased by the same number of percentage points, from 40% in H2 2023 to 44% in H1 2024. Additionally, according to intermediaries, 75% of smaller businesses are looking to grow in the next 12 months.[52] As such, this may reveal an increased disposition towards finance, through its adoption as a tool to foster growth and ultimately enable businesses to fulfil their aspirations.

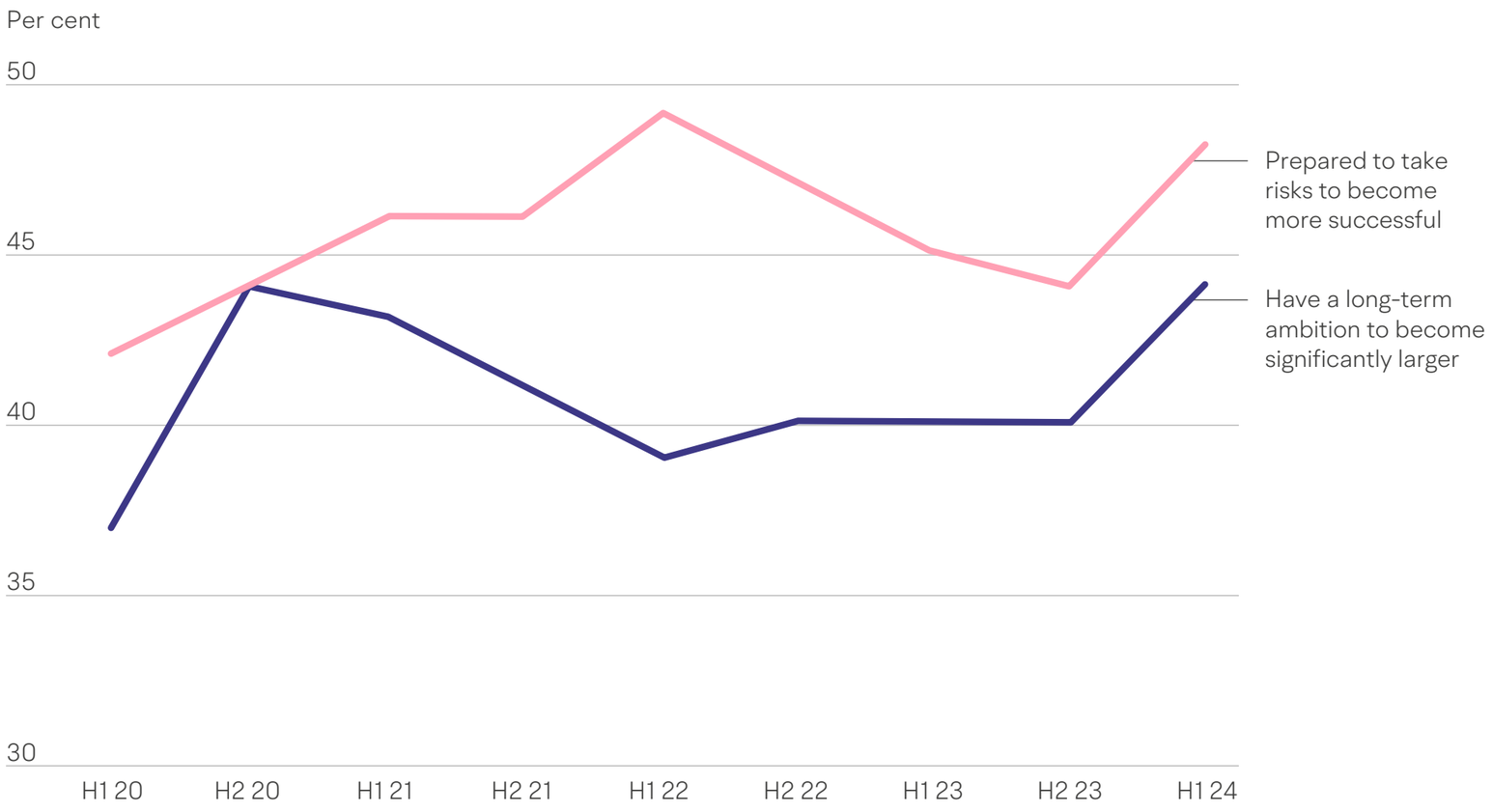
Businesses were more likely to consider just one provider

The Bank's Business Finance Survey provides information on the extent to which smaller businesses explore different finance providers when they have a finance need. Just under four in ten (38%) smaller businesses were considering more than one provider in 2024, marking a decline from last year when it was at 41% (figure B.25).

Figure B.24

Proportion of smaller businesses that are prepared to take risks to become more successful and have a long-term ambition to become significantly larger

Source: British Business Bank analysis of UK Finance BVA BDRC SME Finance Monitor, Q1 2020-Q2 2024



The proportion that considered a sole provider increased by 7 percentage points (from 51% to 58%). This could reflect the types of finance that businesses sought, as they may have been less inclined to shop around given that credit cards and overdrafts remained the most used finance types, with these typically obtained from the main bank providing current account facilities.

Another explanation may lie in the declining share of smaller businesses that reported confidence in obtaining information on the types of finance and specific providers available to them, which fell from 60% in 2023 to 57% in 2024.[53]

Smaller businesses that are willing to use finance to grow their business, or for working capital and to help manage their cash flow, may not be aware of all the finance options and/or the range of finance providers available. The Bank's 2024 survey of intermediary contacts highlighted smaller businesses' lack of awareness as the most significant barrier to their demand for finance (with 69% of responding intermediaries highlighting this).[54]

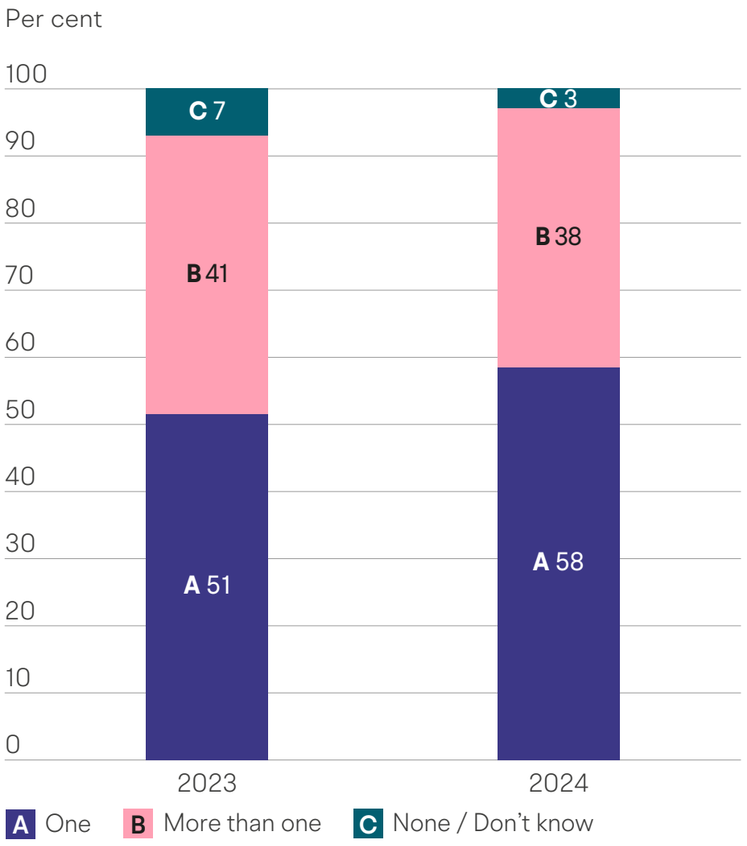
Reducing the information barriers that businesses face when considering their finance options and going on to apply, remains a key priority for the Bank. The Bank's Finance Hub and business guidance pages provide information on finance options that enable smaller businesses to connect to finance providers.

The Bank's UK Network team continues to engage across the UK with partners and intermediaries to raise awareness, increase understanding of finance options and generally improve the finance readiness of smaller businesses. Addressing information barriers improves the match between smaller businesses, their finance options and providers in the market, increasing the take up of finance amongst these businesses and generating additional turnover, GVA and jobs growth.

Figure B.25

Number of finance providers considered

Source: British Business Bank 2024 Business Finance Survey – Ipsos. Base sizes vary by year



Diversity, equity and inclusion and environmental sustainability for smaller businesses

– 2.3 Access to finance for underrepresented groups

– 2.4 Regional access to finance

– 2.5 Finance for environmental sustainability

2.3

Access to finance for underrepresented groups

Ethnic Minority-led businesses are more willing to use finance to grow but more likely to be discouraged from applying

Information barriers are more likely to be cited by underrepresented entrepreneurs

Usage of finance varies considerably between different underrepresented entrepreneur groups

Improving access to finance would unlock business growth for underrepresented entrepreneurs

This section looks at access to finance for businesses led by underrepresented groups: women, Ethnic Minorities and, where data is available, disabled entrepreneurs. In 2024, the British Business Bank's Business Finance Survey included a question on the socio-economic background of smaller businesses' leadership, with those results reported in more detail in Box 1.

Estimates of the share of the UK business population that are women-led or Ethnic Minority-led vary, reflecting several surveys that ask about gender and ethnicity of business ownership. According to various business surveys, women-led businesses make up between 17% and 30% of the UK's small business population.[55] Ethnic Minority-led businesses account for between 6% and 11% of the UK business population.[56] Where base sizes allow, results have been reported for broad ethnic groups given the different challenges faced by these businesses.

According to the Bank's Business Finance Survey, businesses led by those with a disability constitute 7% of the business population, while businesses led by those from a lower socio-economic background represent 19% of the business population.[57]

Ethnic Minority-led businesses are more willing to use finance to grow but more likely to anticipate difficulties in accessing finance

Ethnic Minority-led businesses continue to be more ambitious with their growth plans and more willing to use finance to help them achieve that growth. Over two thirds (67%) have a long-term ambition to be significantly bigger, well over the corresponding 38% for White-led businesses. 45% of Ethnic Minority-led businesses are willing to use external finance to help their business grow, much higher than the 31% of White-led businesses reporting the same. However, 43% agreed it would be difficult for them to get finance, substantially higher than White-led businesses, with businesses led by those identifying as Black most likely to say this (59%). Results for broad ethnic groups are shown in figure B.31.

When it comes to differences by gender, there is less of a disparity regarding attitudes to finance. While fewer female-led businesses agreed they would be happy to use finance to grow their business, there were no significant differences in their business ambitions or perceptions of ease of getting finance relative to male-led businesses.[58]

Likely related to these perceptions and attitudes, in 2023, 17% of Ethnic Minority-led businesses identified a need for finance but something stopped them from applying, more than double the rate of White-led businesses (figure B.32).[59] Discouragement amongst Ethnic Minority-led businesses has been higher since 2014, indicating a long term, structural issue.[60] Similarly, according to the SME Finance Monitor, double the share of Ethnic Minority-led businesses were 'would-be seekers', i.e. wanted to apply but something stopped them, (6%) compared to White-led businesses (3%) in the 10 quarters to Q2 2024. This is driven by Asian-led and Black-led businesses at 8% and 7% respectively.[61] As it relates to gender, a similar outcome is observed to a lesser extent, as more than one in 10 women-led businesses identified a need for finance but didn't apply, higher than the 7% of male-led businesses reporting the same.

Figure B.31

Smaller businesses' attitudes to growth and external finance

Source: British Business Bank analysis of UK Finance BVA BDRC SME Finance Monitor, 10 quarters to Q2 2024

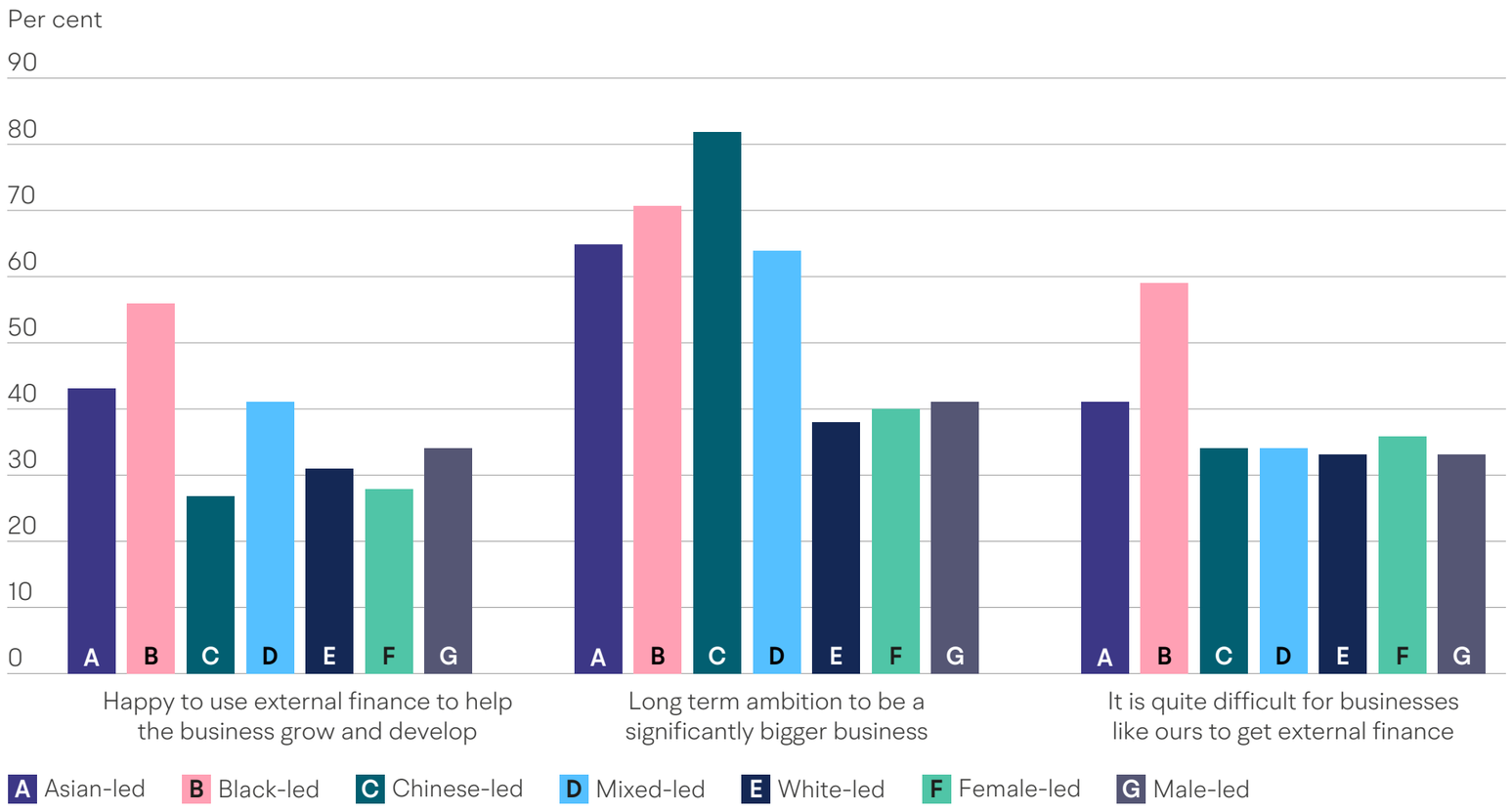
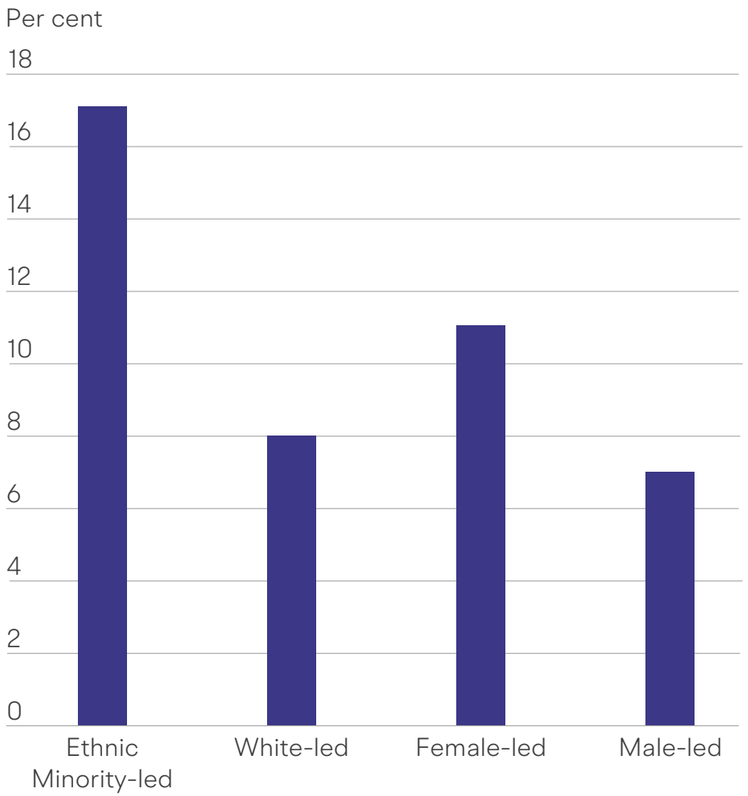


Figure B.32

Share of smaller businesses reporting a need for finance but not applying

Source: British Business Bank analysis of DBT Longitudinal Small Business Survey 2023



Information barriers are more likely to be cited by underrepresented entrepreneurs

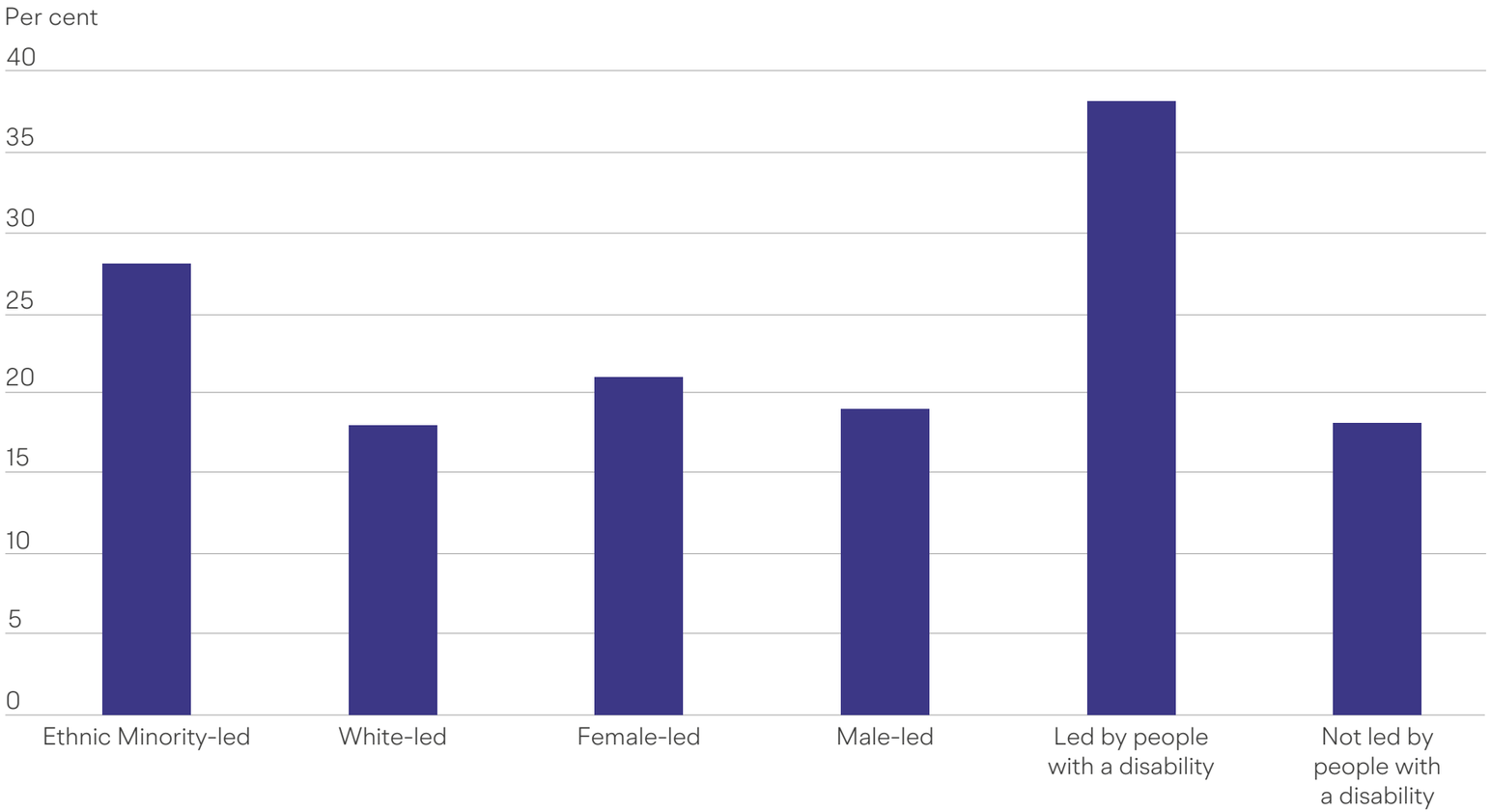
The most frequently mentioned barriers to applying across all smaller businesses are risk, expense, economic conditions and likelihood of rejection. However, Ethnic Minority and female-led businesses are much more likely to cite barriers to applying related to information relative to White-led or male-led businesses respectively. Of those that needed finance but didn't apply, over half of Ethnic Minority-led businesses (56%) didn't apply because they didn't know where to find appropriate finance, significantly higher than the 36% of White-led businesses reporting the same. This is consistent with data in 2020 and 2022.[62]

Almost a third of women-led businesses that needed finance but didn't apply said bank forms and documentation had put them off, at 31% compared to 20% of male-led businesses. Women-led businesses were also more likely to report their main reason for not applying was not knowing where to find appropriate finance or finding bank forms off-putting (6% for each, compared to 1% and 0% of male-led businesses respectively).[63] Taken together, the data continues to indicate persistent issues with information barriers for these groups.

Figure B.33

Share of smaller businesses not confident in knowing where to obtain information on finance types and providers

Source: British Business Bank analysis of the 2024 Business Finance Survey – Ipsos



Information barriers are not limited to those who need finance and/or want to apply but don't. Across the wider smaller business population, the Bank's Business Finance Survey found that underrepresented entrepreneurs are less confident in obtaining information on finance types and providers available (figure B.33). Differences are significant for Ethnic Minority-led businesses, businesses led by those with a disability and those from lower socio-economic backgrounds (discussed more in Box 1), relative to their counterparts.

Levels of awareness of different types of finance, which may be more suited to particular types of business or activities, also differ by business owner characteristics according to the Bank's Finance Survey. For example, female-led businesses are less aware of business angels and invoice finance (35% and 50%, compared to 42% and 61% respectively for male-led businesses), while Ethnic Minority-led businesses are markedly less aware of leasing or hire purchase (71%, compared to 85% amongst White-led businesses).[64] Businesses led by those from a lower socio-economic background were much less aware of almost all the alternative finance types asked about.[65] This could limit their ability to find a product and/or provider that is suited to their business and their entrepreneurial ambitions.

Usage of finance and approval varies between different underrepresented entrepreneur groups

Despite higher discouragement, Ethnic Minority-led businesses are equally as likely to be using some form of external finance as White-led businesses (42% in the 10 quarters to Q2 2024, compared to 44% of White-led businesses). However, female-led businesses are significantly less likely to be using finance, at 38% over the same period, compared to 43% of male-led businesses.[66]

The types of finance used also varies. Ethnic Minority-led businesses are more likely to use loans from directors/friends/family (14%) than white-led businesses (6%).[67] Furthermore, Ethnic Minority-led businesses are almost twice as likely to have applied for or sought government-backed loans over the past three years compared to White-led businesses, at 19% and 10% respectively.[68] There are no finance types that female-led businesses are more likely to use than male-led businesses, but they are less likely to be using core debt products (bank loans, overdrafts and credit cards) at 23% vs 29% and less likely to be using leasing/hire purchase (5% vs 10%) than male-led businesses.

Unlike Ethnic Minority or female-led businesses, those led by people with a disability are significantly more likely to seek finance. Businesses led by people with a disability sought nearly double the amount of government-backed finance (loans and grants) over the past three years (23% compared to 13%), as well as being more likely to seek non-government-backed finance more broadly (27% compared to 17%).[69]

According to UK Finance data from Investing in Women Code (IWC) signatories, there is no significant difference between application approval rates for all-female, all-male and mixed gender teams, and this is supported by SME Finance Monitor data on application outcomes.[70] However, average approved facility size for women-led businesses was half that of male-led businesses, £104k compared to £198k.[71] Unfortunately, we do not have data to assess whether female-led businesses are applying for lower amounts or being only approved for these lower amounts.

Ethnic Minority-led businesses applying for bank loans were significantly more likely to have been turned down, at 49% compared to 32% of White-led businesses.[72] Looking at the data on self-reported reasons for rejection, this appears to have been driven by credit rating issues, albeit on very low base sizes, possibly signalling a need for further support.[73]

Nonetheless, progress has been made in certain areas of the market, with Community Development Financial Institutions (CDFIs) being particularly effective at lending to underrepresented groups. In 2023, 41% of enterprise lending, whether to start ups or smaller businesses, went to women entrepreneurs and 24% to Black, Asian and other Ethnic Minority entrepreneurs. This is well above the share of the business population those groups account for. A large share of this was driven by lending through the Bank's Start Up Loans programme.[74]

Improving access to finance would unlock business growth for underrepresented entrepreneurs

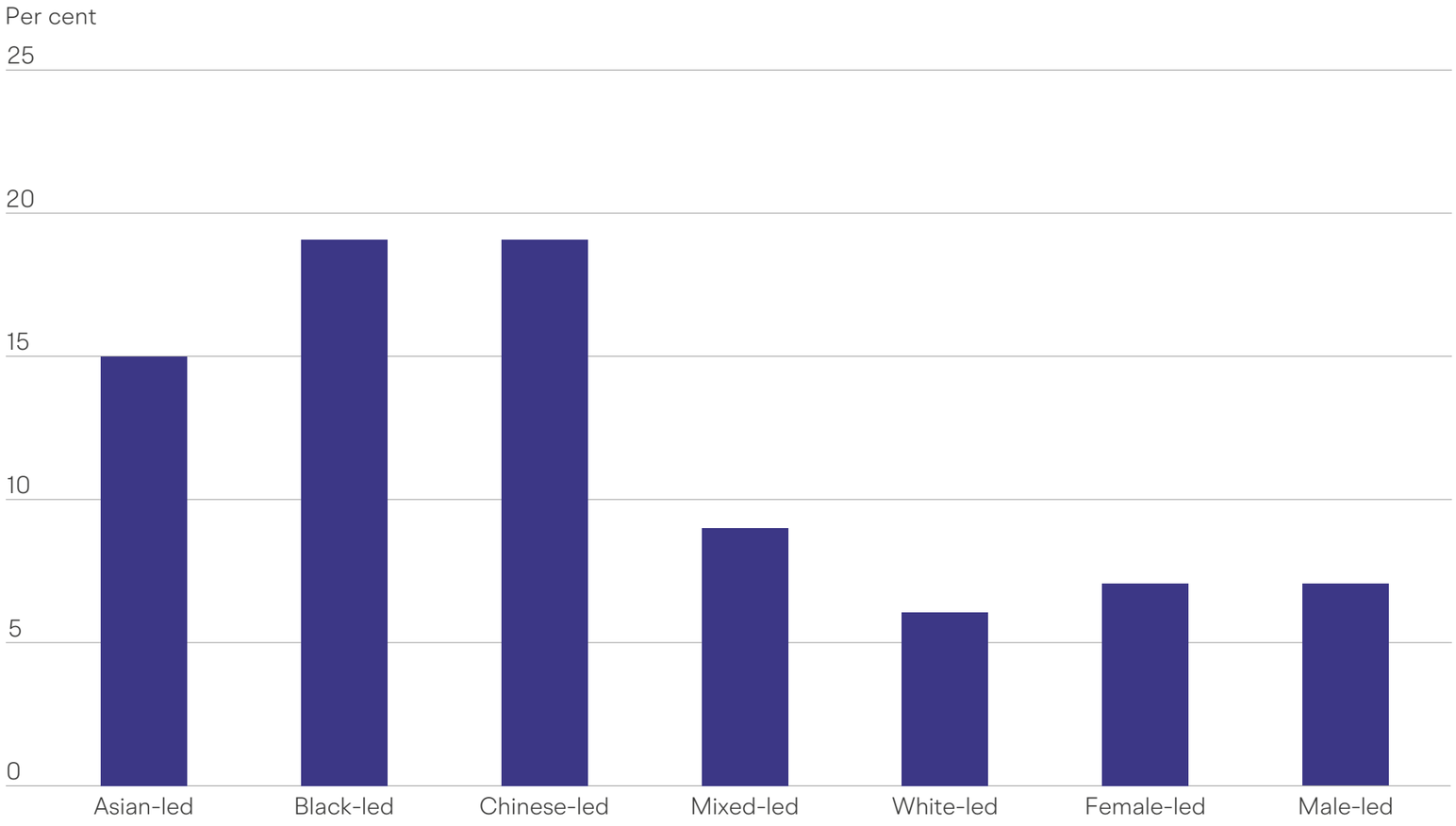
Businesses that use external finance are more likely to grow, both in terms of turnover and employment.[75] Improving access to external finance for underrepresented groups could help unlock business growth and development.

More than twice as many Ethnic Minority-led businesses see access to finance as a major obstacle to running their business as they'd like, compared to White-led businesses (15% compared to 6%). This perception is

Figure B.34

Access to finance is a major barrier to their business

Source: British Business Bank analysis of UK Finance BVA BDRC SME Finance Monitor, 10 quarters to Q2 2024



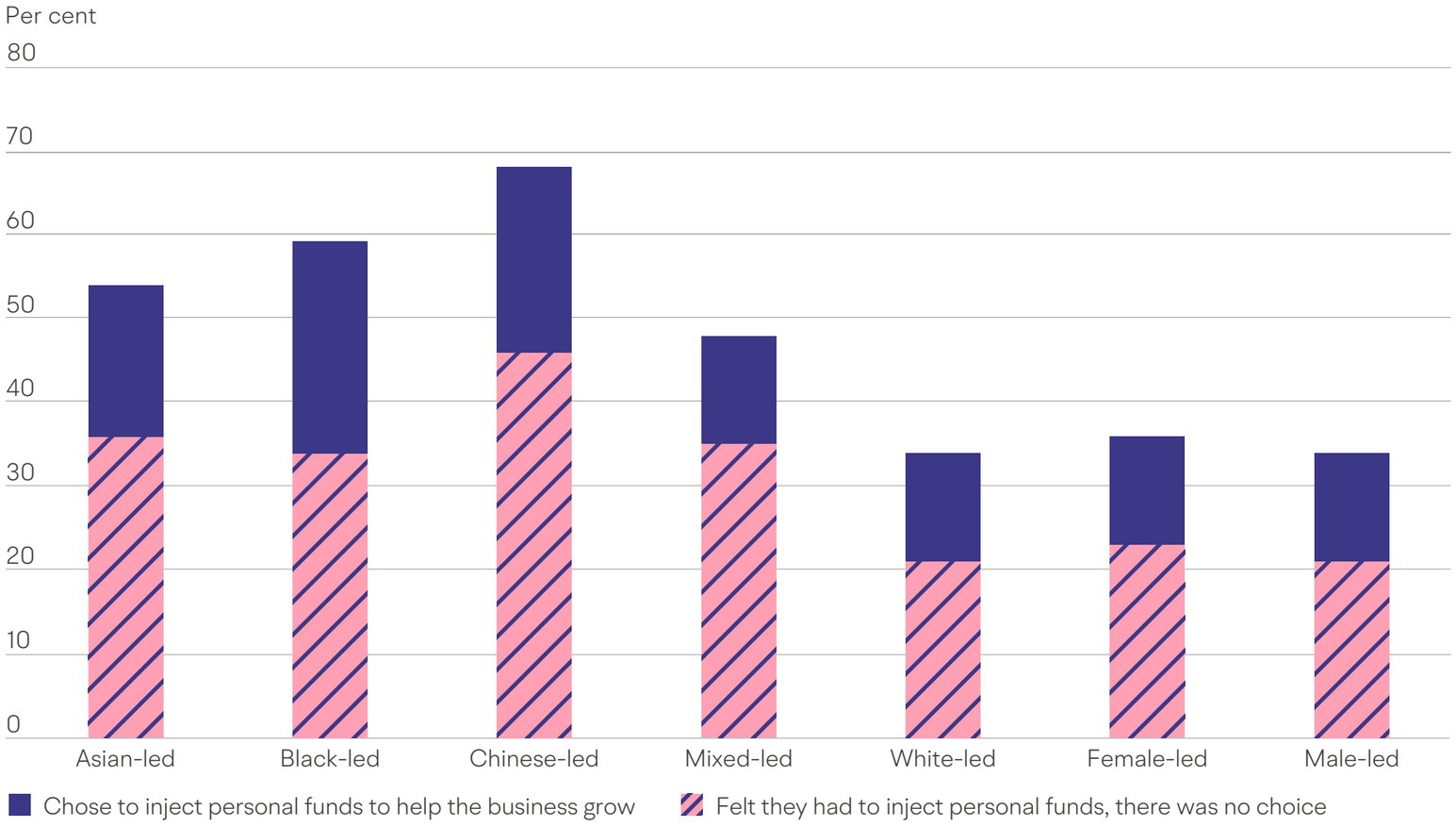
particularly high amongst Black-led businesses and Asian-led businesses (figure B.34).

The implications of not being able to acquire finance have been explored in previous British Business Bank research.[76] Those unable to secure finance may substitute by using their own personal funds in the business. Ethnic Minority-led businesses are significantly more likely to have injected personal funds into their business (54%, compared to 34% of White-led businesses), and significantly more likely to have felt they had to do so, as opposed to having a choice (36% compared to 21%). Results by ethnic group are shown in figure B.35, with no significant differences by gender of business leadership. This could present a particular constraint for those from low income or wealth backgrounds, correlated with identifying as an Ethnic Minority entrepreneur.[77] Businesses led by those with a disability are three times more likely to have used personal funds from their owners or directors, at 16% compared to 5% of those not led by people with a disability.[78]

Figure B.35

Share of smaller businesses injecting personal funds, whether they felt it was a choice or they had to

Source: British Business Bank analysis of UK Finance BVA BDRC SME Finance Monitor, 10 quarters to Q2 2024



Looking ahead, businesses led by those from underrepresented groups are more likely to consider applying for finance in the next 12 months (as at Q4 2024). A third (34%) of Ethnic Minority-led businesses, a quarter (26%) of businesses led by those with a disability and 22% of businesses led by those from a lower socio-economic background were considering applying (see Box 1).[79] Given the appetite for finance amongst these groups combined with their growth ambitions, finance products and providers with reach across these networks could unlock considerable growth and economic potential.

In addition to growth, improving diversity and inclusion is also significantly more important to businesses led by those from underrepresented groups. Over half (57%) of Ethnic Minority-led businesses and almost half (47%) of businesses led by those from lower socio-economic backgrounds see this as a high priority, indicating that better serving these businesses could also have positive impacts in terms of their employees, leadership and suppliers.[80]

Improving access to finance for communities across the UK to unlock potential for growth is a high priority for the British Business Bank, which we are seeking to address through a range of interventions. Increasing capital available to a broad group of investors is key to widening access to finance for entrepreneurs from communities across the UK. We have committed £50m to support female fund managers in the UK, in addition to capital from our existing programmes, and in line with the aims of the Invest in Women Taskforce. The Bank has established a majority female 'Invest in Women Committee' to advise on how this capital is allocated, giving increased focus and support to bring these opportunities forward. We are also supporting the angel community through assistance in the establishment of diverse angel syndicates in order to broaden the pool of angel investors allocating capital to early-stage businesses in the UK.

The UK's Community Development Finance Institutions (CDFIs) are key to supporting a diverse range of business owners with debt finance, and the Bank is supporting them through our Start Up Loans programme, and our new Community Enable Funding programme which is providing wholesale finance to CDFIs to help them to significantly scale their lending. Our partnership with Responsible Finance and the JPMorgan Chase Foundation is helping to get CDFIs access to grant funding to scale their operations to be able to more quickly absorb increased wholesale capital, creating a step change in the scale of the sector and the impact it can deliver.

The Bank will continue to enhance our approach to data in order to track and monitor our impact for a range of different communities, giving us the critical information required to continue improving our long-term impact.

Box 1: New data on business leaders' socio-economic backgrounds

Successful businesses are founded and led by a hugely diverse set of people. Reaching and sustaining business success is challenging for anyone; however, we know from prior research that entrepreneurs with certain characteristics can face additional challenges in achieving their goals.[81]

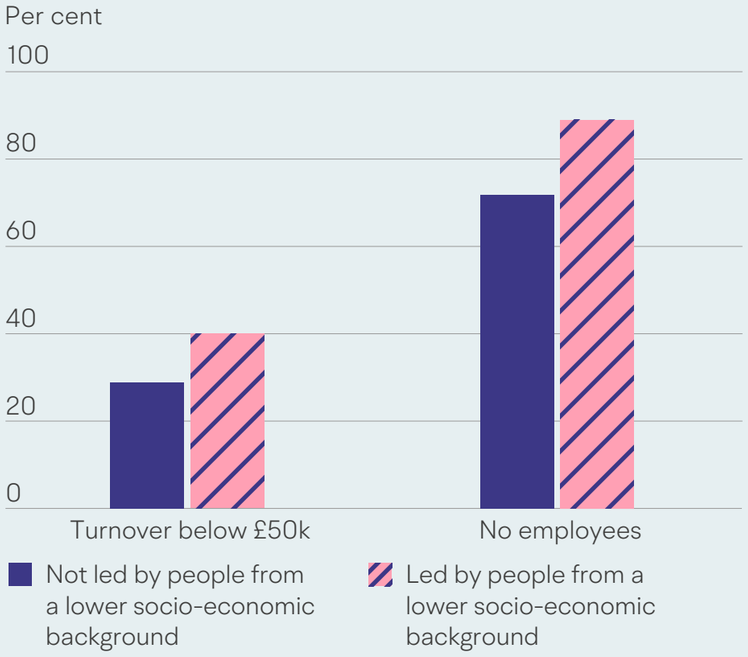
In recent years we have expanded our efforts to understand these challenges through collecting data on the gender, ethnicity and disability status of business leaders. For this year's report we have also collected data on the socio-economic backgrounds of business leaders for the first time.

Across our Business Finance Survey of around 1,600 smaller businesses, 19% reported that they were led by people with lower socio-economic backgrounds. These businesses tend to be slightly smaller, in both employment and turnover terms, than those not owned by individuals from a lower socio-economic background (figure 1).

Figure 1

Measures of business size by socio-economic background of business leadership

Source: British Business Bank analysis of the 2024 Business Finance Survey



Our data also show differences in broad sector. Businesses led by those with lower socio-economic backgrounds are more likely to be in 'other services', which consists of education, health, social work, arts, entertainment, recreation and other service activities. They are less likely to be in 'business services' which consists of information and communication, finance, insurance, real estate, professional, scientific and technical activities and administrative and support service activities.[82]

The group of businesses led by those with lower socio-economic backgrounds shows some significant correlations with other groups. Around 20% are also Ethnic Minority-led compared to just 7% of businesses not led by those with lower socio-economic backgrounds. Similarly, 11% of businesses led by those with lower socio-economic backgrounds are led by people with disabilities compared to 6% of other businesses.

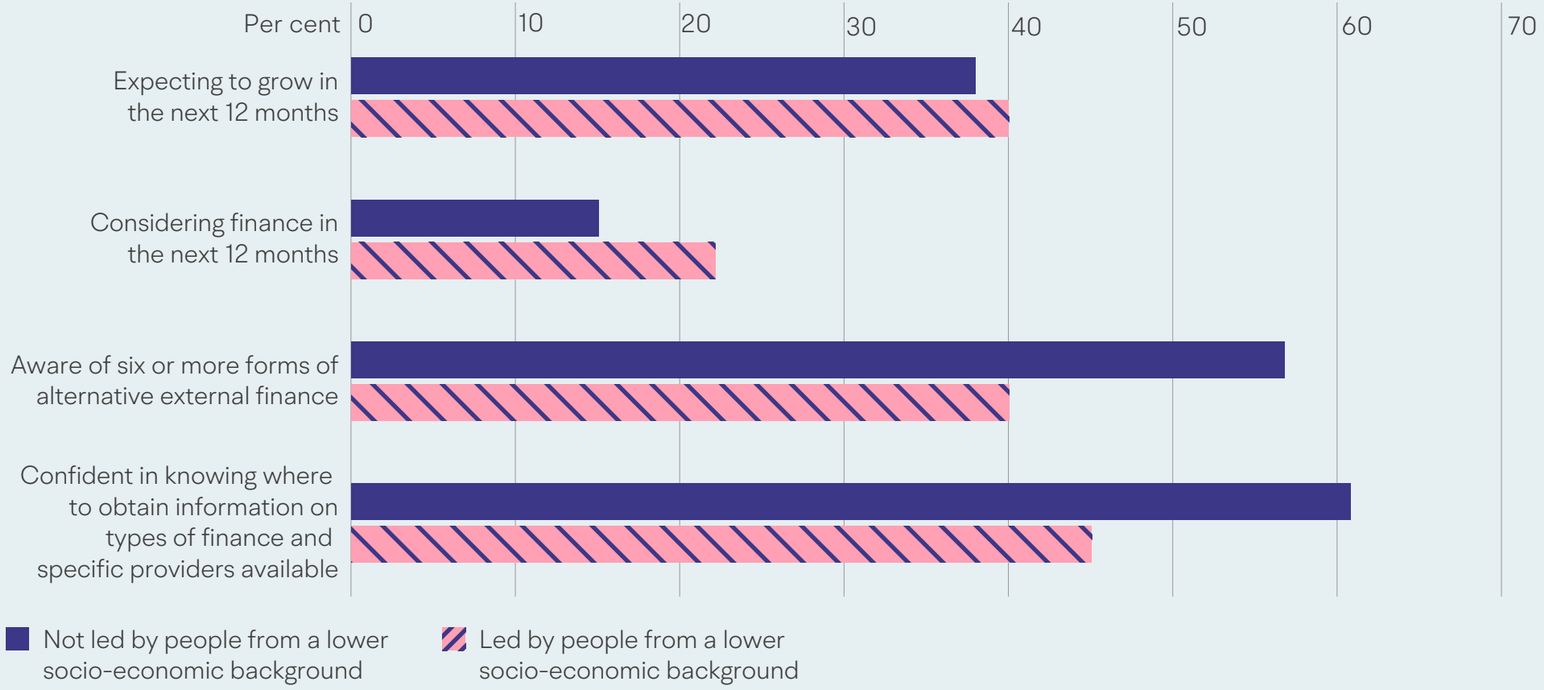
We also see a positive correlation between businesses led by those with lower socio-economic backgrounds and businesses based in more deprived locations. 39% of businesses run by those with lower socio-economic backgrounds are based in locations in the two most deprived quintiles compared to 28% of other businesses. One area of contrast is female-led businesses, however. Just 19% of businesses led by those with lower socio-economic backgrounds are also female-led compared to 33% of other businesses.

Understanding the relative presence of overlaps between lower socio-economic backgrounds and other characteristics is important as it highlights areas of intersectionality, where challenges may be even more acute. Quantifying overlaps also guards against inaccurate assumptions. For example, despite the correlations discussed above, it is still the case that most businesses led by individuals from lower socio-economic backgrounds are not in deprived locations. Likewise, the majority of Ethnic Minority-led businesses and those led by people with disabilities have leadership teams that are not from lower socio-economic backgrounds.[83]

Figure 2

Growth expectations, finance intentions, financial awareness and financial information confidence by socio-economic background of business leadership

Source: British Business Bank analysis of the 2024 Business Finance Survey



Looking again at the whole group of businesses led by those with lower socio-economic backgrounds, around 40% expect to grow in the year ahead which is comparable to the 38% of other businesses who expect growth. Despite comparable growth expectations, businesses led by those with lower socio-economic backgrounds are significantly more likely to be considering finance in the year ahead (22% compared to 15%). Alongside this, however, they also display lower current financial awareness levels and lower confidence that they know where to obtain information on the types of finance and specific providers available (figure 2).

In terms of finance applications, data covering the last three years suggest that 29% of businesses led by people with lower socio-economic backgrounds sought some form of external finance over the period. This proportion is comparable to other businesses; however, our survey sample size does not allow us to reliably analyse the outcomes of these applications. Similarly, we do not have enough data to judge whether businesses led by those with lower socio-economic backgrounds are more or less likely to be discouraged from making a finance application, perhaps as a result of their lower levels of confidence in obtaining finance information.

These evidence gaps mean we will continue to include questions on socio-economic background alongside other business characteristics in our own survey. Collecting data on socio-economic background is increasingly on the agenda in the finance ecosystem and the Bank intends to support this initiative further.[84] Alongside continued research, the Bank will continue to provide a wealth of financial information through our Finance Hub to help businesses of all characteristics understand their finance options.

2.4

Regional access to finance

Access to finance is vital for companies with the highest potential to drive regional growth and investment, including innovative smaller businesses

Highly deprived areas are home to ambitious entrepreneurs who could benefit from external finance, but barriers like low awareness hold them back

The majority of Nations and regions saw a decline in finance use in 2024

Use of credit cards and grants declined throughout the UK in 2024

Half of the UK's Nations and regions are seeing growth in the value of equity deals in 2024, despite challenging market conditions

Ensuring that businesses across the UK benefit from access to external finance is crucial to supporting business investment, resilience and productivity in the overall economy. However, the location of a business often determines its ability to access a diverse set of finance options.

This section provides new analysis on smaller businesses' access to finance patterns across the UK Nations and regions, building on our latest Nations and Regions Tracker annual publication and previous Bank analysis of the place-based challenges that shape regional finance ecosystems. The analysis draws on multiple datasets that can be disaggregated down to the regional level, including BVA BDRC's quarterly SME Finance Monitor Survey (available up to Q2 2024) and the Bank's annual Business Finance Survey (undertaken in Q4 2024).

Access to finance is vital for companies with the highest potential to drive regional growth and investment, including innovative smaller businesses

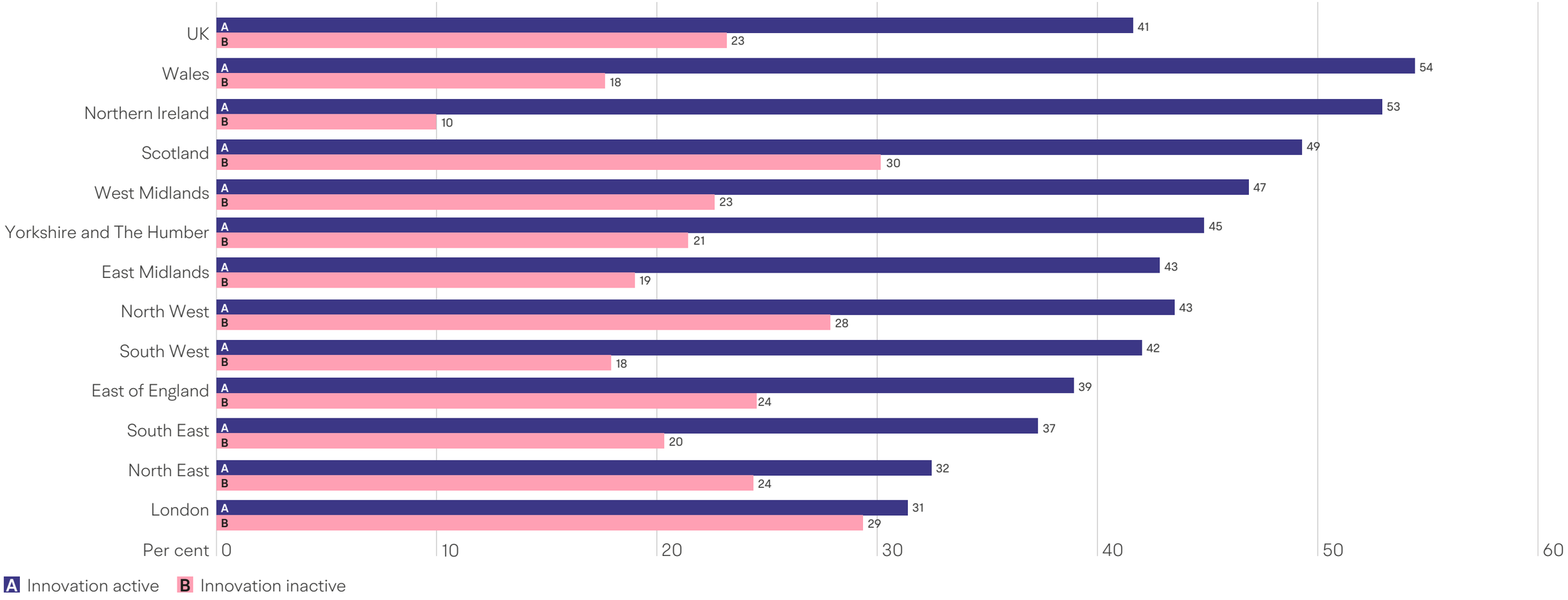
Chapter 1.1 has outlined the historical underperformance of Nations and regions outside of London and the South East on business investment levels and productivity. This is directly connected to the issue of place-based disparities in access to external finance, since these can exacerbate the barriers to productivity growth and investment experienced by businesses located in certain geographies.

Our evidence suggests that access to external finance is particularly important for those businesses that are most likely to play a part in fostering geographically balanced growth and investment across the UK. This includes, among others, businesses that export their products and services or undertake research and development. For instance, figure B.41 illustrates that in 2024, innovation-active smaller businesses were consistently more likely than other businesses to have considered, sought or applied for external finance in the last three years across most UK Nations and regions. All other things equal, these businesses were on average almost twice as likely to report this than their innovation-inactive counterparts.

Figure B.41

Smaller businesses that have engaged with external finance in the last three years, by Nation and region and innovation activity, 2024

Source: British Business Bank analysis of British Business Bank Business Finance Survey



Highly deprived areas are home to ambitious entrepreneurs who could benefit from external finance, but barriers like low awareness hold them back

Previous Bank analysis has considered the access to finance barriers experienced by smaller businesses in localities affected by complex socio-economic challenges. This includes highly deprived areas, which are found throughout the UK and are home to around half a million smaller businesses.[85,86] With the help of additional SME Finance Monitor data linking to markers of high deprivation, we present below some updated data insights on this issue, including breakdowns for the UK Nations and regions where possible.

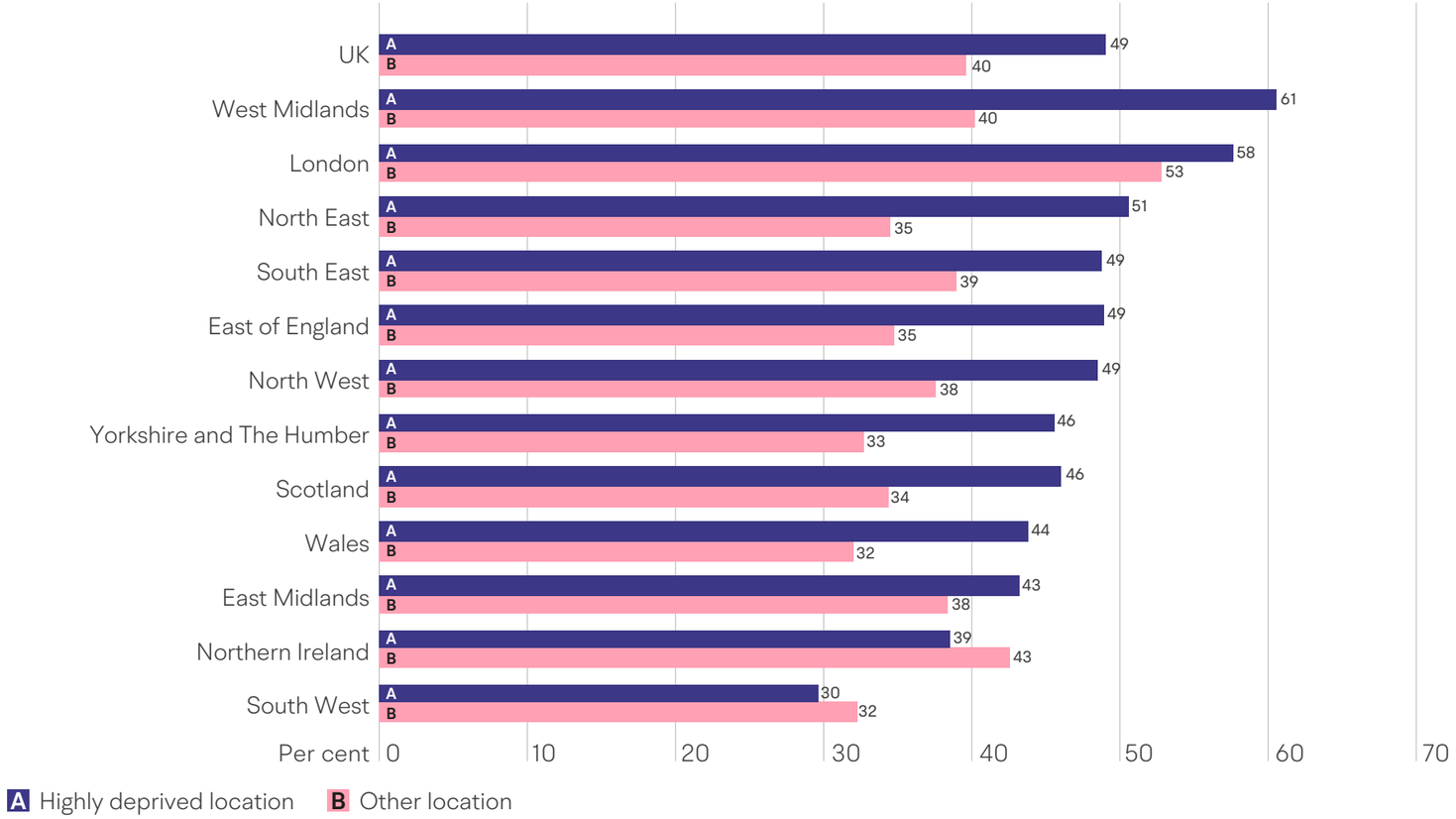
One aspect we're able to examine is businesses' propensity to pursue ambitious growth plans as well as to consider using external finance to achieve this objective, drawing comparisons between those located in highly deprived areas and those located elsewhere.

Figure B.42 presents this data, which suggests that a larger share of smaller businesses in highly deprived areas (49%) report having an ambition to grow significantly than their counterparts from less deprived

Figure B.42

Smaller businesses with a long-term ambition to be significantly bigger, by Nation and region and local deprivation status (Q1 2022-Q2 2024 average)

Source: British Business Bank analysis of UK Finance BVA BDRC SME Finance Monitor



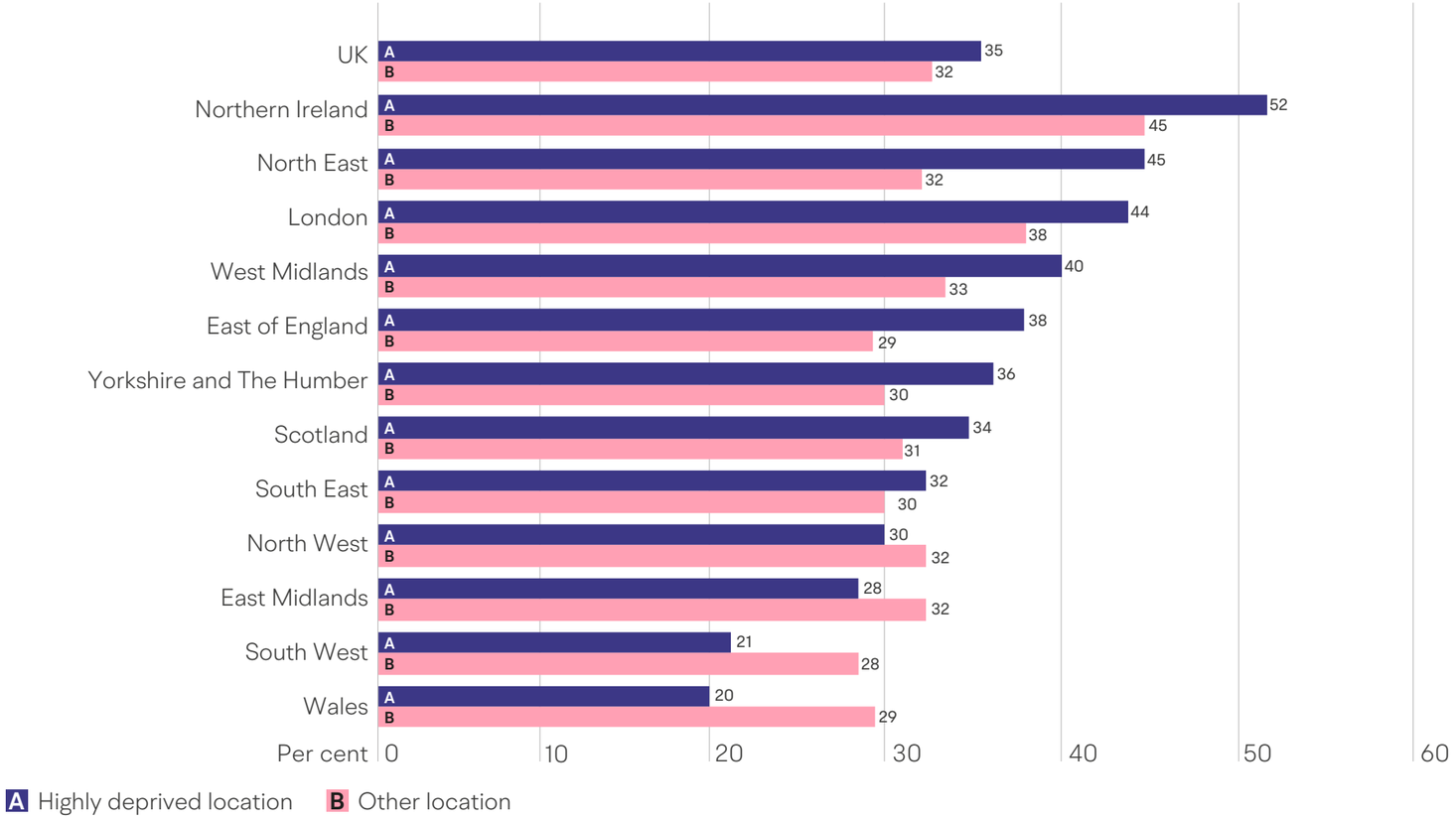
areas (40%), and this is replicated across all Nations and regions except the South West and Northern Ireland, where the particularly small sample sizes may affect the results. Similarly, 49% of businesses in highly deprived areas of the UK said they were prepared to take risks to be successful, which compares well to the 45% recorded for the comparator group.[87]

Meanwhile, figure B.43 shows that these businesses are also more inclined to report they would be happy to use external finance in order to grow, with 35% reporting this overall (compared to 32% of businesses in less deprived areas). This is consistent across the UK with very few exceptions. These results align with our previous analysis of the issue, which highlighted how these areas are home to several businesses with large appetite for growing and investing and an interest in using external finance for these purposes.

Figure B.43

Smaller businesses that are happy to use external finance to grow, by Nation and region and local deprivation status (Q1 2022-Q2 2024 average)

Source: British Business Bank analysis of UK Finance BVA BDRC SME Finance Monitor



What our previous analysis also indicated is that the high appetite for finance reported by smaller businesses in highly deprived areas often comes with evidence of increased barriers in securing this finance compared to their peers based elsewhere. This is confirmed by our updated analysis, which suggests that challenges remain within the business communities located in those areas, both from the perspective of financial planning capabilities and general awareness of finance options.

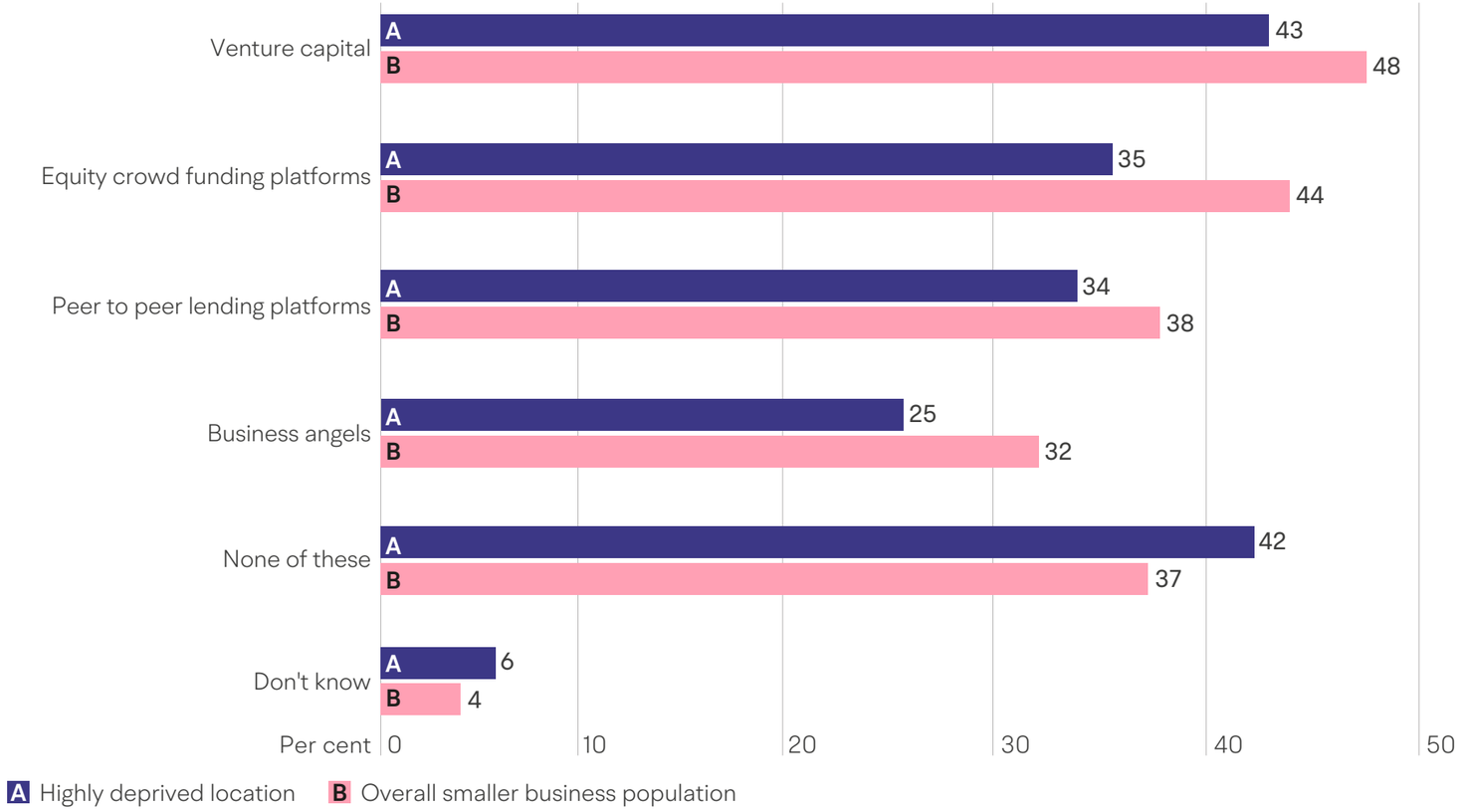
For instance, smaller businesses in highly deprived areas are generally less confident in their ability to get finance from their main bank, with 47% reporting confidence in a successful outcome versus 51% elsewhere, and more likely to see access to finance as an obstacle (9% compared to 7% elsewhere).[88]

Additionally, these businesses demonstrate lower awareness of finance options, as indicated by the smaller proportion of businesses reporting they are aware of established non-core finance types such as venture capital and business angels (figure B.44).

Figure B.44

Smaller businesses' awareness of selected alternative finance types, by local deprivation status (Q1 2022-Q2 2024 average)

Source: British Business Bank analysis of UK Finance BVA BDRC SME Finance Monitor



The majority of Nations and regions saw a decline in finance use in 2024

Chapter 2.2 has illustrated the overall fall in the share of UK smaller businesses using external finance in the first few quarters of 2024, which marks a notable shift from the growing trend observed through most of 2023. Data from the last two half years available shows a slight decline in this share, from 50% in the second half of 2023 (H2 2023) to 46% in the first half of last year (H1 2024). Despite this downturn, it is important to highlight that it occurred against a backdrop of increased finance usage rates on a year-on-year basis. The most recent four quarters of data (Q3 2023 to Q2 2024) still reflect a higher average proportion of UK smaller businesses using finance (48%) compared to the preceding four quarters (38%) in every UK Nation and region.

At the regional level, the picture was more mixed in H1 2024 compared to H2 2023 (figure B.45). The North West was one of only three regions – alongside the East of England and Yorkshire and the Humber – to see an increased use of finance, recording the highest share of smaller businesses using finance (55%) as well as the largest uptick in this indicator from H2 2023 (8 ppts). Many of the UK Nations and regions, including London, Northern Ireland, the West Midlands and Wales, had seen a recovery in this indicator in the first half of 2023, which came after a prolonged period of decline in finance use in 2022. However, since then, these regions have shown a relatively stable trend that continued into the first half of 2024.

In contrast, Scotland (-18 ppts), the North East (-16 ppts), and the East Midlands (-18 ppts) have recorded significant dips in finance usage in the first half of 2024. This also correlated with a marked increase in the proportion of permanent non-borrowers, which rose to 35% in all three Nations and regions in H1 2024, from 26%, 23% and 28% respectively in H2 2023 (in line with the UK trend over the same period). Notably, all three had previously recorded considerable spikes in external finance usage in the latter half of 2023, suggesting that the current trend may partly reflect a natural adjustment to more normalised levels of external finance use. The North East and East Midlands recorded falling usage rates predominantly in core forms of finance (bank overdrafts, loans and credit cards). In Scotland, on the other hand, the most substantial declines occurred among non-core external finance types.

Reductions in finance usage rates were also observed, albeit to a slightly lesser degree, in the South East (-11 ppts) and the South West (-5 ppts) of England over the same period.

Taken together, the trends reflect a challenging finance landscape for smaller businesses in the first half of 2024, although the small regional sample sizes mean that a comprehensive assessment of trends across the UK can only be conducted once the full year data becomes available.

On a more encouraging note, the share of smaller businesses who remain happy to use external finance to grow increased overall, and did not decline as sharply as finance usage rates across the UK during this period (figure B.46). All UK Nations and regions but the East Midlands and Northern Ireland have generally either maintained or even increased their share of smaller businesses reporting they would be happy to access external finance in order to grow over the latest two half years of data. While regional data was not yet available for Q3 2024 at the time of writing, the UK-level data suggests it continued to rise between July and September of last year.

Figure B.45

Smaller businesses' use of external finance by Nation and region, H2 2022-H1 2024

Source: British Business Bank analysis of UK Finance BVA BDRC SME Finance Monitor

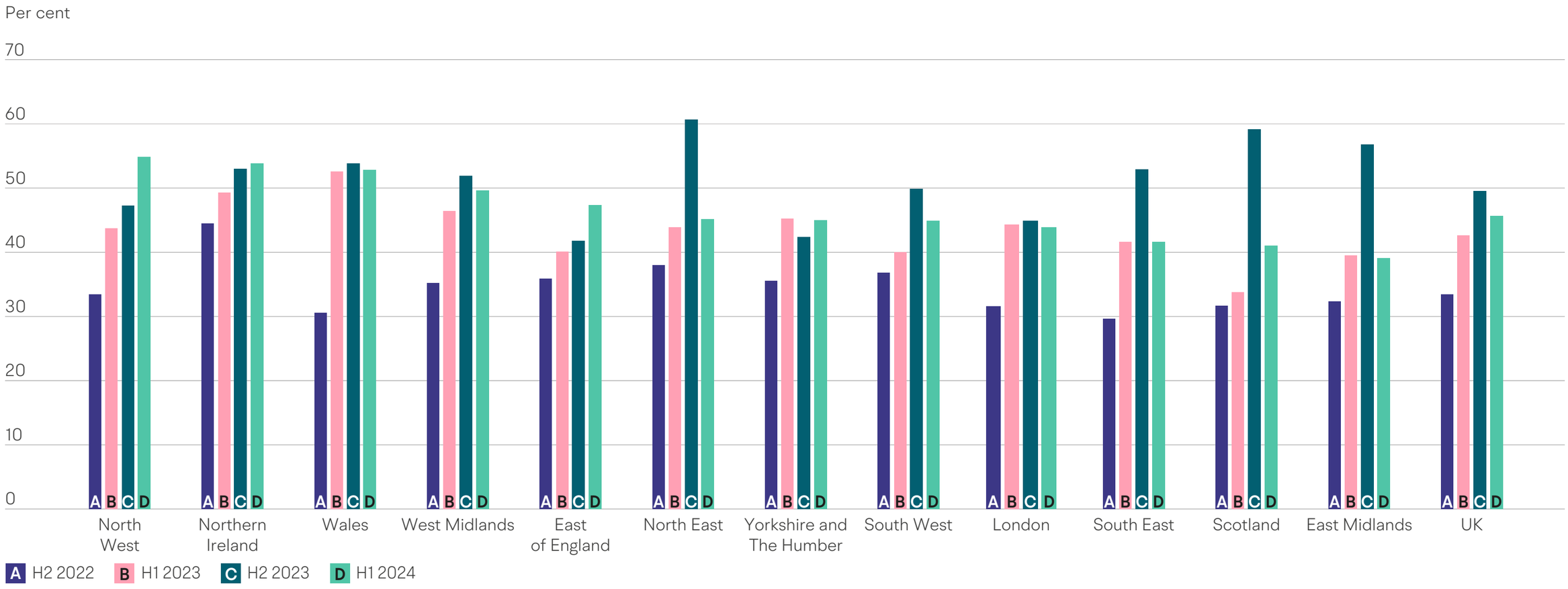
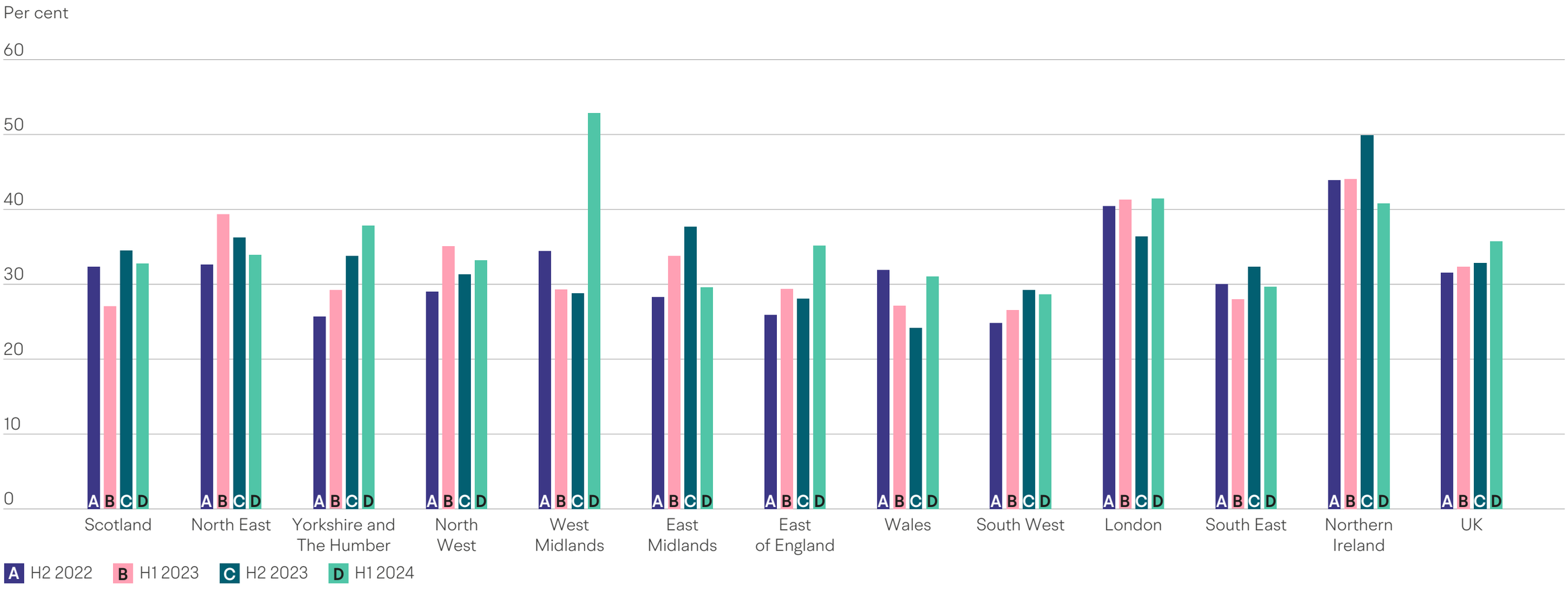


Figure B.46

Smaller businesses happy to use external finance to grow by Nation and region, H2 2022-H1 2024

Source: British Business Bank analysis of UK Finance BVA BDRC SME Finance Monitor



Use of credit cards and grants declined throughout the UK in 2024

An analysis of external finance usage by type also reveals mixed trends across the UK Nations and regions. As presented in Chapter 2.2, the most pronounced decline at the UK level was seen in credit card usage, although this remained the most frequently used finance type. The share of smaller businesses using credit cards decreased by over 5 percentage points between H2 2023 and H1 2024 (figure B.47). It should be noted that although declining regional trends are consistent with this overall fall, the robustness of this data is impacted by small sample sizes for the UK Nations and regions. Therefore, complete annual data will be necessary to obtain a more reliable picture of sub-national trends in the use of different finance types.

During this period, the North East (-13 ppts), East Midlands (-12 ppts), and the South East (-10 ppts) reported the most marked drops in usage rates for this finance type. Alongside credit cards, more modest reductions were evident across other commonly used forms of finance, including bank overdrafts, bank loans, grants, and leasing/hire purchase/vehicle finance.

Figure B.47

Smaller businesses' use of selected[a] external finance types by Nation and region, H1 2024 and percentage point change from H2 2023

Source: British Business Bank analysis of UK Finance BVA BDRC SME Finance Monitor

UK Nation/region	Credit cards		Bank overdrafts		Bank loans		Leasing/hire purchase/ vehicle finance	
Scotland	13%	-5	15%	2	12%	0	10%	-5
North East	15%	-13	5%	-15	6%	-13	7%	-16
Yorkshire and The Humber	15%	-4	13%	1	10%	0	14%	3
North West	17%	-2	19%	5	8%	1	10%	-3
West Midlands	13%	-3	11%	-7	11%	-3	13%	3
East Midlands	12%	-12	10%	-8	5%	-6	10%	-9
East of England	16%	-1	11%	2	12%	6	9%	1
Wales	12%	-6	16%	-3	11%	-2	14%	0
South West	17%	0	14%	-1	8%	-2	7%	-5
London	14%	-5	10%	-5	10%	-3	7%	1
South East	15%	-10	13%	-3	7%	-1	9%	0
Northern Ireland	17%	-3	10%	-6	16%	6	17%	6
UK	**15%**	**-5**	**12%**	**-2**	**9%**	**-1**	**10%**	**-1**

a The table presents the most commonly used finance types by smaller businesses, excluding those where the source is not a finance provider (e.g. loans from directors/friends/family)

Use of bank overdrafts declined everywhere except in Scotland, the East of England, the North West and Yorkshire and the Humber, while usage rates for bank loans also fell by over 1 percentage point in half of the 12 UK Nations and regions.

Grants displayed a further fall across all UK Nations and regions, continuing on their consistent downward trend since 2022. Both our data analysis and consultations with businesses suggest this represents a return to the declining trajectory observed for grants up to 2019 and interrupted by the creation of temporary grant schemes to help businesses survive through the Covid-19 pandemic.

Against this backdrop of declining finance usage across the UK, the North West stood out by reporting an uptick in usage rates for bank overdrafts (5 ppts) and loans (1 ppts) and relatively modest reductions for credit cards (-2 ppts) and leasing/hire purchase/vehicle finance (-3 ppts). Among the Nations and regions that experienced a material fall in finance usage rates, the North East was the most severely impacted across nearly all finance types, with the exception of grants.

The share of smaller businesses using leasing/hire purchase/vehicle finance in the North East fell to 7% in H1 2024 from a peak of 23% in H2 2023. Similarly, use of bank overdrafts in the region dipped to just 5% in H1 2024 (from a peak of 20% in H2 2023). This level was significantly lower than the UK average of 12%. In addition, use of bank loans in the North East also dropped by 13 percentage points to 6% (compared with 9% UK wide).

The East Midlands closely followed the North East in terms of reductions experienced on credit card usage, which in H1 2024 fell to around half (12%) the rate seen in H2 2023 (24%). Nevertheless, decreases in the use of bank overdrafts (-8 ppts) and bank loans (-6 ppts) were more contained. In Scotland, the decline primarily affected use of loans from directors/friends/family (-11 ppts) and to a lesser extent, credit cards and leasing/hire purchase/vehicle finance (both falling by 5 ppts).

Half of the UK's Nations and regions are seeing growth in the value of equity deals in 2024, despite challenging market conditions

Changes in regional equity market activity do not generally impact overall finance use indicators because of the relatively small share of smaller businesses who engage with it compared to other finance types. Even so, they are an important complement to information on regional finance usage rates, since many high potential companies rely on securing equity deals to finance their growth plans. The available data for 2024, which covers the first three quarters, suggests conditions continue to be challenging in regional equity markets too, even though some signs of resilience can be taken from this information (figure B.48).

During the first three quarters of 2024, all Nations and regions but the North East (with a 2.4% increase in deal count) experienced a decrease in the number of deals relative to the first three quarters of 2023. The best performing areas on this measure after the North East were Scotland (-1.5%) and the North West (-12.2%). Scotland now ranks second in the UK for its share of deals, accounting for 10.4%, overtaking the South East which has recorded a particularly weak year to date.

Figure B.48

Number and value of equity deals by Nation and region (based on the head office of the recipient business), Q1-Q3 2024 and year-on-year change

Source: British Business Bank analysis of Beauhurst data

Nation or English region	Number of equity deals (Q1-Q3 2024)	YoY % change in number of deals	Proportion of deals (Q1-Q3 2024)	Investment value £m (Q1-Q3 2024)	YoY % change in investment value	Proportion of investment value (Q1-Q3 2024)
London	600	-27.9%	46.0%	4,367.2	11.2%	63.4%
Scotland	135	-1.5%	10.4%	407.2	14.2%	5.9%
South East	107	-36.3%	8.2%	599.1	-18.8%	8.7%
East of England	90	-26.2%	6.9%	660.7	22.0%	9.6%
North West	86	-12.2%	6.6%	237.2	36.9%	3.4%
South West	65	-30.1%	5.0%	167.0	-5.4%	2.4%
Wales	48	-14.3%	3.7%	54.9	-45.7%	0.8%
Yorkshire and the Humber	45	-19.6%	3.5%	107.5	-24.2%	1.6%
North East	42	2.4%	3.2%	92.1	63.4%	1.3%
East Midlands	40	-14.9%	3.1%	125.3	25.5%	1.8%
West Midlands	33	-38.9%	2.5%	35.8	-63.4%	0.5%
Northern Ireland	12	-29.4%	0.9%	37.5	-34.0%	0.5%
UK	**1,303**	**-24.3%**	**100%**	**6,891.5**	**6.6%**	**100%**

Trends were more positive across the UK when assessing growth in equity investment value. Half of the Nations and regions experienced an increase in funding when compared to Q1-Q3 2023, including London, Scotland, East of England, the North West, the North East and the East Midlands. The East of England now accounts for the second largest share of UK investment behind London (9.6%). Overall, across both measures, the best performing Nations and regions during the first three quarters of 2024 were the North East, Scotland and the North West.

Our Nations and Regions Tracker 2024 report[89] highlighted that London continues to attract a disproportionate amount of equity finance when benchmarked against its share of fast-growing businesses.

For example, London had an average of 0.5 deals and £3.9m of investment value per high-growth enterprise between 2021 and 2023, two to three times the corresponding UK averages of 0.24 and £1.4m. This overrepresentation is driven by spatial dynamics such as the proximity of businesses to investors and the presence of innovation-led clusters.

During Q1-Q3 2024 a total of 600 deals took place in London, accounting for 46% of all UK investments and in line with its equivalent share in 2023. On a value basis, £4.37bn of funding was raised was in the capital. London's share of UK equity investment increased from 58% to 63% in 2024, reflecting the fact that growth stage funding has been relatively resilient over the past year and a disproportionate amount of this late-stage investment is London-based.

The Bank's Nations and Regions Investment Funds continue to unlock finance for growing businesses wherever they are located

These insights confirm that addressing place-based access to finance challenges is often a more complex issue than tackling regional economic imbalances between London and other Nations and regions. This complexity is well illustrated by the fact that pockets of businesses who are underserved by local finance markets can exist even in proximity to high performing regional finance hubs.

As a result the Bank continues to work closely with national and local partners throughout the UK to ensure NRIF can unlock investment opportunities for smaller businesses wherever they are located. The Bank's six NRIF funds play an essential role in alleviating market failures and levelling up access to finance in the areas they cover, which currently include all UK Nations and regions except London, the East and the South East of England.

The significant impact of NRIF and its predecessors in driving regional investment and growth is evidenced by evaluation studies and estimates produced for the Bank's 10-year impact report.[90,91,92]The latter suggests investment in these programmes over the last decade is expected to create 12,120 additional jobs and £1.2bn in Gross Value Added (GVA) over the life of the finance.[93] In addition to making investments in the SMEs in their relevant areas, the funds also aim to have a demonstrable presence in each area, linking up the finance community to increase reach, as well as raise awareness of the variety and availability of finance.

This is complemented by the Bank's UK Network who aim to strengthen stakeholder relationships across the UK. Their outreach work has an important role in understanding local challenges and helping strengthen finance ecosystems and business awareness of external finance opportunities all across the country, and particularly where finance networks are less developed.

2.5

Finance for environmental sustainability

The number of smaller businesses prioritising environmental sustainability continues to grow compared to two years ago

Nearly three quarters of smaller businesses have already undertaken at least one measure to become more environmentally sustainable

The proportion of smaller businesses measuring their carbon emissions remains low

This section explores smaller businesses' attitudes towards environmental sustainability over the past three years using data from the Bank's latest and previous two Business Finance surveys. This year's survey asked businesses about the actions they have undertaken to become more environmentally sustainable. The section also examines smaller businesses' reported barriers to becoming more environmentally sustainable and the proportion of businesses measuring their carbon emissions.

The number of smaller businesses prioritising environmental sustainability continues to grow

Over half of smaller businesses (53%) are prioritising environmental sustainability over the next 12 months. This is up from the 50% figure reported in last year's survey, and higher than the 46% reported in the 2022 survey. However, the latest 2024 figure is lower than the 57% reported in 2021, when Glasgow hosted the COP26 UN Climate Change Conference, with widespread media activity covering the conference and raising awareness of environmental issues. This suggests smaller businesses are continuing to become more aware of environmental sustainability issues over time. Medium sized businesses (74%), and businesses in the production sector (68%) are the most likely to prioritise environmental sustainability over the next 12 months.

Of those smaller businesses who do not consider environmental sustainability a priority in the next 12 months (41%), the main reason given for this was the perception that "there is not much we can do/little improvement is possible/due to the nature of the business", given by 38% of these businesses. The next highest response was the business "already having a low environmental impact/have focused on being sustainable" given by 35% of small business respondents who were not prioritising environmental sustainability.

Whilst the impact of individual smaller businesses, especially micro businesses may be insignificant compared to the UK's overall total emissions, previous Bank research showed that collectively smaller businesses generate a substantial proportion of the UK's emissions.[94] Smaller businesses contributed 35% of the UK's total emissions in 2021 and 51% of all business-driven emissions. Other reported reasons included focusing on other priorities (7%), costs of being environmentally sustainable are too high/too expensive (7%) and 6% reported they "do not care/not interested/ do not believe in climate change".

Smaller businesses were asked about their views on the obstacles to becoming more environmentally sustainable. Of those businesses who are prioritising environmental sustainability in the next 12 months (53%), current economic conditions was the most frequently quoted barrier given by 48% of smaller businesses, suggesting it remains an important barrier, despite declining from 55% in 2023 and 67% in 2022 (figure B.51).

Uncertainty around government policies/regulations was close behind, reported by 47% of businesses. This was slightly lower than in 2023 when 52% of businesses prioritising environmental sustainability reported it as a barrier.

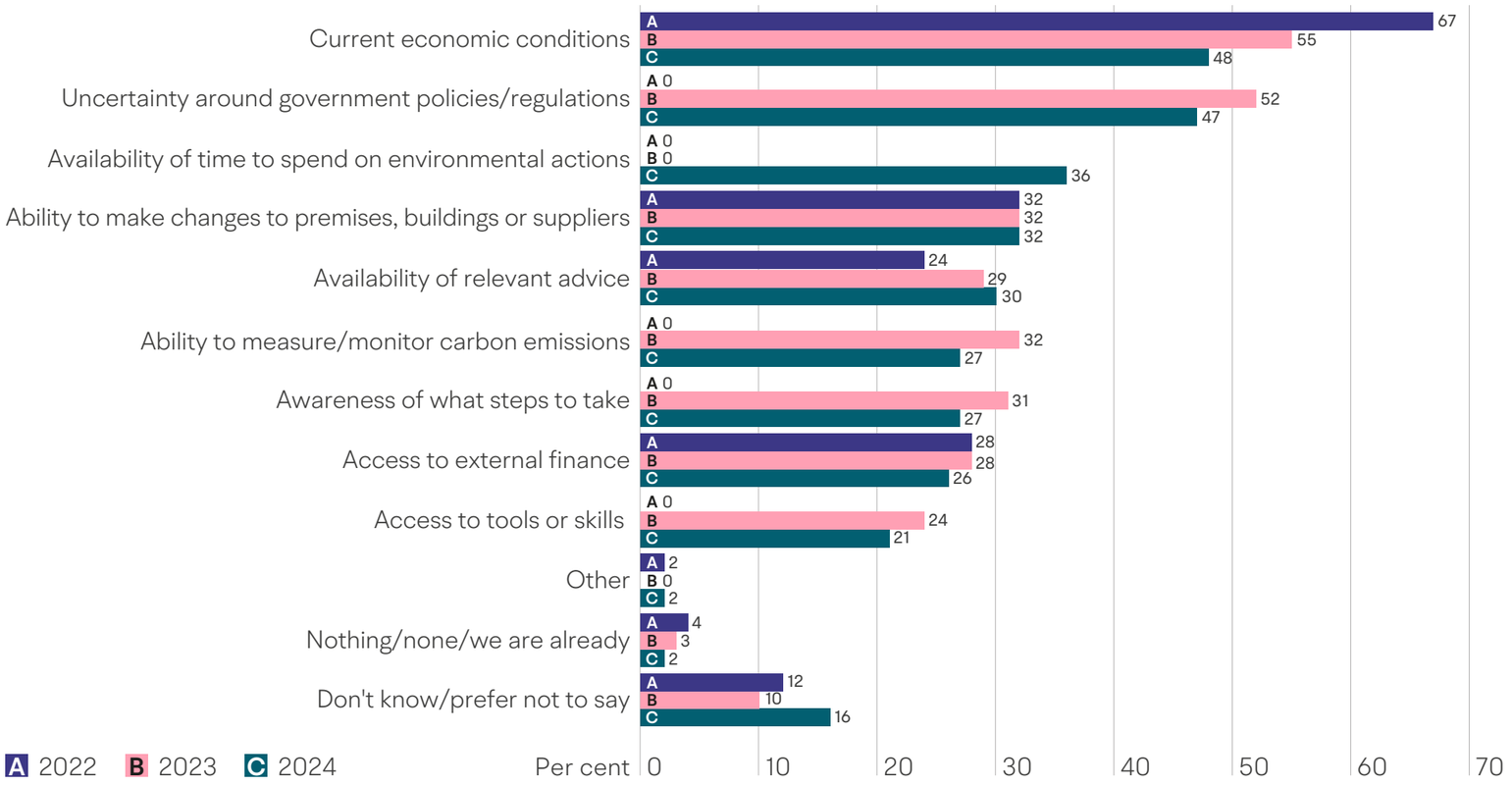
The third largest reported barrier was availability of time to spend on environmental actions given by 36% of businesses prioritising environmental sustainability. This was not reported in previous surveys, which may reflect the decrease in the relative impact of the other barriers like current economic conditions and uncertainty around government policy and regulations.

This year the question on obstacles to becoming more environmentally sustainable in the next 12 months was asked to all smaller businesses, not just those prioritising environmental sustainability. Figure B.52 shows those prioritising environmental sustainability were more likely to report barriers to becoming environmentally sustainable compared to those who did not, with statistical significant differences related to economic conditions, uncertainty around government regulations, access to external finance for environmental sustainability, access to relevant advice and also availability of time to spend on environmental actions.

Figure B.51

Obstacles to becoming more environmentally sustainable for businesses prioritising environmental sustainability in the next 12 months

Source: British Business Bank analysis of the 2024 Business Finance Survey. Base = all businesses who consider environmental sustainability a priority in the next 12 months (n=599 in 2022, n=462 in 2023, n=431 in 2024)



This may suggest those that are not prioritising environmental sustainability are not aware of the barriers or have not directly experienced the barriers because they have not yet taken steps to becoming environmentally sustainable.

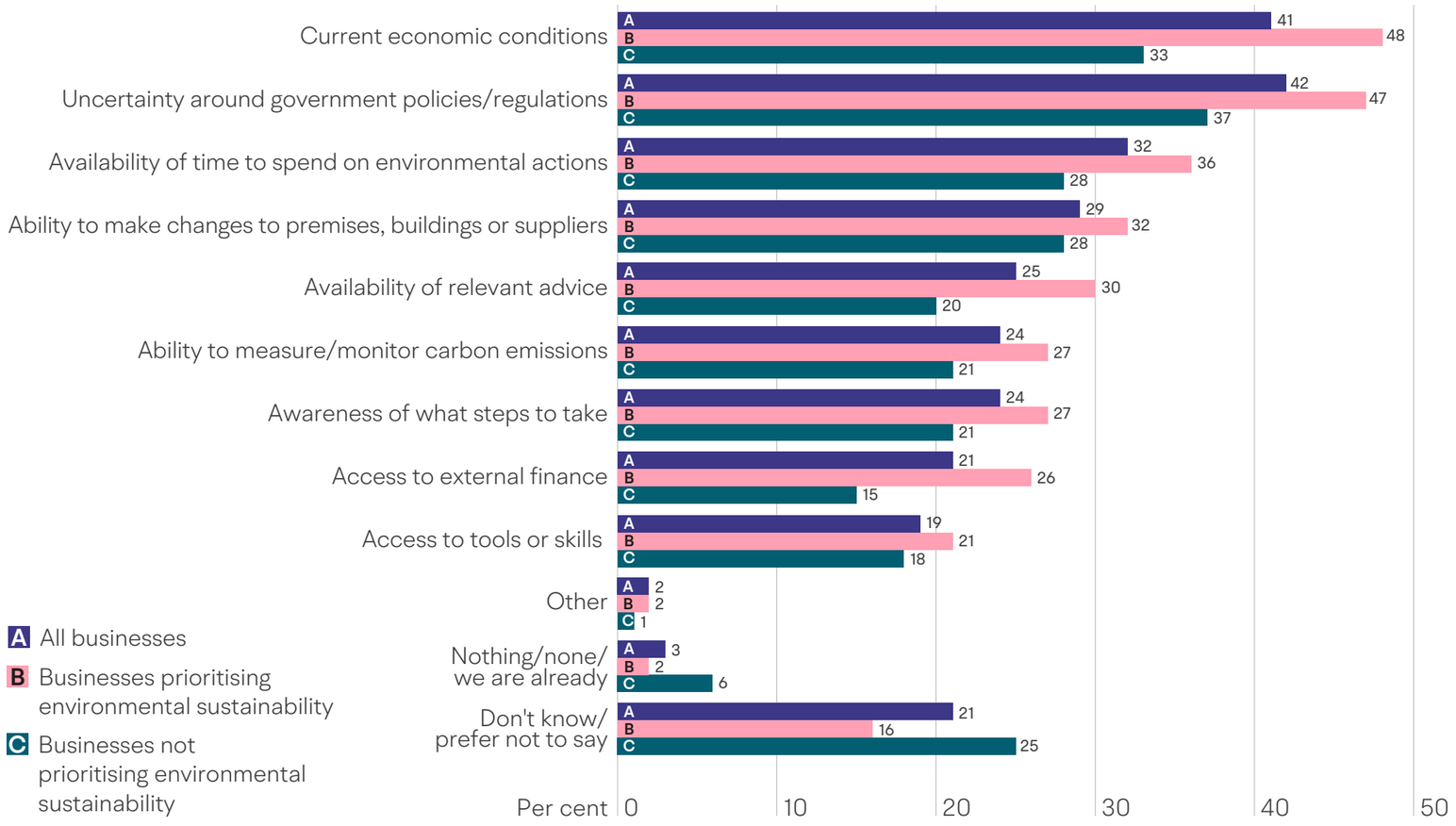
Smaller businesses were asked about their views on the impact of implementing environmental sustainability practices on business performance. Consistent with previous SBFM reports, the results are only presented for businesses that are prioritising environmental sustainability as these businesses are most likely to be aware of the potential benefits of implementing environmental sustainability practices. This year the question was also asked for businesses that are not prioritising environmental sustainability.

There are clear differences between these two groups with those not prioritising environmental sustainability less likely to agree that environmental sustainability leads to business performance benefits. For example, only 31% of those not prioritising environmental sustainability agreed implementing environmental sustainability practices enhanced business reputation (compared to 67% of those prioritising environmental sustainability).

Figure B.52

Obstacles to becoming more environmentally sustainable in the next 12 months

Source: British Business Bank analysis of the 2024 Business Finance Survey. Base = all businesses (n=753 in 2024)



Similarly, only 18% agreed implementing environmental sustainability led to lower business costs (compared to 49% that prioritised environmental sustainability). A lack of identifiable business performance benefits may help explain why some businesses are not prioritising environmental sustainability.

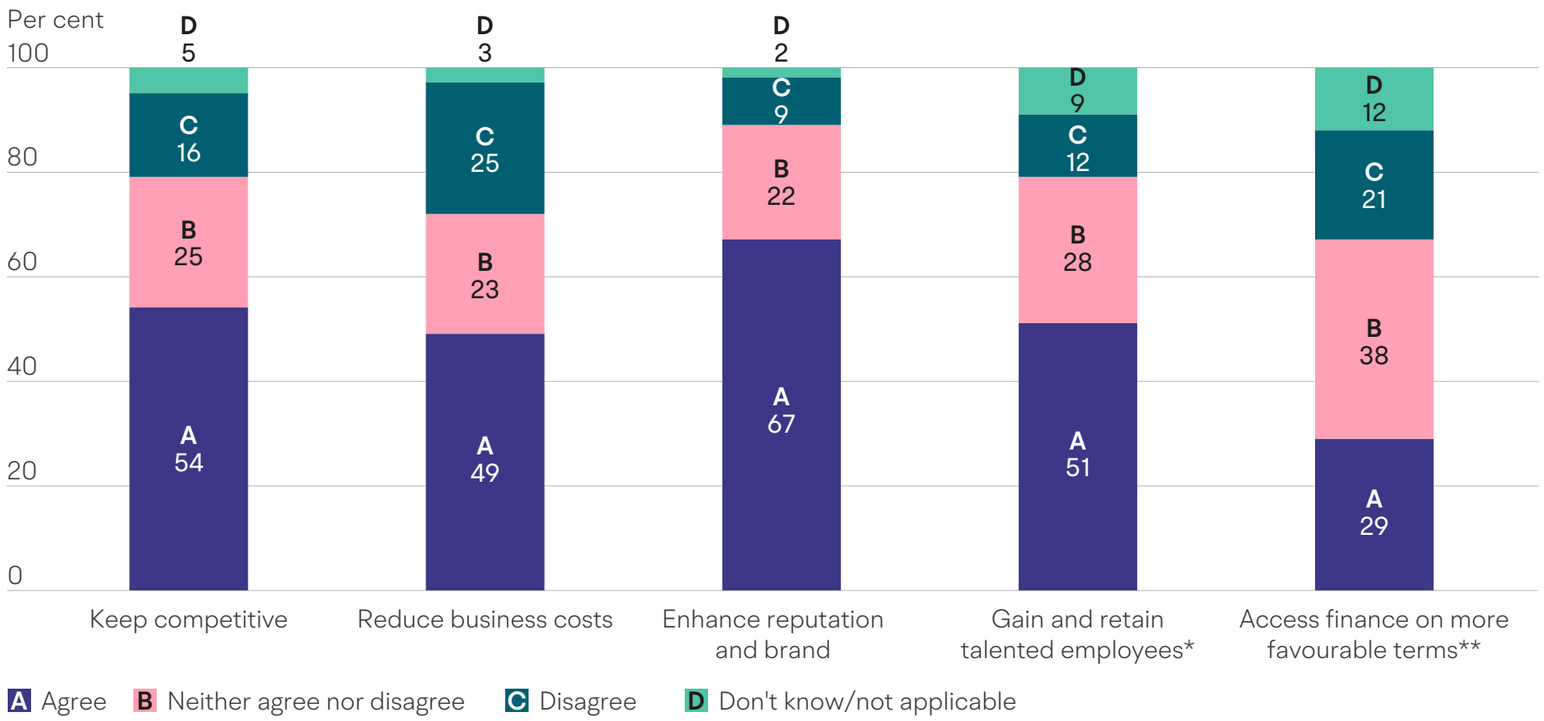
Figure B.53 shows of those prioritising environmental sustainability over the next 12 months, businesses have a positive perception of environmental sustainability practices on business reputation but are more uncertain when it comes to its impact on retaining talented employees and helping the business to raise finance on more favourable terms. Furthermore, 67% believed adopting environmental sustainability practices would enhance the business reputation and brand, whilst 54% believed it will help enable the business to be competitive.

49% of businesses prioritising environmental sustainability thought implementing business environmental sustainability practices helped businesses to reduce costs, but 25% of businesses disagreed with this statement, suggesting the picture is more mixed. Only a minority (29%) believed implementation of environmental sustainability

Figure B.53

Smaller business views towards the impact of implementing environmental sustainability practices on business performance

Source: British Business Bank analysis of the 2024 Business Finance Survey. Base = all businesses who consider environmental sustainability a priority in the next 12 months (n=431, n=259 for businesses with more than one employee, n=271 for businesses who have sought finance)



Notes: *Asked to businesses with more than one employee only. **Asked to businesses who have sought finance.

practices helped businesses to raise finance on more favourable terms. Whilst 21% of respondents disagreed with the statement that adopting environmental sustainability practices would lead to accessing finance on more favourable terms, a much higher percentage (38%) neither agreed nor disagreed with this statement.

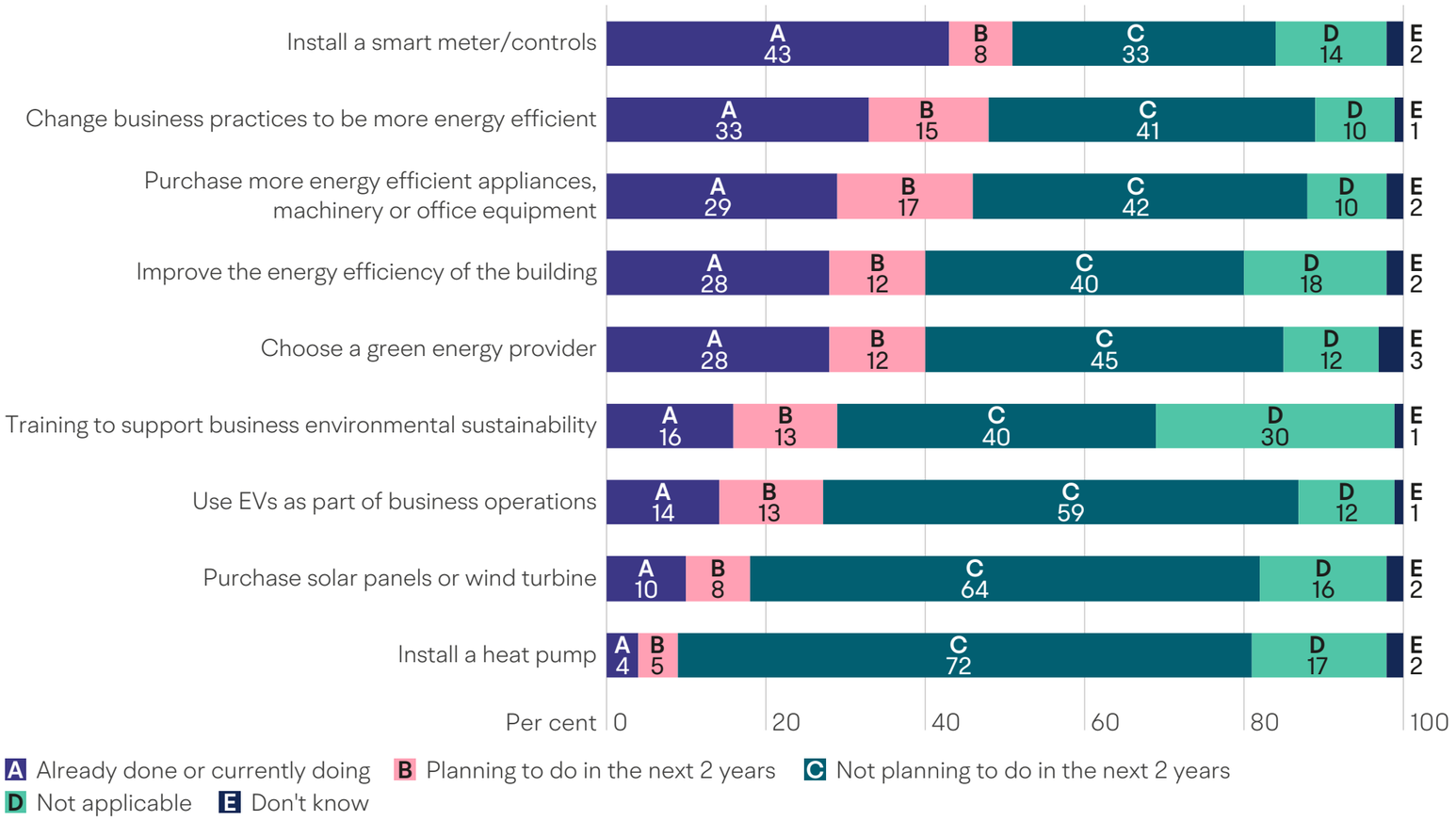
It is unclear whether these respondents felt adopting greater environmental sustainability practices had no impact on finance terms or whether it would lead to finance being accessed on worse terms.

The take up of green or sustainability-linked finance products by smaller businesses is low with only around 15 products currently being offered by finance providers.[95] This may suggest that environmental sustainability performance is not yet leading to increased access to finance or finance available on better terms for many businesses. Green or sustainability-linked finance products tend to feature more complex monitoring criteria than standard products, such as the need for the business to demonstrate improvements to their environmental outcomes. This can be a barrier for some smaller businesses as they are less likely to have relevant monitoring processes or an ESG strategy.

Figure B.54

Smaller businesses environmental sustainability actions taken or intend to undertake in next two years

Source: British Business Bank analysis of the 2024 Business Finance Survey. Base = all businesses (n=753)



Businesses may also lack awareness of funding types, information on how these products work, and also where to obtain them from. A lower proportion of businesses prioritising environmental sustainability report that they are confident in obtaining information on types of finance and specific products available than those not prioritising environmental sustainability (56% compared to 65%). However, a higher proportion of businesses prioritising environmental sustainability report they would seek external advice if they were seeking finance in the future (61%), compared to 40% of businesses not prioritising environmental sustainability (40%).

Nearly three quarters of smaller businesses have already undertaken at least one measure to become more environmentally sustainable

Businesses were asked which actions they had undertaken to become more environmentally sustainable. 71% of smaller businesses had undertaken at least one action, with the proportion increasing by size of business from 68% of zero employee businesses to 82% of medium sized businesses.

The most frequent action taken was installing a smart meter or controls (43%). The next highest category was changing their business practices or operations to be more energy efficient (33%) or purchasing more energy efficient appliances, machinery or office equipment (29%). 28% have improved the energy efficiency of the building. A similar proportion have changed to a green energy provider. 16% have undertaken training to support their business to become more environmentally sustainable. Only a small proportion of businesses are using electric vehicles as part of their operations (14%), have purchased solar panels or wind turbines (10%) or have installed a heat pump (4%) (figure B.54).

Whilst a large proportion of businesses are not planning on undertaking actions in the next two years, especially in relation to installing heat pumps (72%), purchasing solar panels or wind turbines (64%) or using electric vehicles (59%), some businesses are planning on undertaking actions. 17% of businesses plan to purchase more energy efficient appliances, machinery or office equipment, 15% plan to change business practices or operations to be more energy efficient and 13% plan to use electric vehicles as part of their business operations. 13% also plan to undertake training to support the business becoming more environmentally sustainable.

Overall, 81% of businesses have done, or are planning to undertake at least one energy efficiency or environmental sustainability measure in the next two years.

Many of these energy efficiency and environmental sustainability measures have a financial cost. Respondents were asked for the measures they have undertaken how these were funded. 88% of smaller businesses funded these measures using internal sources of funding e.g. from existing savings and cash flow, showing only a minority of businesses use external finance to fund environmentally sustainable measures. 7% of businesses used seller trade credit, credit card or overdrafts, and 7% used “external private sector sources that you apply for, e.g. (personal) loans, finance agreements”. 6% used grant finance.

For businesses that were planning to undertake energy efficiency and environmentally sustainable measures in the next two years (45%), a higher percentage was planning on using external sources of finance, with 16% planning on using loans and finance agreements and 9% planning on using seller trade credit/credit card and overdrafts. 21% were planning on using grants and 7% were planning on using publicly backed non-grant

finance. This suggests external finance will have greater role in funding smaller businesses future adoption of energy efficiency and environmental sustainability measures.

This year's finance survey also included questions on business use of vehicles. 55% of smaller businesses operated vehicles of some type as part of their business operations with cars and light goods vehicles (vans) being the main vehicles used by smaller businesses. As a proportion of all smaller businesses, 38% used cars, and 24% used light goods vehicles.

The proportion of smaller businesses measuring their carbon emissions remains low

The latest survey shows 6% of smaller businesses stated they were measuring, monitoring or reporting their business carbon emissions. This is a similar proportion to the 5% reported in last year's survey[96] and 6% of smaller businesses reporting they measured their carbon footprint in the previous five years in 2021 Bank research.[97] This suggests there has been no real change in the proportion of businesses reporting their carbon emissions over the last three years. 8% of smaller businesses in the latest survey reported they intend to start measuring, monitoring or reporting their carbon emissions in the future, but this percentage is down from 14% last year.

Measuring, monitoring or reporting carbon emissions is linked to business size with 28% of medium sized businesses compared to 5% of zero employee businesses. 8% of employer businesses overall measure their emissions. Businesses that prioritise environmental sustainability were most likely to report their carbon emissions (9%), but there were no statistical significant differences by sector.

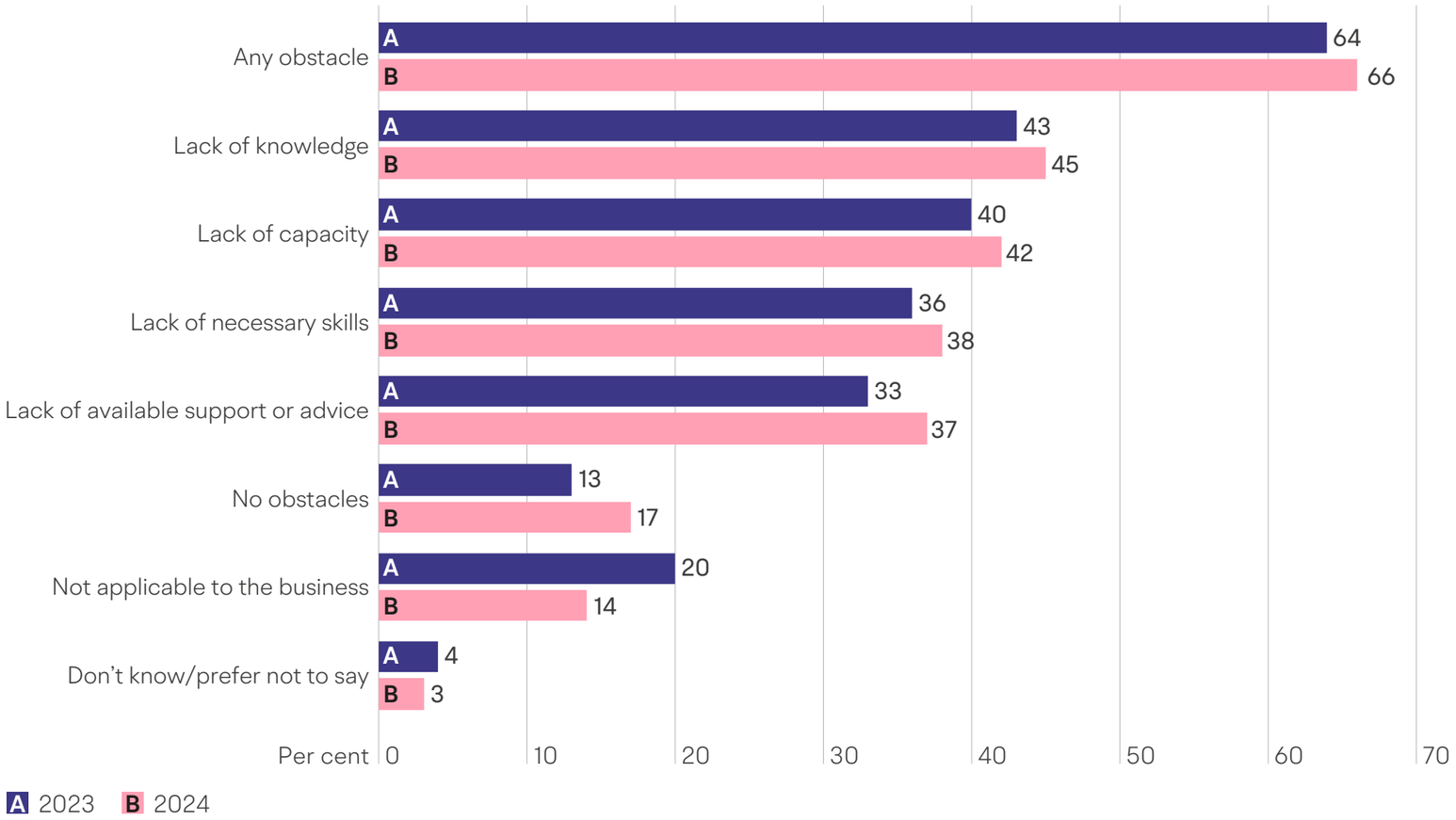
Smaller businesses were asked about what barriers they faced for measuring, monitoring or reporting their carbon emissions. Figure B.55 shows lack of knowledge of what to measure, monitor and report was the most frequent reported barrier (45%), followed by lack of capacity (42%) and lack of necessary skills (38%), a similar ranking to the previous 2023 finance survey. 66% of smaller businesses overall reported at least one obstacle to reporting their carbon emissions, which is slightly higher than 64% reported last year.

The British Business Bank is committed to supporting the UK's transition to a net zero economy by 2050. The Bank has a strategic objective to build a modern green economy by financing innovative solutions to climate change and supporting smaller businesses accessing finance to thrive in a net zero economy. The Bank currently estimates up to 37% of supported businesses used some of their finance for environmental objectives.[98] The Bank will continue to ensure its programmes are targeted at market gaps, supporting smaller businesses' transition to net zero. The Bank is also developing a green finance offer. It will pursue collaboration opportunities with its delivery partners, supporting initiatives which enable small businesses to become more environmentally sustainable.

Figure B.55

Smaller businesses views on obstacles to measuring, monitoring or reporting their carbon emissions

Source: British Business Bank analysis of the 2024 Business Finance Survey. Base = all businesses (n=822 in 2023, n= 753 in 2024)



Equity finance and private debt

2.6

Equity finance

Equity investment in 2024 is similar to 2019 and 2020 levels

Growth and seed stages rebounded in the first half of the year, but Q3 was challenging for all stages

Exit activity improved during the second half of the year

Fundraising is concentrating with more established managers

This section provides an assessment of the latest trends in the UK SME equity finance market, drawing upon data from Beauhurst up to the end of September 2024. The Bank's Small Business Equity Tracker report, to be published in the summer, will provide a more comprehensive picture of 2024 once sufficient time has passed to capture and validate equity deals across the full year.

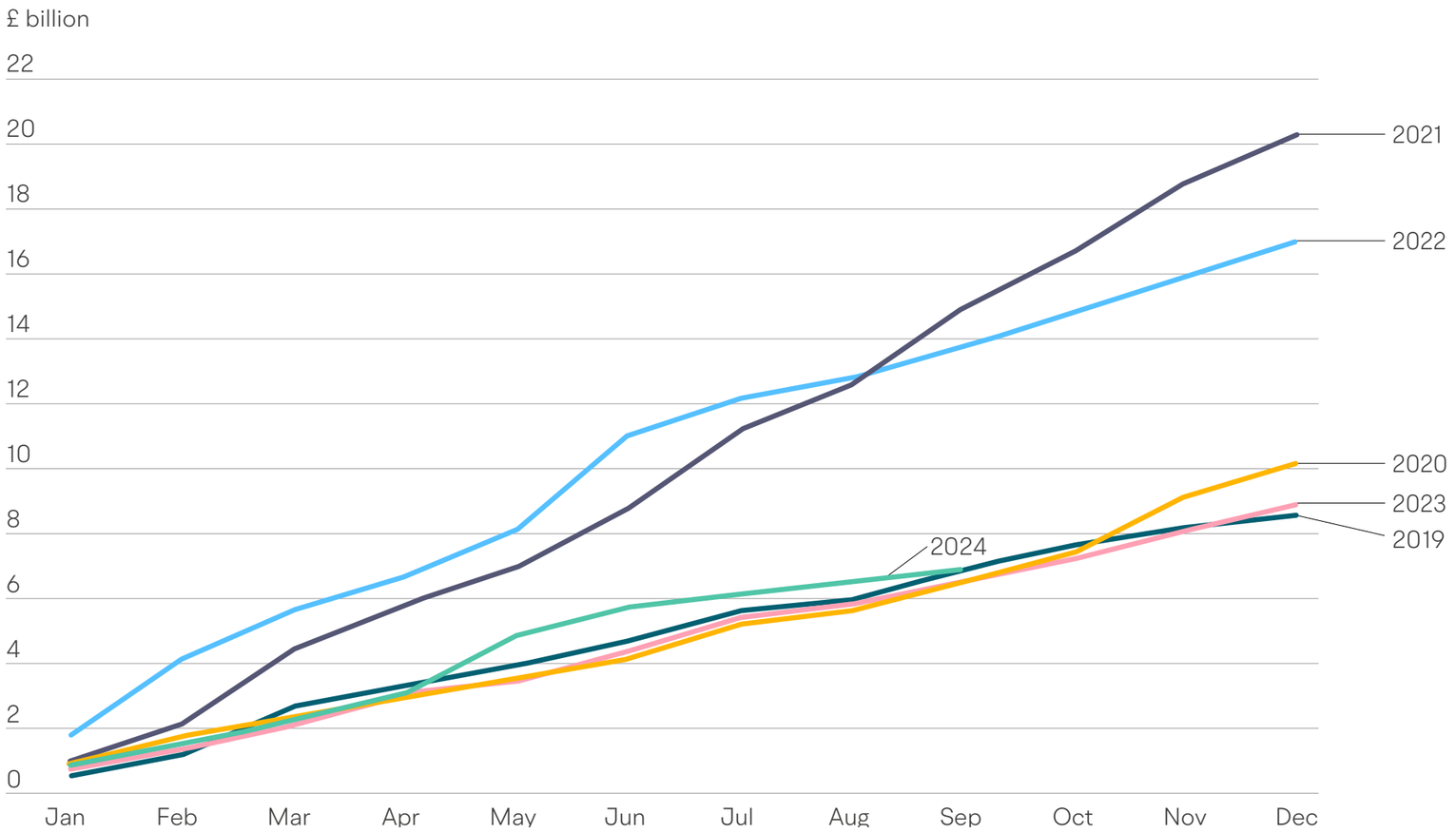
This analysis focuses on announced equity deals, for which more detailed information is available. However, deals involving some investor types (such as business angels) are less likely to be announced. Instead, the Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS) provide helpful indicators of business angel activity. A total of £2.1bn was raised by 6,020 companies through the schemes during 2022-23, highlighting the importance of business angels for the early-stage equity ecosystem.[99]

Regional breakdowns of the equity data are presented in Chapter 2.4.

Figure B.61

Cumulative monthly equity investment, by year

Source: British Business Bank analysis of Beauhurst data



Equity investment in 2024 is similar to 2019 and 2020 levels

Equity investment in UK smaller businesses was £6.89bn in the first three quarters of 2024. As shown in figure B.61, this is 6.6% higher than the equivalent period in 2023 and similar to both 2019 and 2020 levels, prior to the unsustainable increase in activity that began during the pandemic. It is now clear that 2021 and 2022 were outlier years for the UK market, during which £20.3bn and £17.0bn of equity investment was deployed respectively.

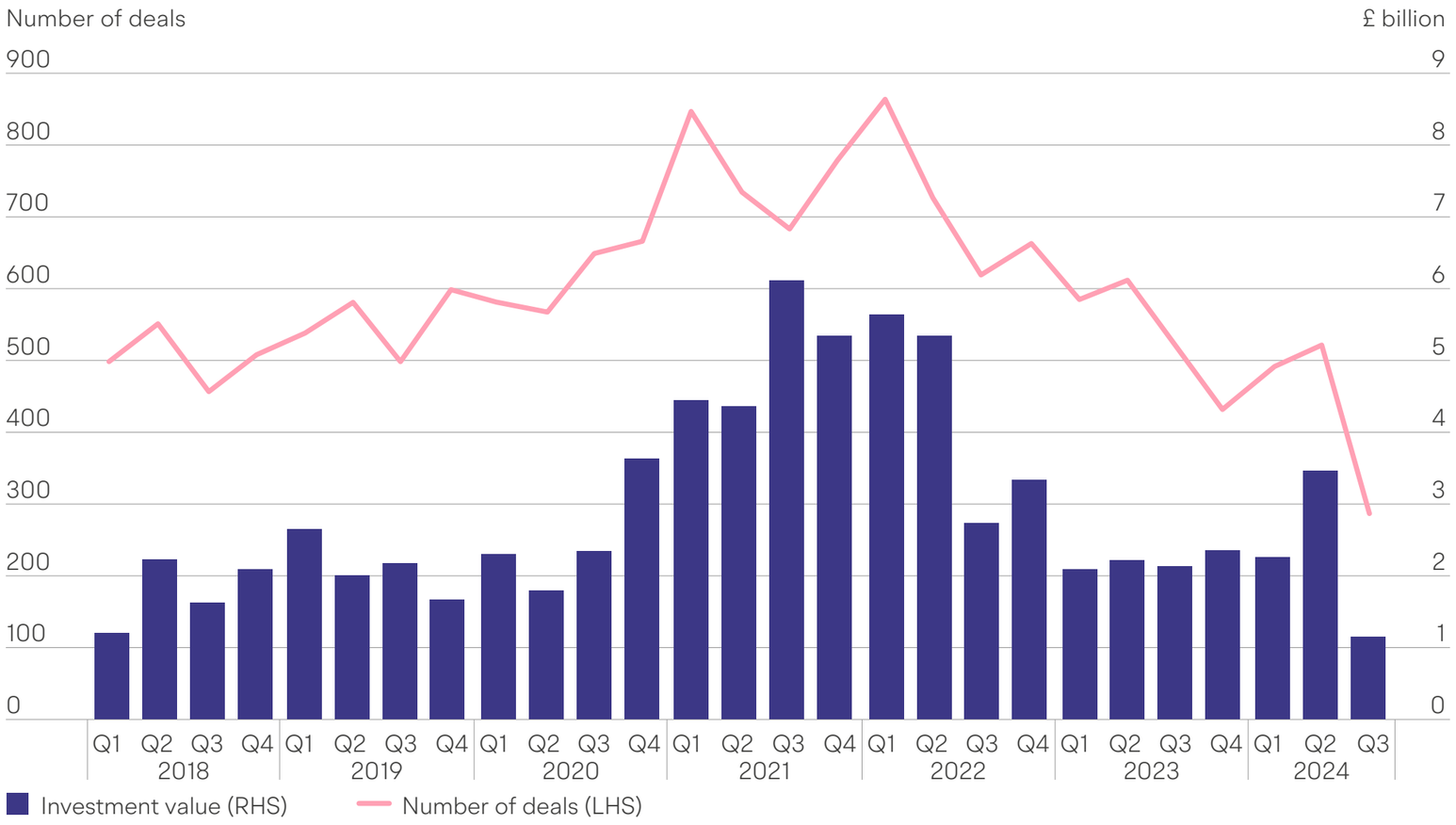
Figure B.62 shows the number and value of UK SME equity deals by quarter. While total investment has been relatively resilient in 2024, this growth was largely driven by Q2, during which £3.45bn was invested. This was the most since 2022Q2 and more than both Q1 and Q3 combined, including a large £833m funding round for London-based AI company Wayve. In contrast, the total of £1.18bn raised by UK SMEs in Q3 was the lowest since 2016Q4.

Looking at the number of deals, the first three quarters of 2024 saw a total of 1,303 UK SME equity deals announced, which was a 24.3% reduction compared

Figure B.62

Quarterly number and value of equity deals

Source: British Business Bank analysis of Beauhurst data



to the equivalent period in 2023. This was also the lowest Q1-Q3 total since 2016, demonstrating a particularly subdued year so far on a deal numbers basis. This has almost entirely been driven by a very weak Q3 (with 288 deals recorded), before which deal volumes had been on an upward trend in 2024.

Political uncertainty was a headwind for the UK market heading into the second half of 2024. The Budget provided some clarity on capital gains tax and tax on carried interest.

Macroeconomic headwinds that emerged during 2022 have also continued to affect the asset class over the past year. This has resulted in fund managers pausing their activity and focusing on existing portfolio companies, rather than prioritising funding for new ventures. While inflation has returned to more stable levels, higher interest rates (with the Bank of England's base rate set at 4.75% in December) are still having the effect of limiting exit opportunities, increasing investor caution and reducing the overall attractiveness of VC investments.

On the pace of the global VC market's recovery, PitchBook note that continued subdued activity is "due largely to the persistent headwinds that have blocked the pipeline of exits, fundraising, and dealmaking activity. As liquidity remains elusive, increasingly cautious venture investors have stepped up their standards, opting for quality over quantity as they increase time spent on due diligence and advocate for more investor protections in term sheets".[100]

Looking at equivalent international trends, PitchBook's Venture Monitor[101] reported that US VC investment had increased by 8.2% year-on-year during the first three quarters of 2024 – in line with the UK market. However, US VC deal numbers only declined by 2.6%, indicating its overall market is in a more robust position than the UK's. In comparison European VC investment and deal count fell by 8.7% and 18.9%, respectively, indicating that the rest of Europe is recovering at a similar pace to the UK at present.

Growth and seed stages rebounded in the first half of the year, but Q3 was challenging for all stages

Figure B.63 illustrates recent quarterly trends in equity investment by stage.[102] Between 2024 Q1-Q3 a total of £2.95bn was raised by growth stage companies, which represented a 30% increase on the same period in 2023. Given that growth stage investment had fallen by 65% in last year's report, activity in this segment of the market has demonstrated some recovery in 2024.

The picture for seed stage companies also improved during the first three quarters of the year. A total of £1.26bn was invested in this stage of the market – an annual increase of 8%, again highlighting recovery from the 31% decline recorded in last year's report. Venture stage investment during 2024Q1-Q3 fell by 12% on the year to £2.68bn, though this was a smaller contraction than was reported in 2023 (of 43%).

At the top end of the market, megadeals include deal sizes larger than £100m. Between 2024Q1-Q3 a total of four megadeals were recorded in the UK, an increase from two during the same period in 2023. The largest of these deals was completed by Wayve (£833m), a London-based company which develops AI and machine learning technology for autonomous vehicles. HarperCrewe, a Warwick-based company that designs and builds housing, also raised a £200m funding round in April.

Since the number of deals is not skewed by outlier values, it can be a more useful indicator of the underlying strength of the equity finance market. However, the latest data shows that recent trends have been less positive for UK companies across all deal stages. Looking at year-on-year growth during the first three quarters of 2024, seed, venture and growth stage deal counts declined by 22%, 28% and 20%, respectively. These reductions are similar to thoserecorded in 2023, indicating that the market is still in decline and yet to start recovering on a volume basis.

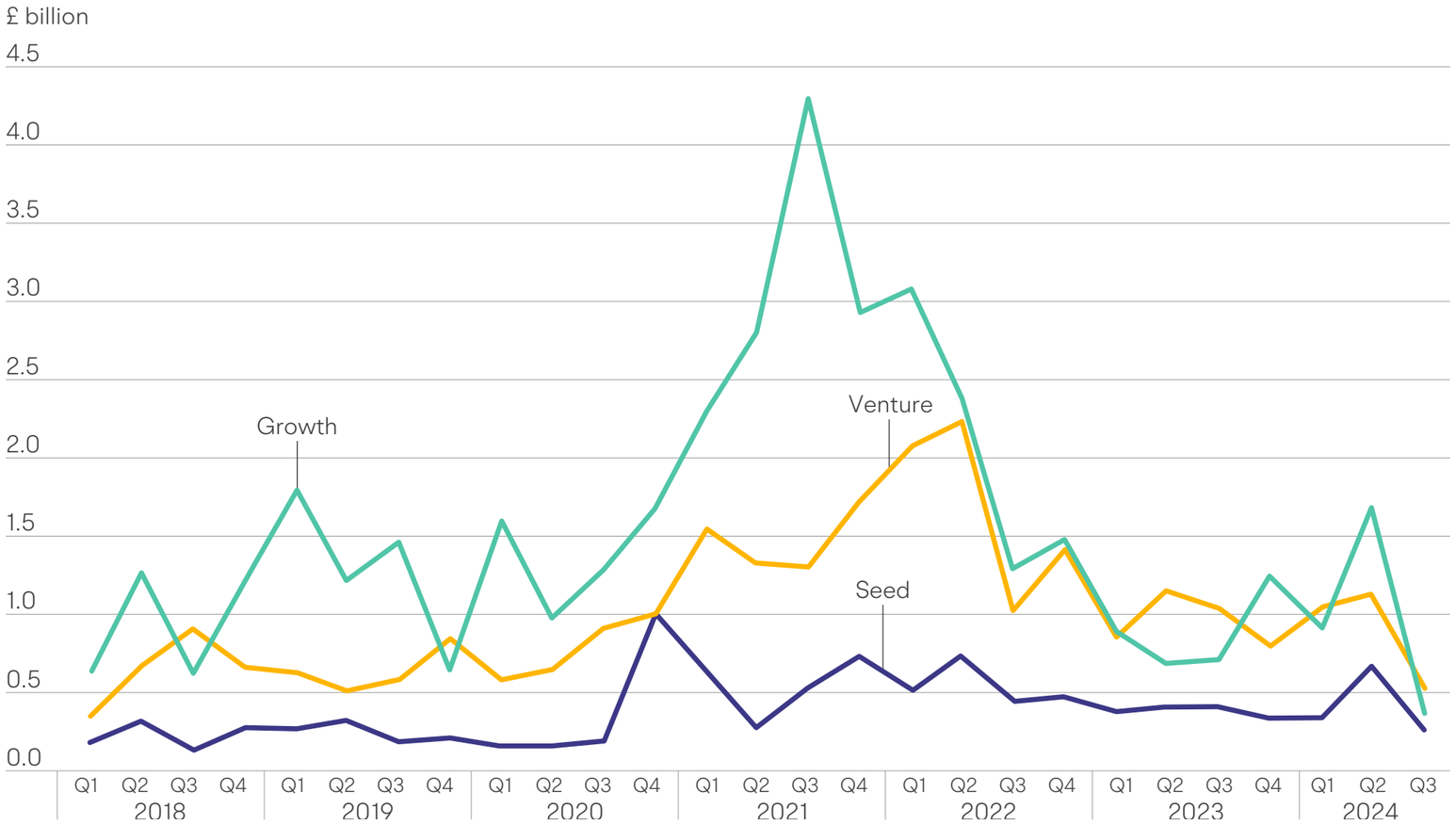
As mentioned previously, activity in the third quarter of 2024 was particularly low. On an investment value basis the reduction in finance was particularly acute for venture and growth stage companies, with declines of 49% and 47%, respectively. However, when measuring the number of deals, the seed stage experienced a pronounced decrease in activity – with an annual fall of 56%.

These trends can be partly explained by investors focusing on more proven companies during times of uncertainty, rather than newly established businesses, to minimise their risk exposure. Fund managers are instead considering companies with more proven

Figure B.63

Value of announced equity deals, by stage

Source: British Business Bank analysis of Beauhurst data



commercial potential and value propositions, as well as focusing on existing companies within their own portfolio – either for follow-on investment or to position them for an exit once the exit environment improves (which is explored later in this section).

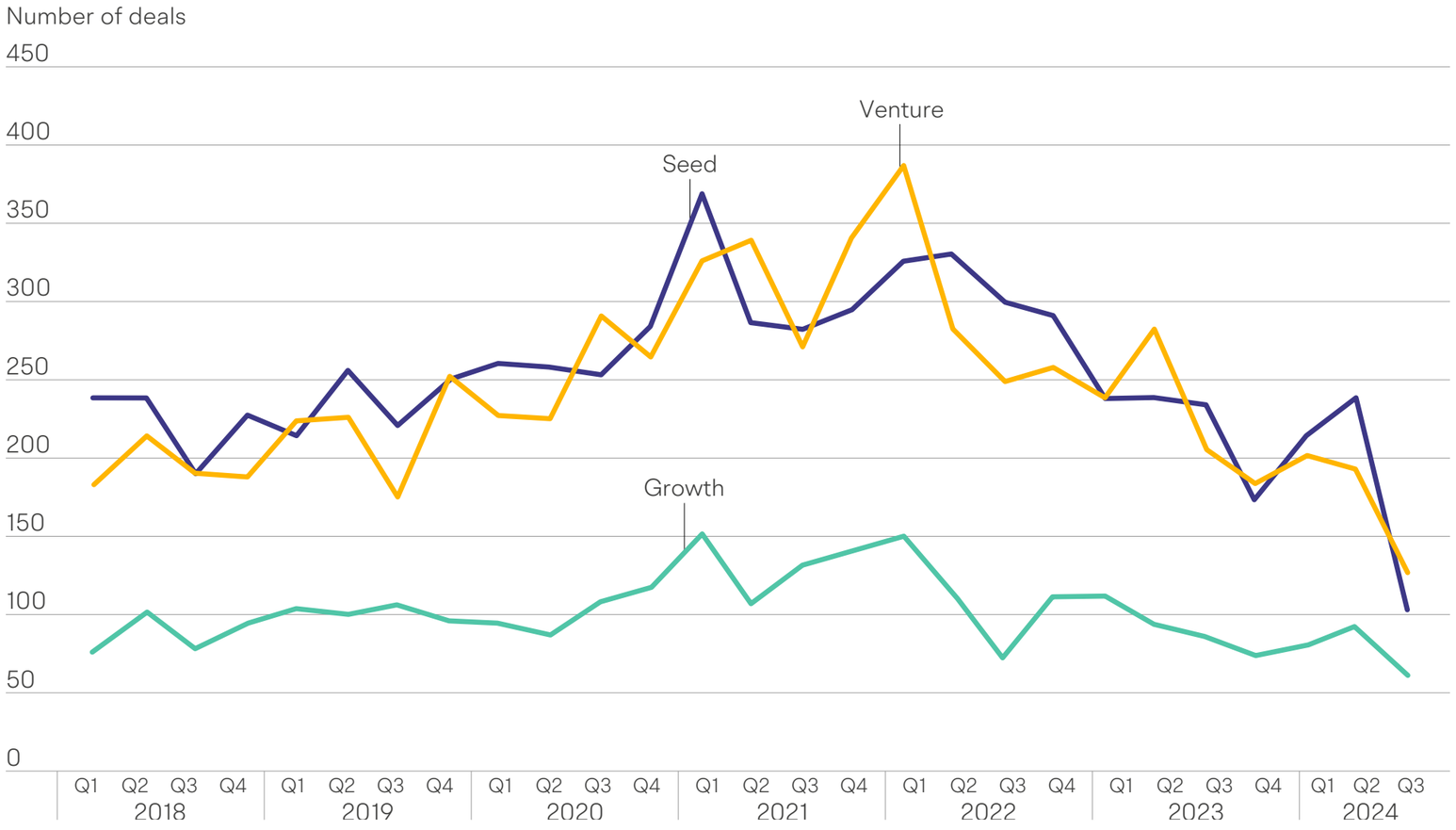
Equity deal sizes saw a large increase during the market peak period between 2020 and 2022. This was mainly due to an expansion of growth capital available at later stages of the market, fuelled by non-traditional investors (such as private equity funds and asset managers) entering the market in search of financial returns amid a low interest rate environment. While deal sizes subsequently declined in 2023 to £1.09m, across the overall market they have since recovered to £1.15m in 2024.

Average deal sizes at the growth stage of the market have continued to decline in 2024, albeit at a slower pace. The median growth stage deal size decreased by 24% from £3.70m in 2023 to £2.80m in 2024. Median deal sizes for growth stage companies have now fallen by 65% from their peak of £8.05m in 2021.

Figure B.64

Number of announced equity deals, by stage

Source: British Business Bank analysis of Beauhurst data



Conversely, median seed and venture stage deal sizes increased by 11% and 32%, respectively.

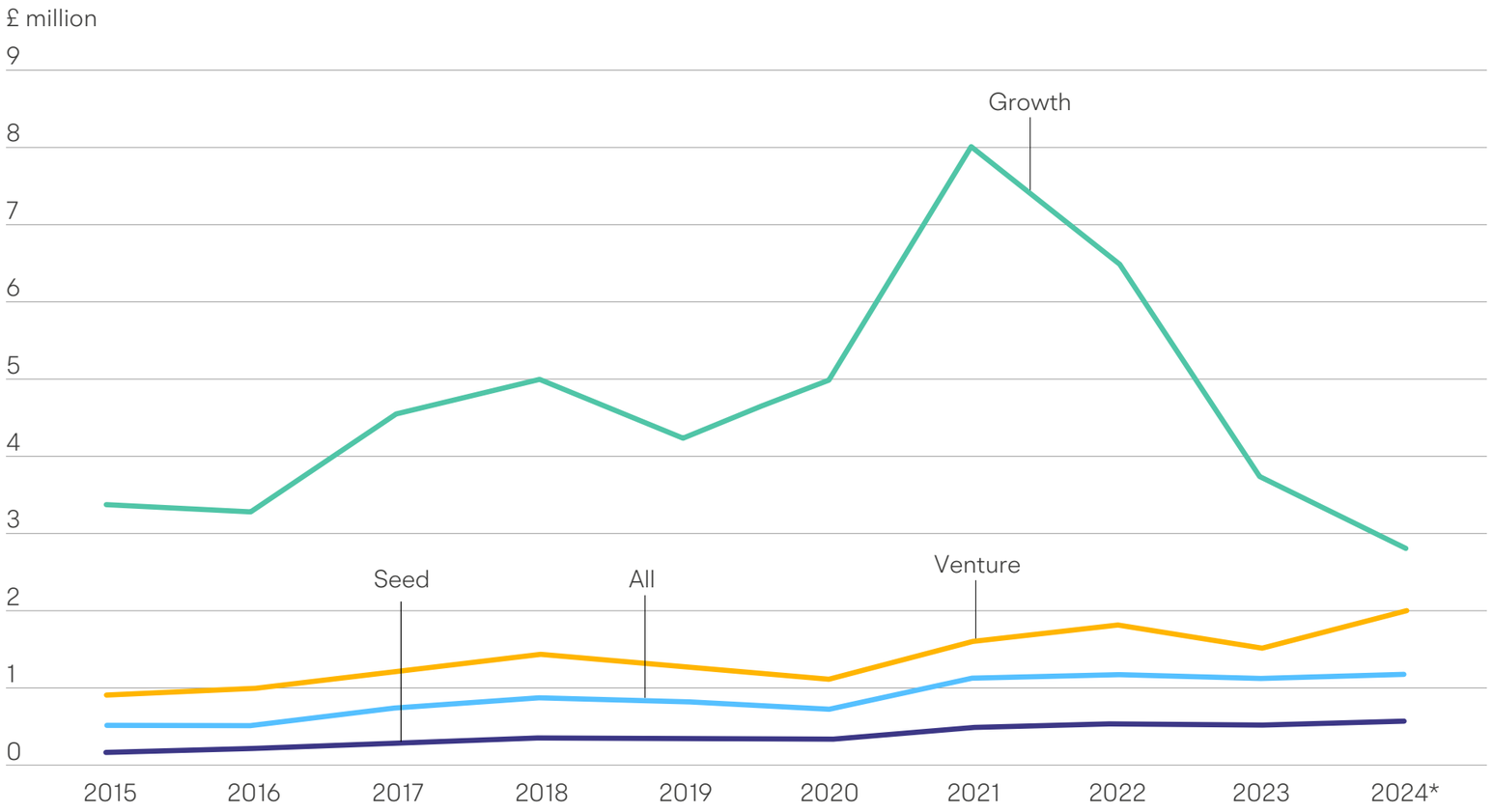
Mean average pre-money valuations can also be influenced by distortion from large outliers. It is therefore useful to look at trends in the median, as shown in figure B.66. As with deal sizes, seed and venture stage valuations have demonstrated a positive trend in 2024 – with increases of 7.1% and 17.7% respectively. Although growth stage valuations fell by 9.5%, representing the third successive annual decrease, the pace of decline slowed significantly from 29.1% in the previous year.

Late stage valuations in particular had increased sharply during the pandemic years, with greater competition for deals, increased trade sales, and a number of high-profile IPOs. The dearth of exit opportunities that has followed since 2022 (explored in more detail later in this section) has had a disproportionate impact on this area of the market, with investors continuing to wait for more attractive entry points.

Figure B.65

Median deal size over time, by stage

Source: British Business Bank analysis of Beauhurst data



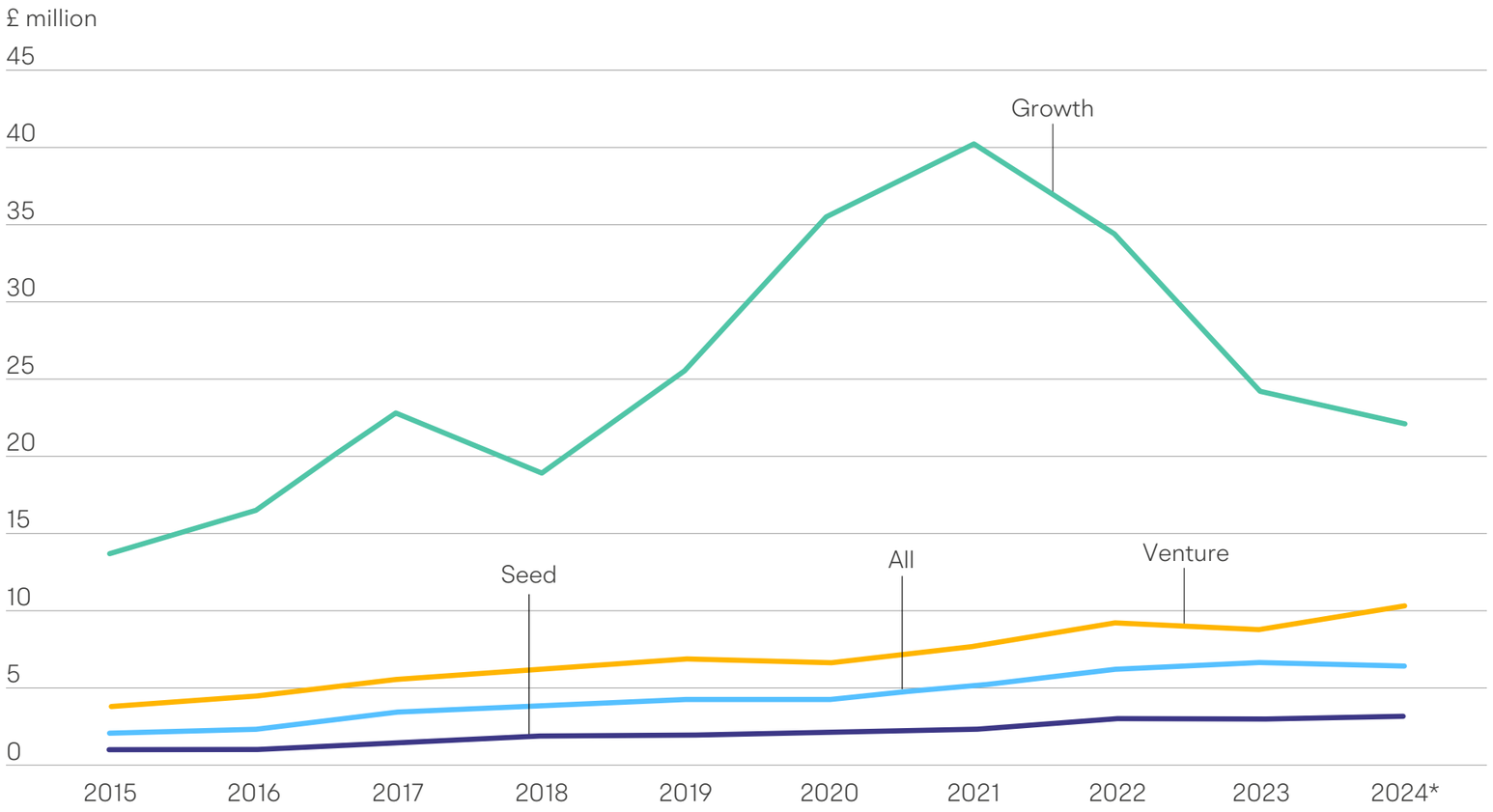
Note: *2024 only includes data up to the end of 2024Q3

In terms of the market dynamics affecting valuations, the Bank's survey of fund managers in our UK Venture Capital Financial Returns 2024 report[103] found that the perceived level of competition in the market is recovering. Of the general partners (GPs) surveyed, 31% reported high competition in their area of the market (up from 16% in 2023) and a further 40% were experiencing some competition. In addition, looking ahead 36% of managers expected valuations to increase over the next 12 months, an increase from 23% in the previous year's survey.

Figure B.66

Median pre-money valuation over time, by stage

Source: British Business Bank analysis of Beauhurst data



Note: *2024 only includes data up to the end of 2024Q3

Exit activity improved during the second half of the year

There were 215 exits of VC-backed companies in the UK in 2024, which was broadly in line with the 2023 total of 211. However, there was a significant increase in the value of these deals, measured by the exited companies' post-money valuation. Exit value doubled from £5.2bn in 2023 to £10.4bn in 2024, driven by a particularly strong second half of the year. The value of exits in Q3 and Q4 in 2024 were the highest since the peak year of 2021, and significantly above the 2018-2020 quarterly average, indicating early signs of an upturn in this area of the VC market.

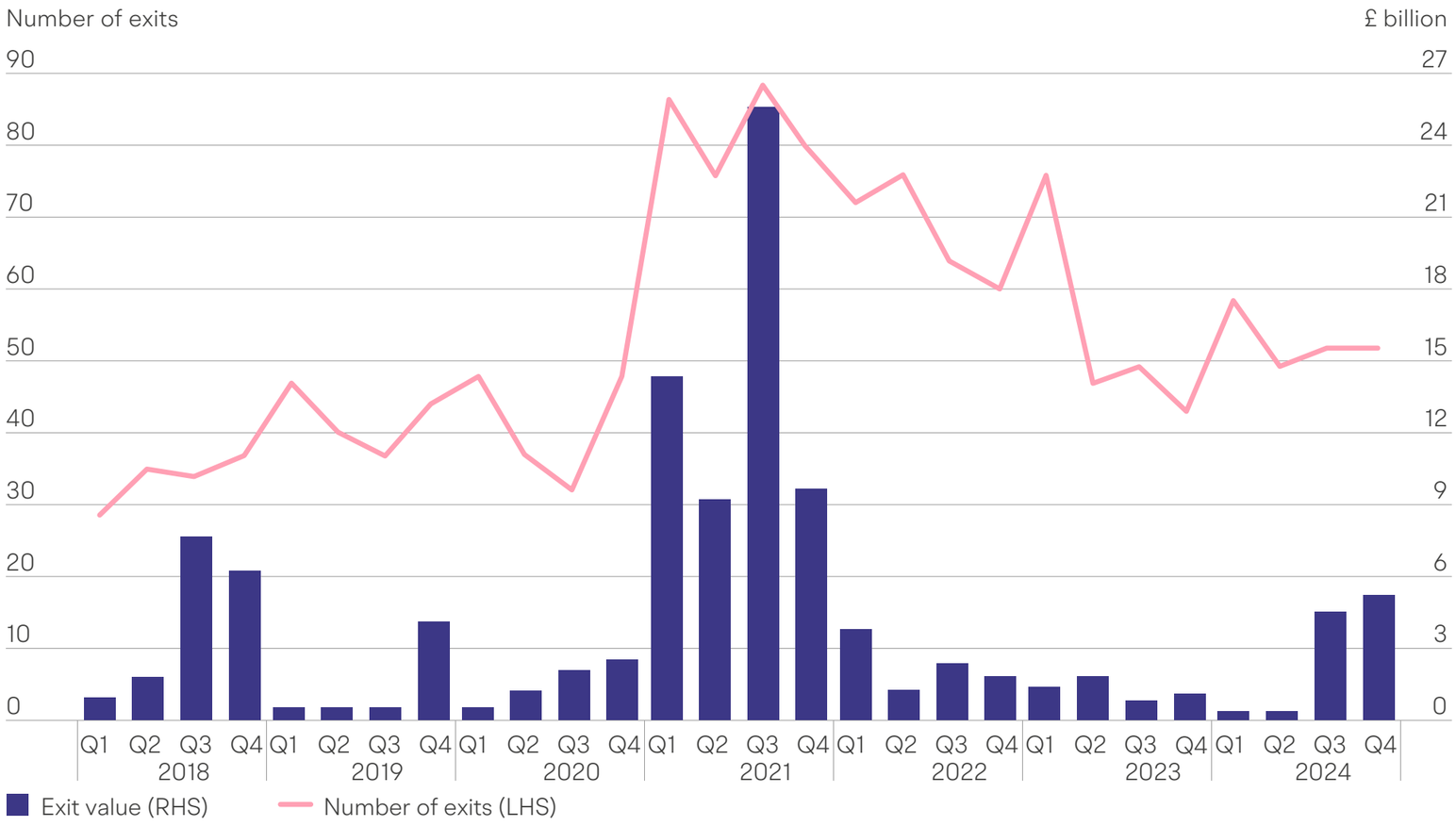
A stagnant exit environment has been a key challenge for the global VC market since the economic downturn in 2022. A lack of appetite for corporate acquisitions, as well as very subdued public market listings, has limited the ability of fund managers to convert the unrealised value of their investments into realised gains. This has reduced their ability to generate returns for LPs and, as a result, attract additional capital for new funds.

The Bank's UK Venture Capital Financial Returns 2024 report found that, while the exit environment had

Figure B.67

Number and value of UK VC-backed company exits

Source: British Business Bank analysis of user defined PitchBook search. Results may differ from PitchBook's own published figures



remained relatively challenging overall, fund managers are expecting conditions to improve during 2025. While 62% of UK-based GPs surveyed perceived the availability of exit opportunities to be poor or very poor, three quarters (74%) expected an improvement over the next year.

The key types of exit routes for VC-backed companies are acquisitions, where a larger corporate buys a promising start-up, or initial public offerings (IPOs). However, IPOs have become less common in recent years; there was just one IPO of a UK VC-backed business in 2024, down from four in 2023 and six in 2022. Since 2018, public market listings have accounted for 4.6% of all exits involving UK VC-backed firms.

Traditionally, companies have sought IPOs for both attracting large scale capital in the hundreds of millions of pounds, and for the prestige of listing on a global stock market (alongside other reasons such as founder liquidity). However, VC markets can now offer some of these benefits to a greater extent, as shown by the prevalence of successful unicorn companies that choose to remain private. In addition, some high profile IPOs in recent years have been unsuccessful, which can dissuade other businesses who may have been considering this exit route.

Fundraising is concentrating with more established managers

Another area of the market which has experienced some recovery recently is VC fundraising, as illustrated by figure B.68. The value of closed UK VC funds increased by 39% to £6.08bn during the full year 2024,[104] the first increase in fundraising since 2021. The number of funds closed remained relatively stable, falling slightly from 50 funds to 45 funds in 2024.

However, the Bank's UK Venture Capital Financial Returns 2024 report found that the majority of UK fund managers perceived current fundraising conditions as either poor or very poor, with 69% providing this response, up from 64% in 2023. GPs reported low LP liquidity (28%), the macroeconomic environment (24%), longer fundraising timelines (19%) and increased difficulty attracting investors (19%) as the most significant challenges affecting the current fundraising environment.

Given macroeconomic uncertainty it is possible that LPs are concentrating their funding in larger or more experienced fund managers with an established track record. For example, the median fund size in the UK increased to a record high of £69.5m in 2024, up from £50.0m in 2023 and £43.0m in 2022. In addition, the number of first time funds remains low, with only 16 closing in 2024 and 13 in 2023 (compared to a ten-year historical annual average of 30).

Fund-level data from Beauhurst, shown in figure B.69, also indicates that the number of unique active funds in the market remains in decline. Combining all investor types together, a total of 700 funds backed at least one announced equity deal in 2024, a 10.6% fall from 2023 and a 19.9% reduction from the peak in 2021. The trend has been slightly worse for PE/VC funds specifically, where the number of funds fell by 14.3% in 2024. So while there have been some positive recent signs for overall UK fundraising, there has yet to be a broader-based recovery in unique active investors.

The British Business Bank's equity programmes will continue to support the market's recovery

The data in this year's report shows that the equity finance market for UK smaller businesses continues to stabilise to activity levels seen before the pandemic, amid a number of macroeconomic headwinds.

The Bank is committed to supporting business across all stages as the market continues to recover from the recent downturn.

At earlier stages of the market, the number of seed stage deals fell more significantly in 2024, while there are signs that capital is being concentrated with more established fund managers. This underlines the importance of the Bank's Enterprise Capital Funds (ECF) programme, which increases the availability of early-stage equity finance to high potential UK companies by supporting emerging fund managers.

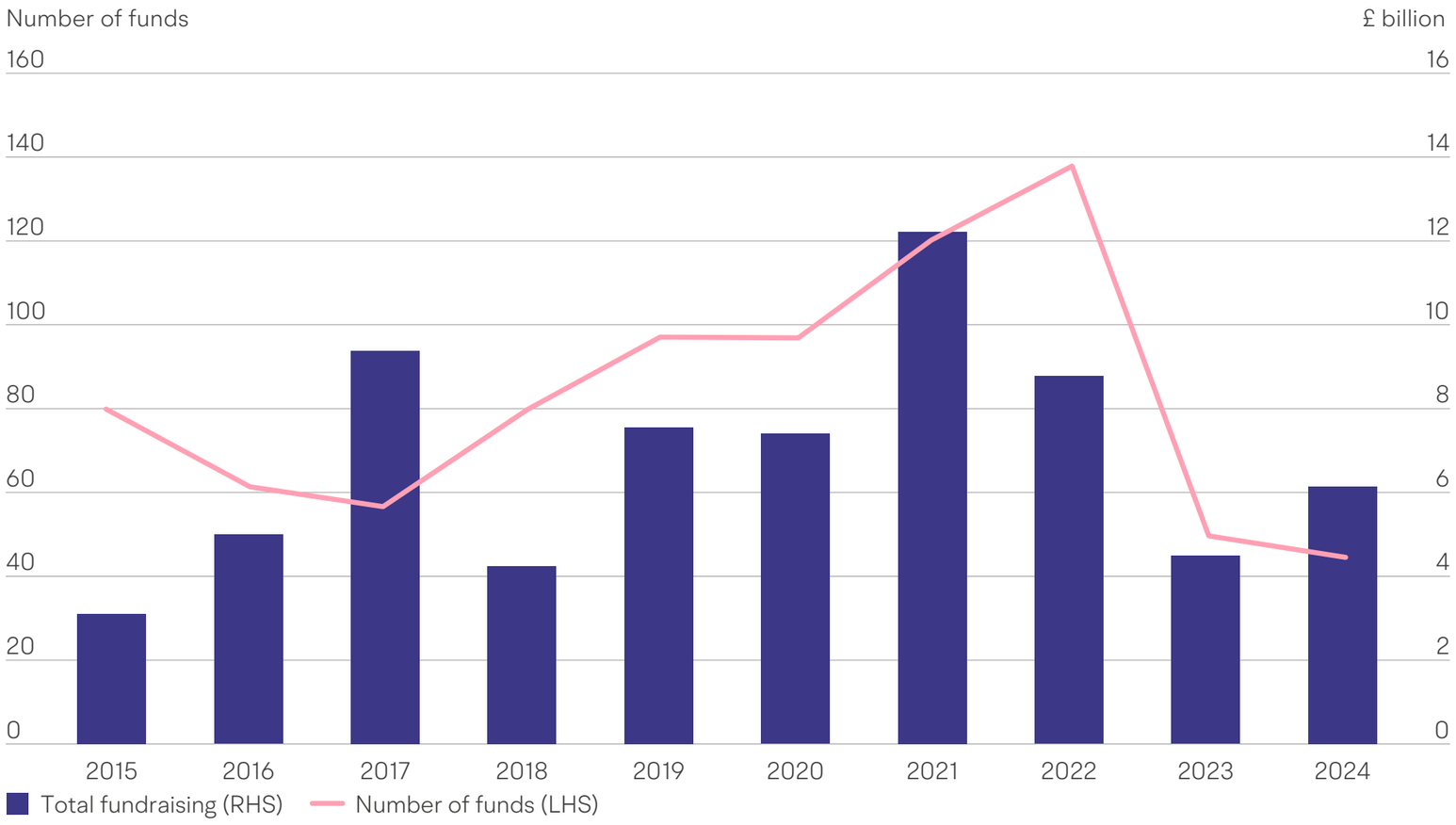
At the venture stage, through both its core funds and direct programmes (such as Future Fund: Breakthrough), British Patient Capital will continue to deploy capital into the market throughout the cycle, catalysing other investors and supporting important UK sectors such as life sciences and deeptech.

Looking ahead, the Bank's British Growth Partnership and the Long Term Investment for Technology & Science (LIFTS) programme will also seek to catalyse institutional funding in the UK's growth economy as part of the Mansion House reforms. In the coming months the Bank

Figure B.68

UK VC fundraising and number of funds closed

Source: British Business Bank analysis of user defined PitchBook search. Results may differ from PitchBook's own published figures



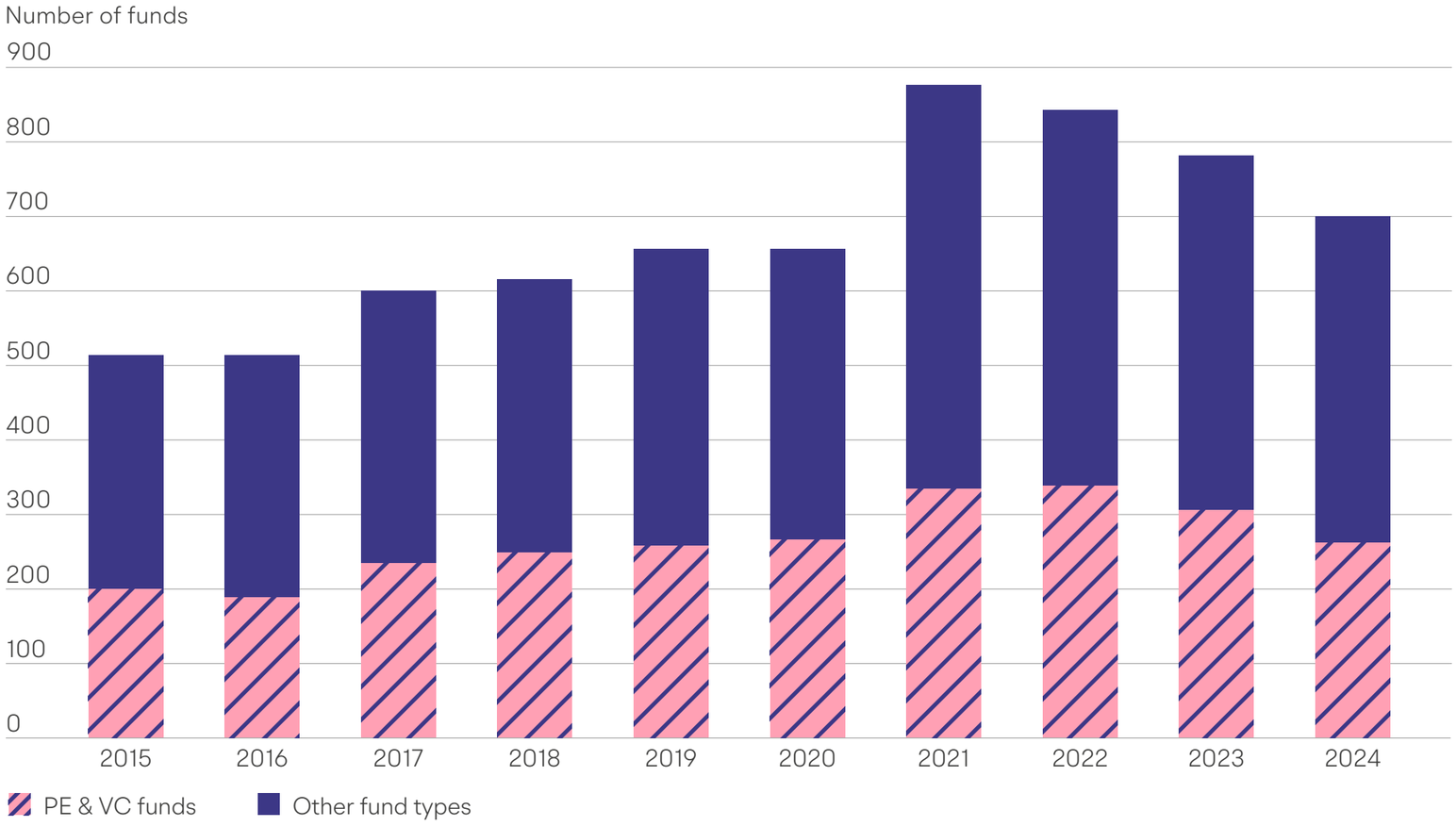
will seek to raise hundreds of millions of pounds of investment for this model, with the aim of making investments by the end of 2025.

Our forthcoming 2025 Small Business Equity Tracker report, covering full year 2024 data, will provide a more in-depth assessment of the trends affecting UK equity finance. The Bank will continue to monitor equity market conditions as part of its mission to make finance markets work better for smaller businesses.

Figure B.69

Number of unique UK funds investing in at least one UK equity deal

Source: British Business Bank analysis of Beauhurst data



2.7

Private debt

The number of mid-market private debt deals increased in 2024

The UK has a larger private debt market than other European competitors

There has been some initial recovery in small-cap activity over the past year

Fundraising declined in 2024 after an especially strong year in 2023

Investors are concentrating their capital in fewer and larger funds

Private debt involves the provision of debt finance through a fund model, rather than through traditional bank lending. This asset class grew in the aftermath of the Global Financial Crisis (GFC) when traditional banks reduced their lending (particularly to SMEs), creating a gap in the market for private debt funds. This section of the report explores recent trends in the UK private debt market from both a dealmaking and fundraising perspective.

Private debt funds generally target established, profit-generating companies seeking finance to implement step-change growth plans. Private debt loans are tailored to the needs of the borrower and typically involve more flexible repayment schedules than traditional bank loans. Due to the additional flexibility, private debt funds fill an important role in the market.

In terms of data availability, leading industry publications such as Deloitte's Private Debt Deal Tracker and Preqin's Global Private Debt Report focus on mid-market deals, given that the market is generally dominated by large funds undertaking buyouts in corporates. Our analysis of the UK private debt market draws on these mid-market data sources but complements them with data from the Bank's small-cap private debt portfolio – given the Bank's focus on this specific part of the market for smaller businesses.

The number of mid-market private debt deals increased in 2024

The latest data shows that there has been a recent recovery in UK private debt dealmaking. As illustrated by figure B.71, which uses a rolling average to smooth out the volatility in quarterly data, an average of 59 UK deals were recorded in the year to 2024Q3. This average was up from 52 in the previous quarter and 35 in 2023Q3.

The recovery in 2024 reverses the downward trend that had previously been evident between 2021 and 2023, initiated by higher levels of inflation and greater macroeconomic uncertainty. While Preqin data also indicates an upturn in UK activity over the past year, the trend is more shallow. Since 2018 Deloitte has recorded a higher volume of activity on the UK mid-market, mainly due to its greater coverage of private debt providers.

Overall, Deloitte data shows that there were 171 UK mid-market deals during the first three quarters of 2024, representing a 74% increase on the equivalent period in 2023. It was a particularly challenging year for dealmaking in 2023, with rising borrowing costs and weaker business confidence affecting the demand for debt finance. Improved stability in inflation and interest rates, as well as more buyouts and exit activity in equity markets, have encouraged greater deployment of mid-market lending over the past year.

In their Private Debt Deal Tracker, Deloitte note that "several factors are contributing to a more fertile backdrop for private debt deal-making, most notably increased visibility around future interest rate cuts and pent-up demand from institutional investors to recycle capital to LPs and deploy new dry powder. The European M&A landscape is slowly-but-surely becoming more buoyant, suggesting that activity levels are not only in the process of rebounding, but also beginning to normalise at sustainable levels."[105]

The UK has a larger private debt market than other European competitors

It is useful to put these recent trends in an international context, to measure the size of the UK market in comparison to global competitors and whether the UK has been more resilient to recent challenges across the industry. Figure B.72 compares the level of mid-market private debt dealmaking to that in France and Germany, as the two other leading markets captured by Deloitte's quarterly data.

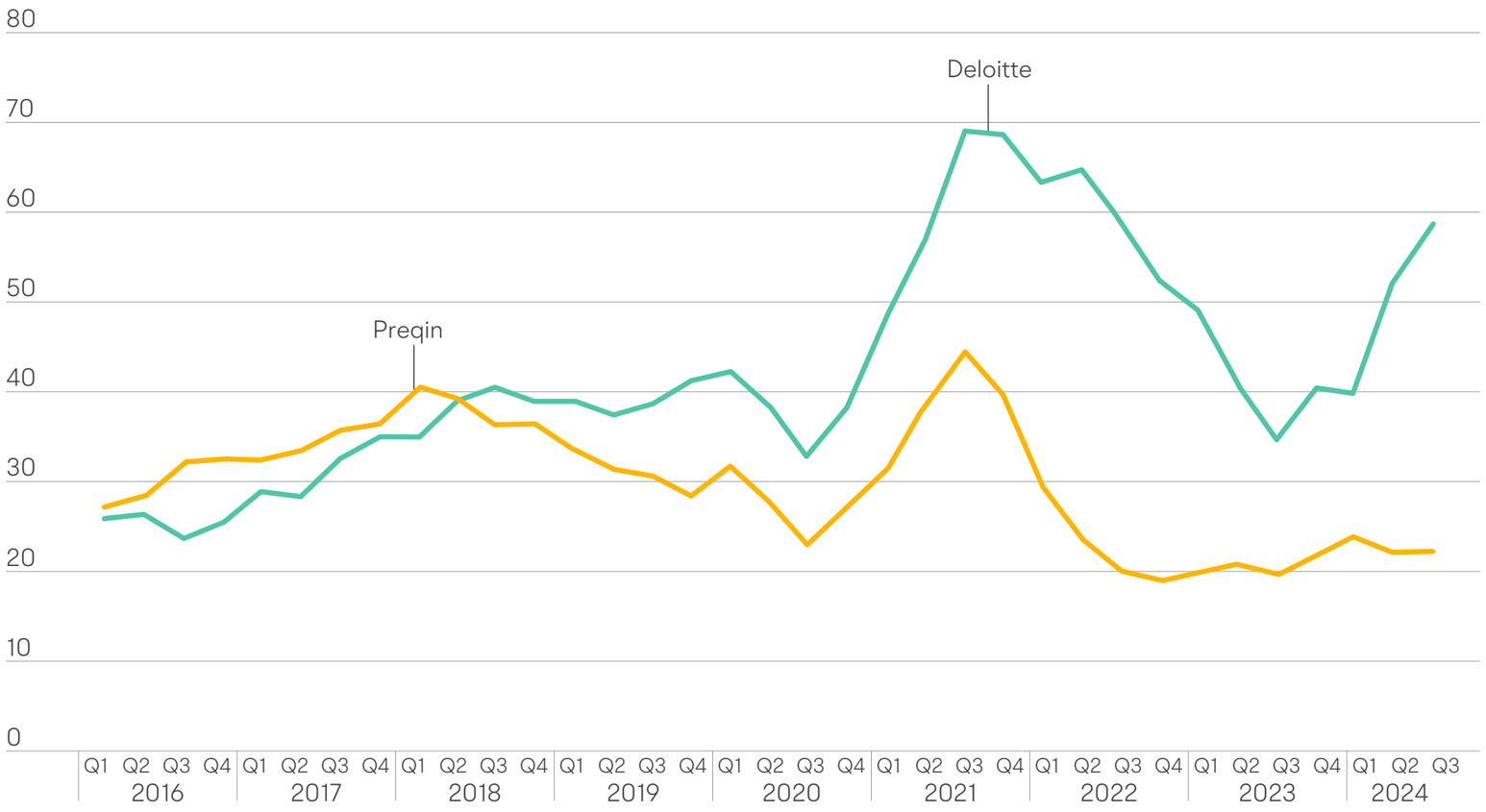
The data shows that the UK has a larger market than both of these European competitors. In the year to 2024Q3 the UK recorded an average of 59 deals per quarter, versus 48 in France and 26 in Germany. Aside from the period between 2023Q2-Q4, the UK has consistently deployed the largest number of deals across the three countries. The UK's reputation as a global financial hub and its strong private equity market, which often leverages debt finance for acquisitions, have led to the UK having a larger private debt market than its European counterparts.

In addition, while the UK experienced a steeper decline in activity during the downturn in 2022, it has also

Figure B.71

Number of mid-market UK private debt deals by data source (four-quarter rolling average)

Source: British Business Bank analysis of Preqin Ltd and Deloitte data



recovered at a quicker rate. Compared with 2023Q3, the UK's quarterly average is now up by 70%, compared with an increase of 14% in France and 29% in Germany. However, it is also worth noting that France is now deploying record numbers of deals in 2024; it's average of 48 in the year to 2024Q3 is the highest total to date.

As well as adding international data, this year's report also looks further into the sectoral composition of the UK's private debt market and how this has evolved over the past decade. Using Preqin data, figure B.73 illustrates the share of mid-market private debt deals by sector during the 2022-2024 and 2015-2017 periods.

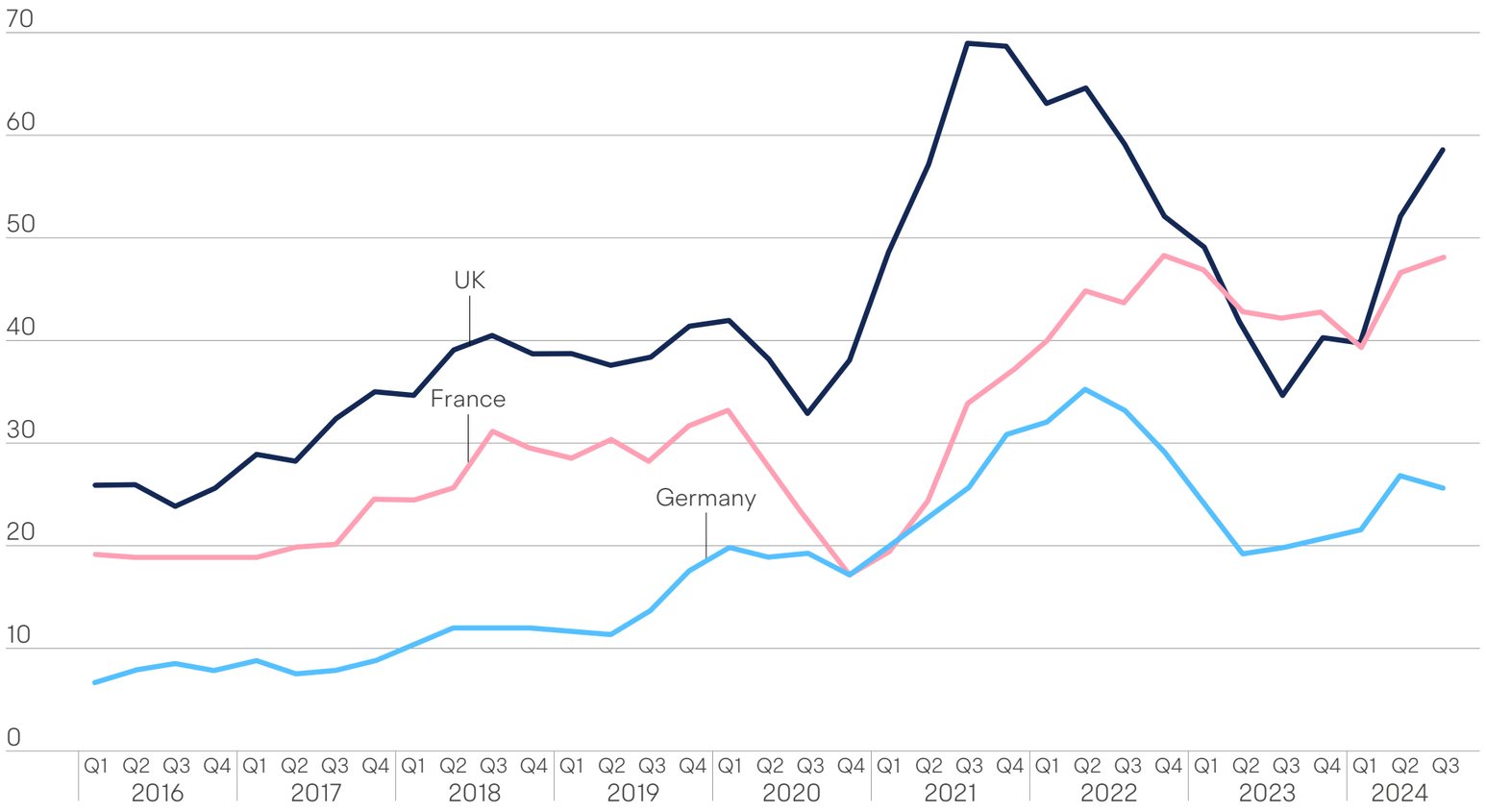
The data shows that the business services and consumer discretionary sectors account for the highest share of UK deals, with 19.8% and 17.1% respectively in 2022-2024. 16.7% of deals were invested in 'other' industries, the largest of which include raw materials, telecoms and energy & utilities. Information technology (IT) and industrials are the next most significant industries, together accounting for over a quarter of the UK market.

Over the past decade there have been some notable shifts in the sectoral composition of UK private debt deals. The share of activity in financial & insurance

Figure B.72

Number of mid-market private debt deals by country (four-quarter rolling average)

Source: British Business Bank analysis of Deloitte data



services has almost doubled from 5.9% to 11.2%, the largest increase of any sector, while healthcare and IT activity has also expanded. These are areas where the UK has underlying competitive strength, and areas where other finance markets have seen growth in parallel (such as the equity market for high-growth companies).

Lastly, there has been a significant reduction in the share of UK private debt deals being invested in the consumer discretionary sector. The proportion of deals in this industry – which includes consumer products, food and travel – has declined from 29.2% to 17.1% since 2015-2017. This will partly be due to the consumer industry being less resilient to the macroeconomic challenges that have recently impacted the market.

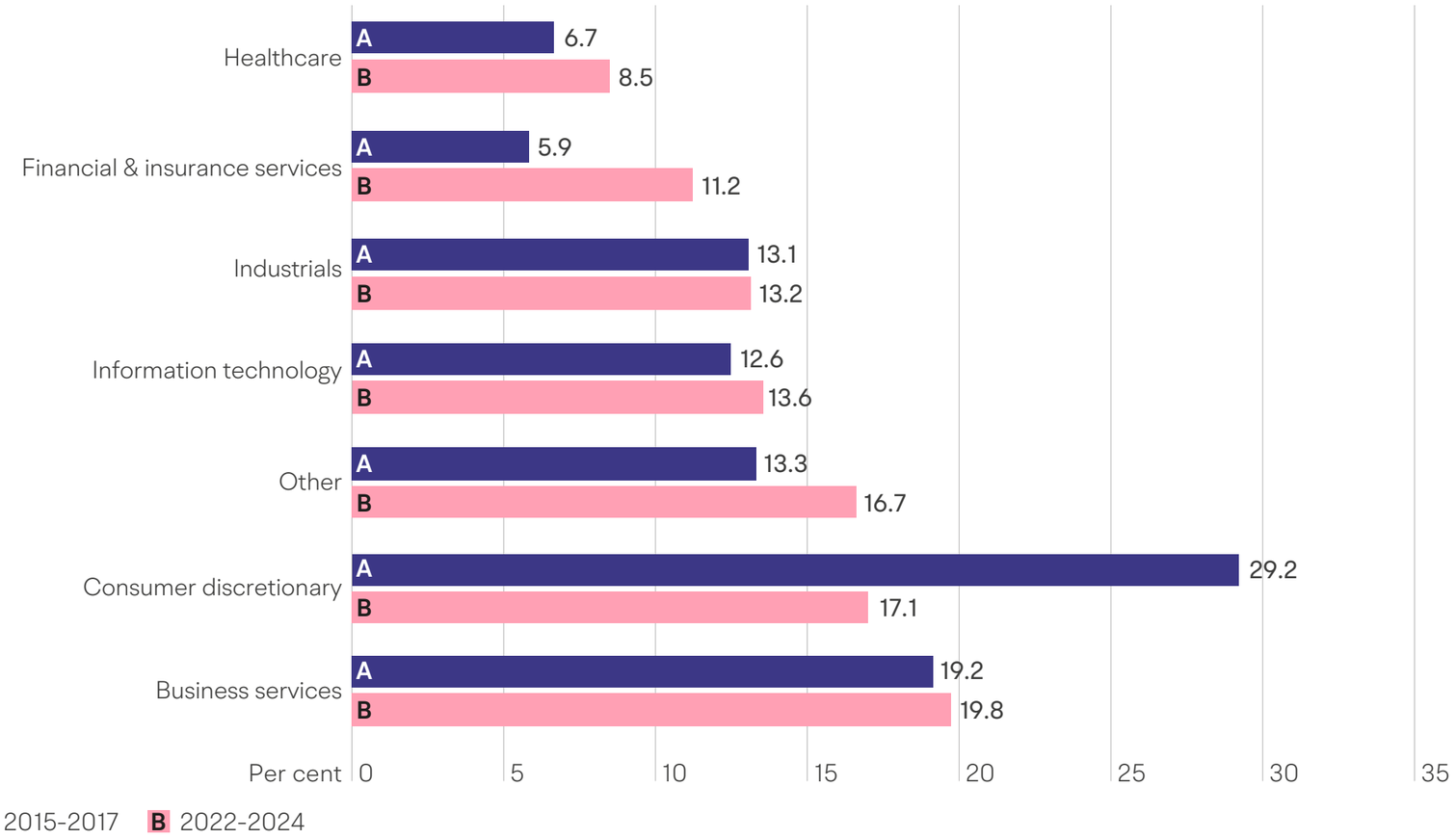
There has been some initial recovery in small-cap activity over the past year

Deloitte and Preqin provide good coverage of mid-market private debt deals, though data is more limited on deals involving small-cap companies (generally defined as having an annual turnover of up to £100m).

Figure B.73

Share of UK mid-market private debt deals by sector, 2015-17 vs 2022-24

Source: British Business Bank analysis of Preqin Ltd



To gain some insights into deal trends in this part of the market, we use the Bank's management information (MI) on its small-cap private debt fund portfolio.

This data covers 39 smaller business-focused debt funds that the Bank's commercial subsidiary, British Business Investments, has invested in through the Investment Programme (IP). Given that this only covers a subset of UK small-cap deals, while giving a useful indication the data is not necessarily representative of all activity in this part of the market.

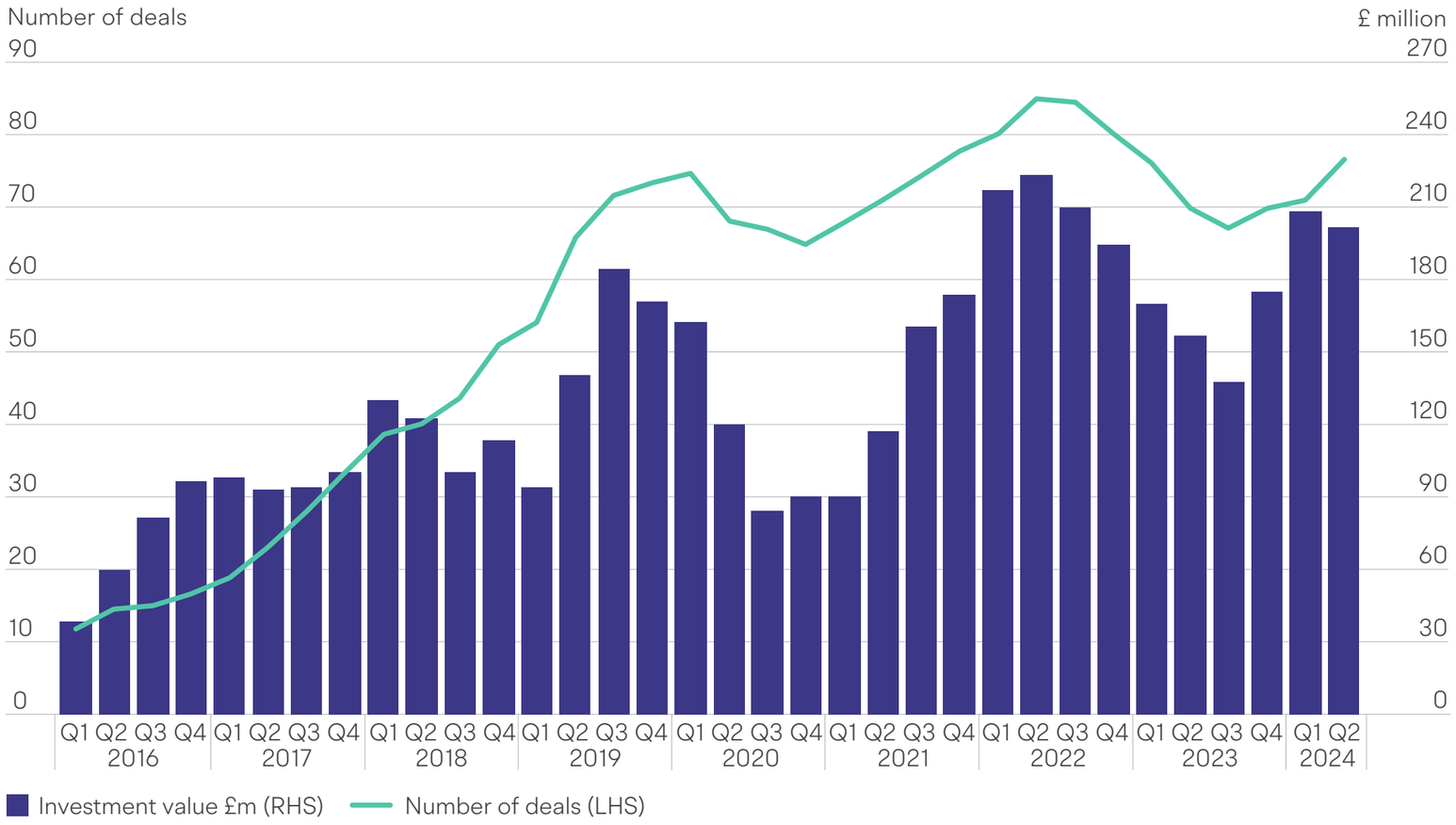
Figure B.74 displays the number and value of smaller business deals involving these small cap private debt funds, again using a four-quarter moving average. The data shows that there has been a notable upturn in activity since the middle of 2023, and in the year to 2024Q2 an average of 77 deals were completed per quarter. This was an increase of 10% compared to 2023Q2, and the highest average since the year to 2022Q4.

On a value basis, an average of £201.2m was advanced by small-cap private debt funds in the year to 2024Q2. While this represented a slight 3% decrease on the previous quarter, the value of deals was up by 29%

Figure B.74

Number and value of deals by British Business Bank small-cap private debt funds (four-quarter rolling average)

Source: British Business Bank Management Information



compared with the year to 2023Q2. Overall, there has been some recovery in dealmaking during 2024 for small-cap private debt funds. This has been very similar to the trend seen for mid-market activity, which has also been on an upward path since its trough in 2023Q2.

Private debt fundraising declined in 2024 after an especially strong year in 2023

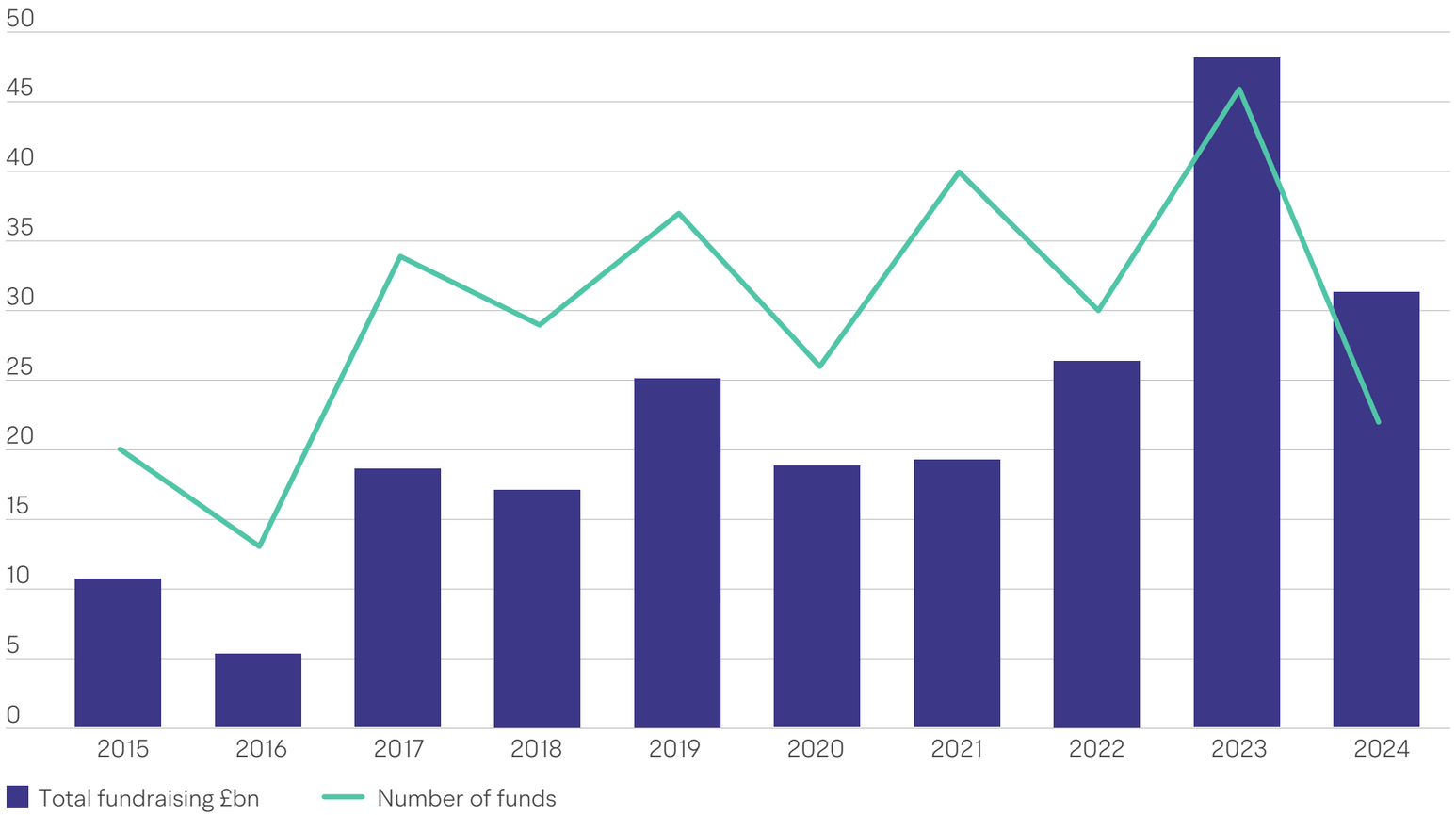
The value of UK private debt fundraising fell by 35% to £31.4bn in 2024 (figure B.75). While more 2024 fundraisings may be announced during the first few months of 2025, this suggests a clear worsening of fundraising conditions in the short term versus the previous year. However, from a longer term perspective this was still the second highest year on record for fundraising and above the 10-year average of £22.1bn.

The number of private debt funds closing in the UK decreased by 52% to a total of 22 funds. As well as being a sharper decline, on a volume basis this was also below the 10-year historical average of 30 funds a year. Overall this indicates that there has been a shift over the past year towards fewer, larger new funds entering the market.

Figure B.75

Number and value of UK private debt funds raised

Source: British Business Bank analysis of Preqin Ltd



Comparing these trends internationally, data from Preqin also shows that private debt funds raised a total of £132.7bn in 2024, down by 23% from £173.3bn in 2023. In addition, the number of funds closing globally fell by 45% from 334 to 184. This suggests that the decline in fundraising activity has also been an international trend in 2024, though the UK has been slightly less resilient than the global market.

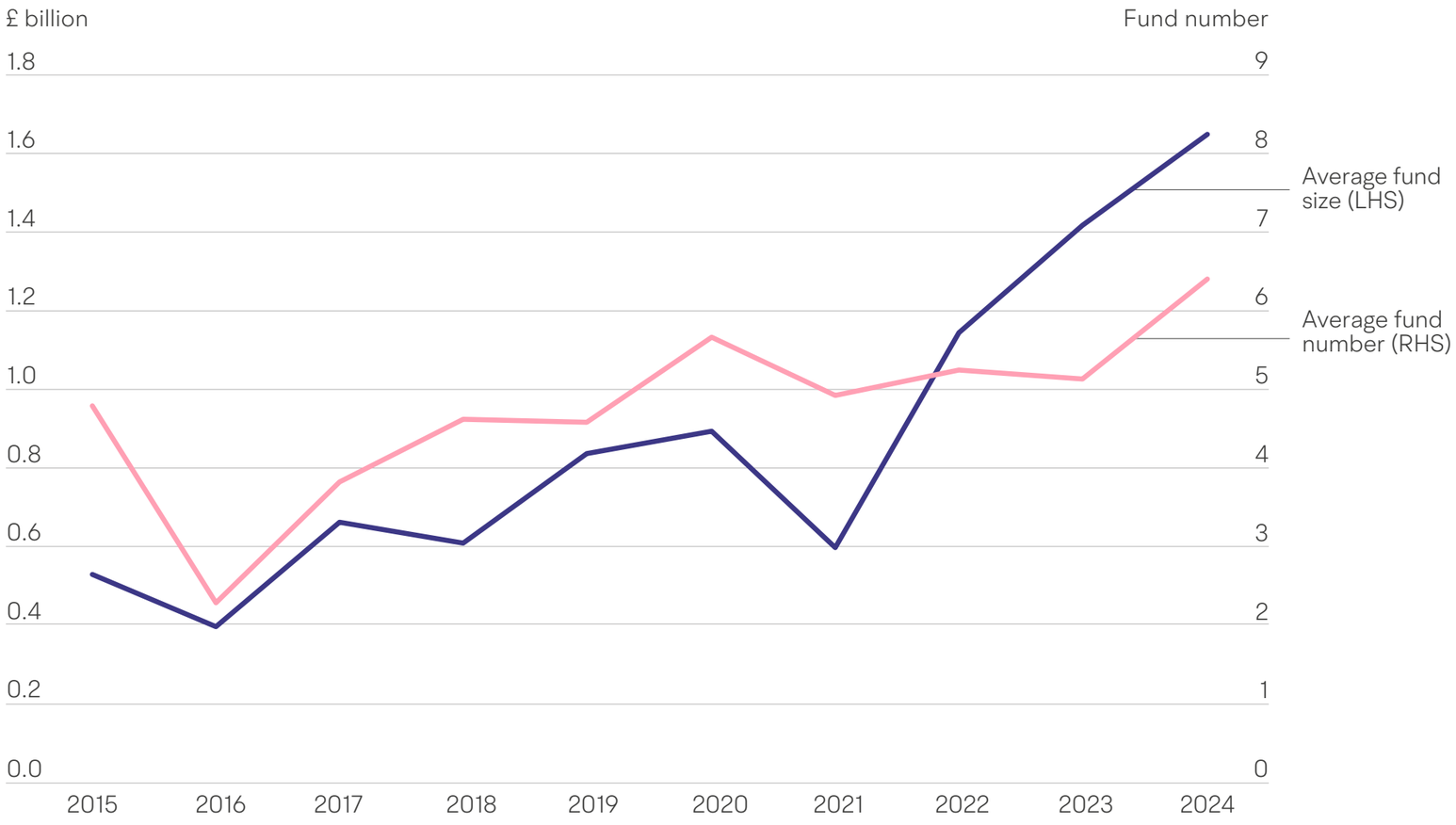
Limited Partners (LPs) – i.e. investors seeking to contribute capital to private fund structures – have been attracted to this asset class due to its potential ability to outperform other private asset classes in higher interest rate environments and provide a reliable income stream. In 2022 and 2023, new investors were drawn to the industry as the relative attractiveness of floating rate instruments or loans generally increase during monetary tightening.

More recently inflation has fallen back closer to target, with the UK Consumer Prices Index (CPI) increasing by 2.5% in the year to December 2024. Initial policy rate cuts and the prospect of further reductions over the course of the next year has resulted in a dampening of LP allocations to private debt assets.

Figure B.76

Average size and ordinal number of UK private debt funds

Source: British Business Bank analysis of Preqin Ltd



In its Alternatives in Europe 2024 report, Preqin note that "...the anticipation of a more rapid rate reduction by the ECB correlates with a slowing of interest in new commitments. While rates may be higher for longer, the private market investment lead times (from initial fund commitments to drawing capital for deployment in deals) can limit the ability to deliver short-term tactical allocations."[106]

Investors are concentrating their capital in fewer and larger funds

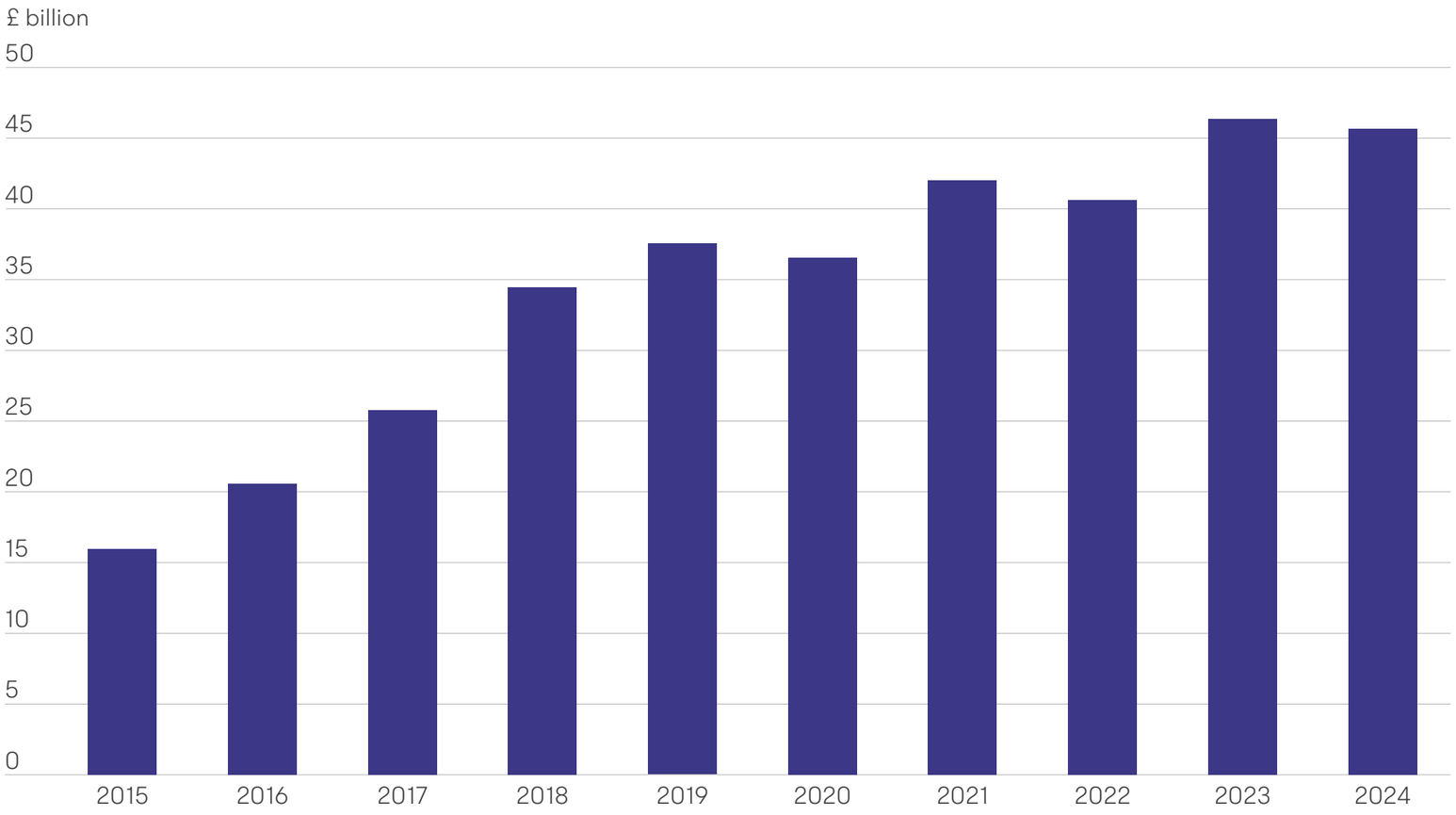
The aggregate fundraising data suggests that capital has been concentrating in larger funds in 2024, and the fund size data in figure B.76 confirms this trend. The average size of private debt funds closing in 2024 increased by 16% to £1.65bn. With the exception of 2021, there has generally been an upward trend in average fund sizes over the past decade – from just £530m in 2015.

In addition, there was an increase in the experience of active fund managers in 2024, as shown by the average fund number for funds closing during the year. This indicator relates to the number of funds within a given fund manager's portfolio. The increase in the average fund number from 5.2 to 6.4 in 2024 demonstrates that

Figure B.77

Dry powder levels in UK private debt funds

Source: British Business Bank analysis of Preqin Ltd



capital is being allocated towards more experienced general partners (GPs) as well as simply larger funds. Whilst one would expect a general positive trend over time as the market matures and managers raise new funds, 2024 saw the sharpest increase since 2017.

There has also been an increase in the time spent fundraising by GPs over the past year. In 2024, UK-based private debt funds spent an average of 22.3 months in the market attracting capital from LPs – an increase from an average of 19.9 months in 2023, and above the 10-year average of 18.9 months. Although this indicator has come down from its 2022 peak (at an average of 27.6 months), these trends further indicate that it has been a challenging year for fund managers, having to push out their timelines and deployment intentions.

In addition, Preqin data shows that just one fund was closed by a first-time fund manager in 2024. This was a decline from seven first time funds in 2023 and a peak of 11 in 2021. This represented just 5% of all funds that closed during the year in 2024, compared to a 10-year average of 23%. This further indicates that investors are concentrating their capital in more experienced managers during these more challenging market conditions. While a high share of follow-on funds demonstrates that the market is maturing, a lack of emerging fund managers could have implications for the health and breadth of the future ecosystem.

Dry powder refers to the amount of committed capital that fund managers have available to invest in new opportunities. Looking at recent trends, a slight increase in deployment in 2024 combined with a reduction in fundraising has resulted in a small decline in dry powder reserves. Figure B.77 shows that, at the end of 2024, UK private debt funds had accumulated dry powder of £45.6bn, down from £46.3bn at the end of 2023. Overall dry powder levels have been on an upward trend, increasing almost three times from £16.0bn in 2015, reflecting the expansion of the asset class in the UK over the past decade.

The British Business Bank will continue to play a key role in expanding the supply of private debt for smaller businesses

Private debt will continue to be an important finance type for supporting UK growth, providing finance to smaller businesses in a risk averse lending environment. However, uncertainty regarding the UK economy's future outlook – with GDP growth flat at 0% in the three months to September 2024 – also suggest an increased risk of defaults and impairments.

The latest evidence in this report demonstrates that long-term market failures are continuing to create barriers for emerging fund managers seeking to enter the market. Capital is concentrating in larger funds, and with more established GPs, rather than new managers who will help broaden the overall supply of finance in the market. Data from 2024 shows that the share of funds closed by first-time managers is low, and average fund sizes have risen significantly over the past few years.

British Business Investment's (BBI) Investment Programme (IP) will continue to play an important role in addressing these market challenges. Its cornerstone investments are helping to leverage additional capital into the asset class, and IP committed £243m across eight funds in 2024. By funding companies outside of London, IP is also supporting the Government's ambition to kickstart growth across UK Nations and regions. Private debt is also a valuable source of finance for smaller businesses in growth sectors such as tech and professional services, which are at the core of the government's Industrial Strategy.[107]

Bank lending

– 2.8 Bank lending

– 2.9 Challenger and specialist banks

2.8

Bank lending

Gross bank lending increased moderately in 2024

Demand for lending has been limited by a range of factors

New lending to smaller businesses from the major UK banks remained subdued

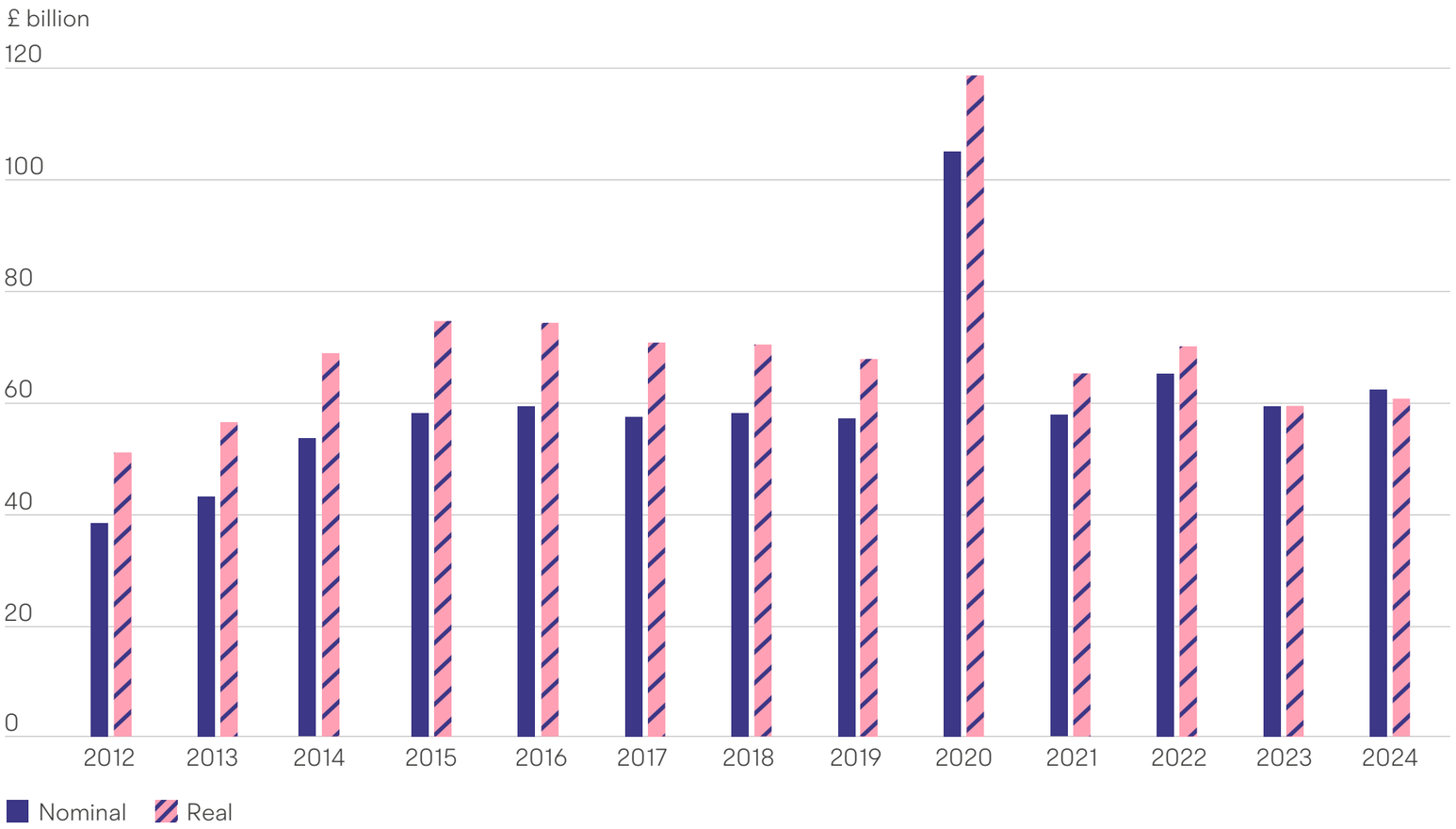
Gross repayments fell for the second consecutive year

This section analyses developments in the UK banking market for smaller businesses in 2024. It draws on the most recent data and market intelligence from sources including the Bank of England (BoE), UK Finance and the British Business Bank (the Bank). The BoE gross bank lending measure consists of term lending, including real estate (RE) lending, and can include other products such as asset finance and invoice finance which cannot be split out.

Figure B.81

Annual gross bank lending to SMEs

Source: BoE and British Business Bank calculations



Gross bank lending increased moderately in 2024

BoE data shows nominal gross bank lending excluding overdrafts to small and medium-sized enterprises (SMEs) in 2024 totalled £62.1bn. This was a nominal increase of 5% from 2023. The nominal value of gross lending was the third highest since records began in 2012 after 2020 (£105bn), which was largely driven by government-guaranteed Covid-19 loans, and 2022 (£65.1bn).

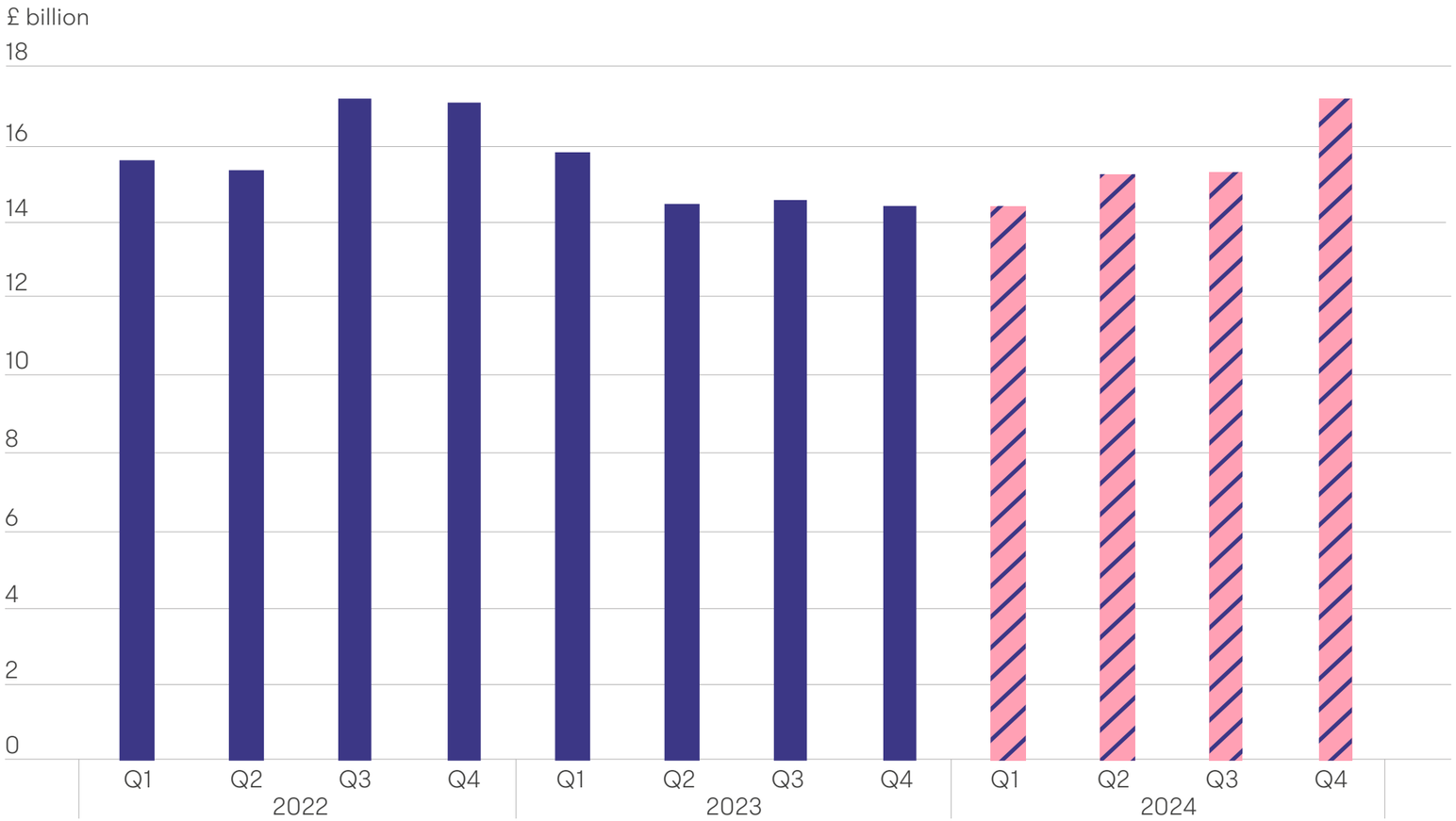
While gross lending rose 5% in nominal terms, when accounting for inflation it was up only 2%. The value of gross lending in real terms was £60.4bn. This was the fourth lowest on record (figure B.81).

Government-guaranteed lending drawn down from banks in 2024 totalled £0.6bn. Of this, 74% was term loans. The £0.6bn was the equivalent of 1% of total gross bank lending for the year.[108] The government-guaranteed lending comprised drawdowns under the third variant of the Recovery Loan Scheme (RLS 3) in the first half of 2024 and the Growth Guarantee Scheme (GGS) in the latter half.[109]

Figure B.82

Quarterly gross bank lending to SMEs

Source: BoE



The £0.6bn of government-guaranteed lending drawn down from banks in 2024 was the highest since 2022 (£1.4bn). However, it remained well below the figure in 2020 (£56.7bn), which comprised drawdowns under the Coronavirus Business Interruption Loan Scheme (CBILS) and the Bounce Back Loan Scheme (BBLS).

The quarterly breakdown showed that during 2024 nominal gross lending increased in Q2 and Q4 but was broadly flat in Q1 and Q3. The pickup in Q4 (12%) was the largest in just over two years. This led gross lending to reach £17.2bn, the highest quarter since Q3 2022 (also £17.2bn) (figure B.82).

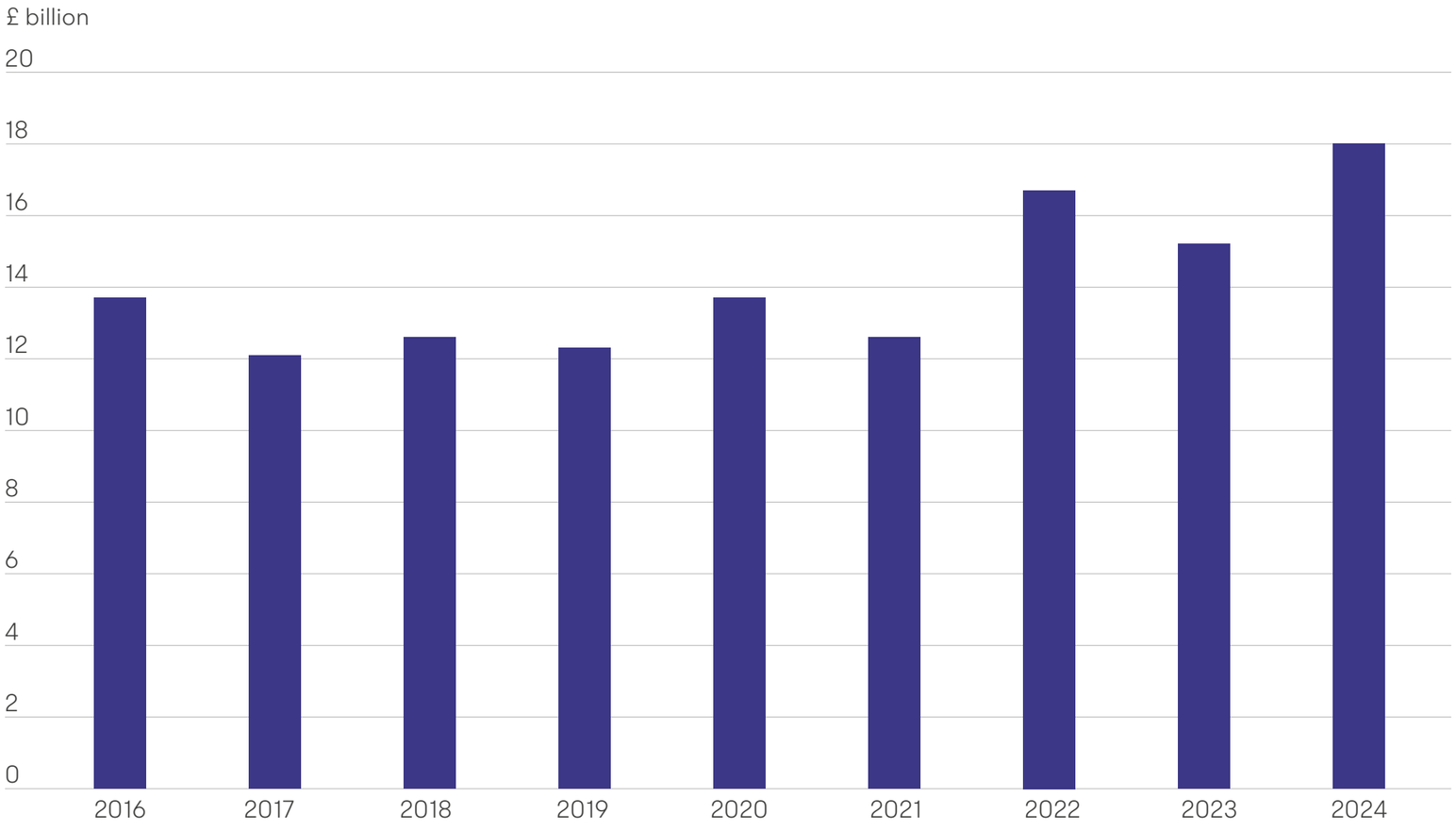
The annual breakdown by sector shows nominal gross lending to SMEs in RE in 2024 was £18bn.[110] This was up 19% from 2023 and the highest since records for RE lending began in 2016 (figure B.83).

While nominal gross lending to the RE sector increased sharply in 2024, it was broadly flat to all other sectors in aggregate. Consequently, RE lending as a share of total gross lending reached 29%. This was up from 26% in both 2022 and 2023 and the highest on record. The Bank's market intelligence is that the recent increase in lending to the RE sector has been driven by actual and expected falls in the Bank Rate. This reflects the demand

Figure B.83

Annual gross bank lending to the real estate sector

Sources: BoE and British Business Bank calculations



from businesses in the RE sector for lending is typically more sensitive to changes in Bank Rate than that from others. As RE projects are often heavily reliant on debt financing, higher interest rates increase the cost of servicing the debt and erode profit margins, and vice versa.[111]

The BoE does not provide a breakdown of the applications for, or approvals of, gross lending. However, an insight can be gained from the BoE agents, UK Finance data for the seven largest UK banks, the UK Finance BVA BDRC SME Finance Monitor and our market intelligence.[112]

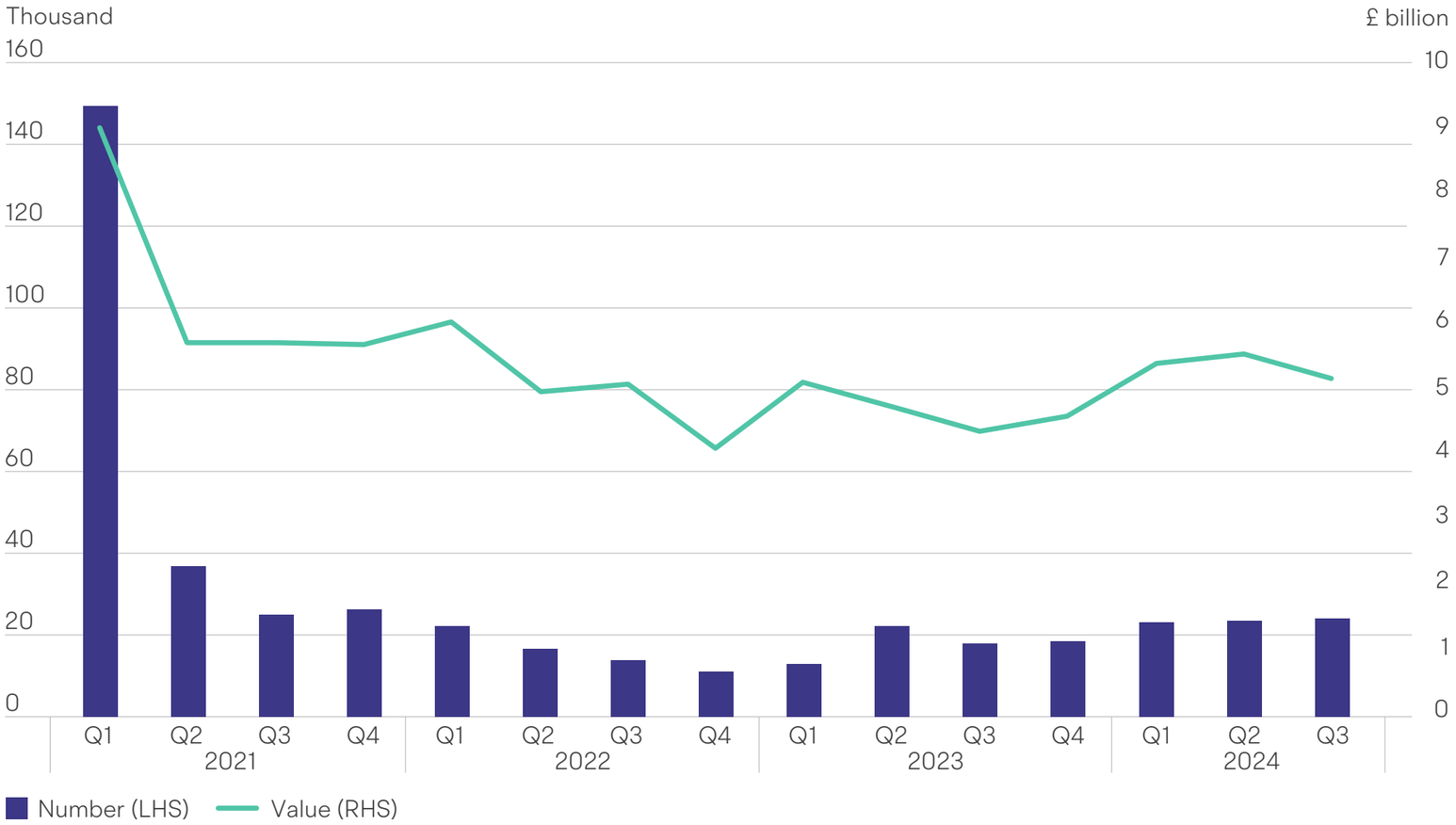
Demand for lending has been limited by a range of factors

The latest available UK Finance data for Q3 2024 indicates smaller businesses' demand for lending from the major UK banks continued to pick up but remained weak. The number of SME applications for loan facilities was 23,764. This was up 32% from Q3 2023 (18,006) but still only around two-thirds of that in Q3 2019 (34,620). The story for the nominal value of loan applications was broadly similar (figure B.84).

Figure B.84

SME applications for loan facilities to the 7 largest UK banks

Source: UK Finance



Likewise, the BoE agents reported during 2024 that the demand from their business contacts for new lending continued to be weak. This was attributed to high borrowing costs, deleveraging and cash reserves remaining relatively large.[113]

Borrowing costs reached record highs during the first half of 2024. In Q1 the weighted average interest rate on all new loans to SMEs i.e., fixed and floating, was 7.51%.[114] This was up slightly from the previous quarter and the highest since records began in 2016. After reaching a new record of 7.65% in Q2 2024, it fell in Q3 to 7.35% and in Q4 to 7.16% (figure B.85). The BoE Credit Conditions Survey indicated spreads on loans to small businesses and medium-sized private non-financial corporations were generally little changed during 2024.[115]

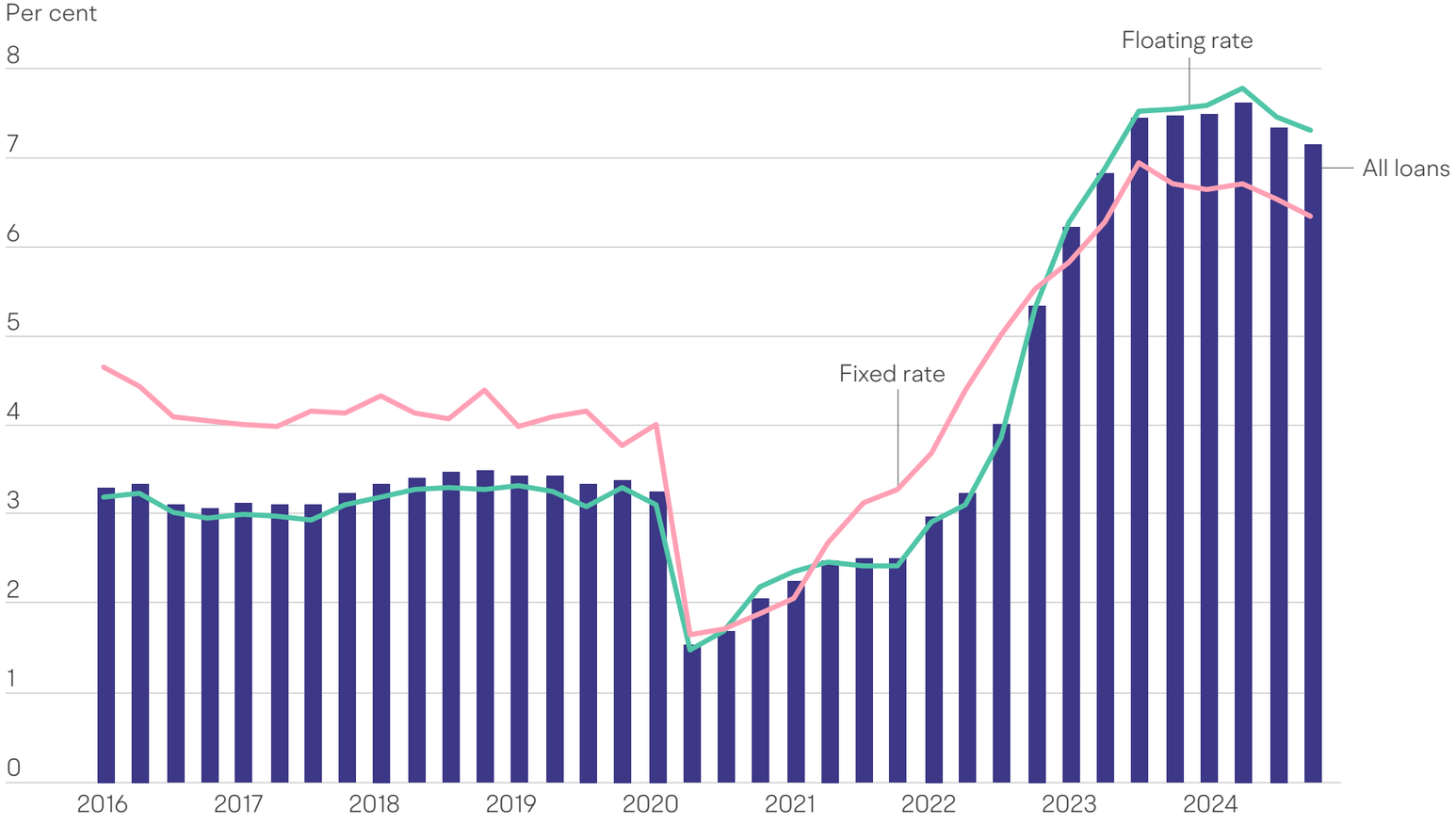
The outlook for borrowing costs improved as 2024 progressed. This was largely due to inflation returning to near the BoE's 2% target in the middle of the year, which led to widespread expectations that Bank Rate had peaked and was likely to start falling later in 2024.

During 2024 the BoE agents flagged that their contacts were generally deleveraging. They noted remaining BBLS obligations were still dampening the appetite of small

Figure B.85

Effective interest rates (new business) for SMEs

Source: BoE



firms.[116] This is consistent with the 2024 mid-year update of the SME Finance Monitor report showing that in Q2 one-in-five SMEs were still repaying pandemic funding.[117] It is also in line with the latest available Department for Business and Trade data as of 30 September 2024 showing 36% of BBLS businesses have used one or more of the Pay As You Grow options offered under the scheme.[118]

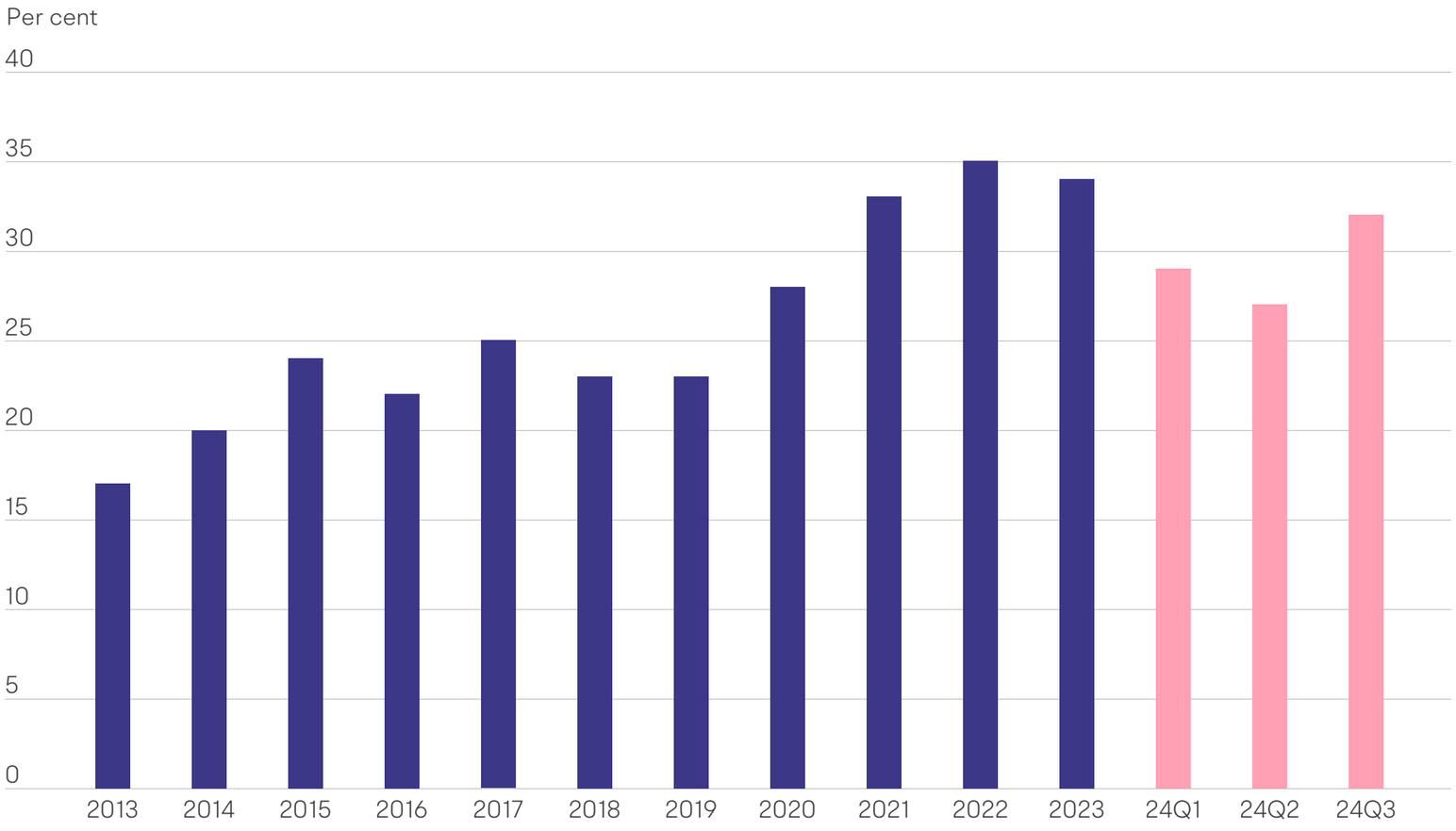
A relatively high proportion of smaller businesses continued to have large credit balances during 2024. The monthly snapshot of the SME Finance Monitor report showed that in Q3 the share of SMEs holding £10,000 or more in credit balances was 32%. This was the highest since Q4 2023 (33%) and above the 2019 average (23%). The latest available monthly snapshot for the three months to end-November showed the share was slightly lower at 30%.[119] Separately, the BoE agents in early 2024 noted firms were using their own cash to fund investment. However, later in the year the agents mentioned there were increasing examples of firms borrowing to fund investment (figure B.86).[120]

During 2024 the BoE agents noted the demand for working capital finance remained stronger than that for capital expenditure. This is in line with the monthly

Figure B.86

Share of SMEs holding £10,000 or more in credit balances

Source: UK Finance BVA BDRC SME Finance Monitor



snapshot of the SME Finance Monitor report showing the main form of finance most mentioned from January to November was credit cards. Overdrafts ranked second in the first half of the year but subsequently slipped to third. The relatively strong demand for working capital products reflects that input costs remained high, continuing to squeeze cash flow, while the economy has remained flat.

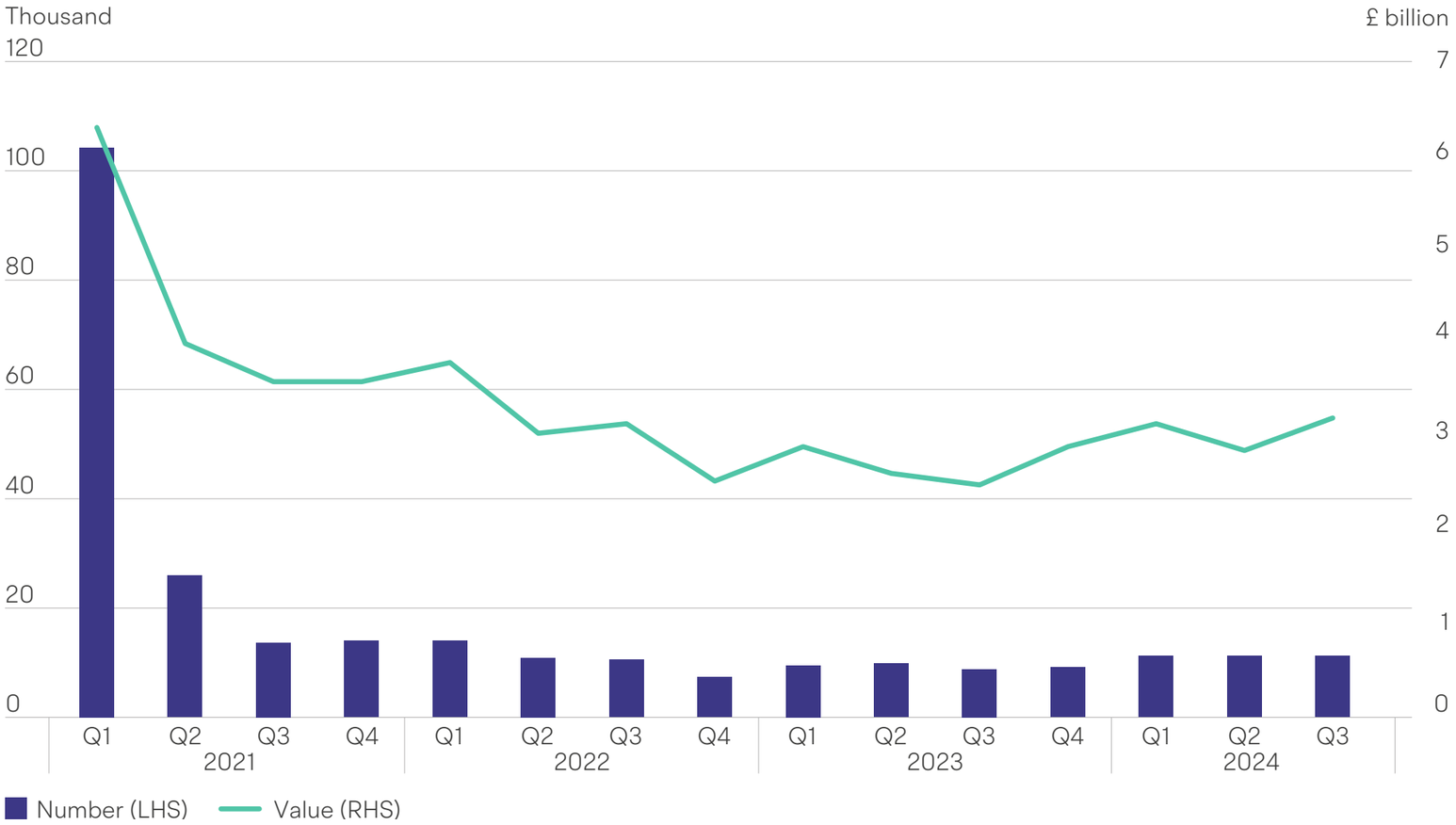
New lending to smaller businesses from the major UK banks remained subdued

The latest UK Finance data for Q3 2024 indicates the number and value of major UK banks' approvals of new lending to smaller businesses increased slightly but remained much lower than prior to the pandemic. The number of SME loan facilities approved or increased was 11,245. This was up from Q3 2023 (8,636) but less than half of that in Q3 2019 (27,617). It was a similar story for the nominal value of loan facilities approved or increased (figure B.87).

Figure B.87

SME loan facilities approved or increased by the 7 largest UK banks

Source: UK Finance



The monthly snapshot of the SME Finance Monitor report also showed success rates for all types of applications have improved but remain below pre-pandemic levels. The rate for the period from Q3 2023 to Q4 2024 was 56%. This was up from Q1 2022-Q2 2023 (49%) but remained below Q1 2018-Q2 2019 (74%).

The BoE agents' reports from Q2 2024 onward noted a general improvement in the supply of credit. Banks continued to compete to lend to the most creditworthy businesses. However, access to credit was still a challenge for smaller businesses, particularly those with low profitability, limited security or high debt. This is broadly in line with the monthly snapshot of the SME Finance Monitor report showing 19% of SMEs said they feel they are 'struggling' in the three months to November. It was also down only slightly from Q1 (22%) and Q2 and Q3 (both 21%).

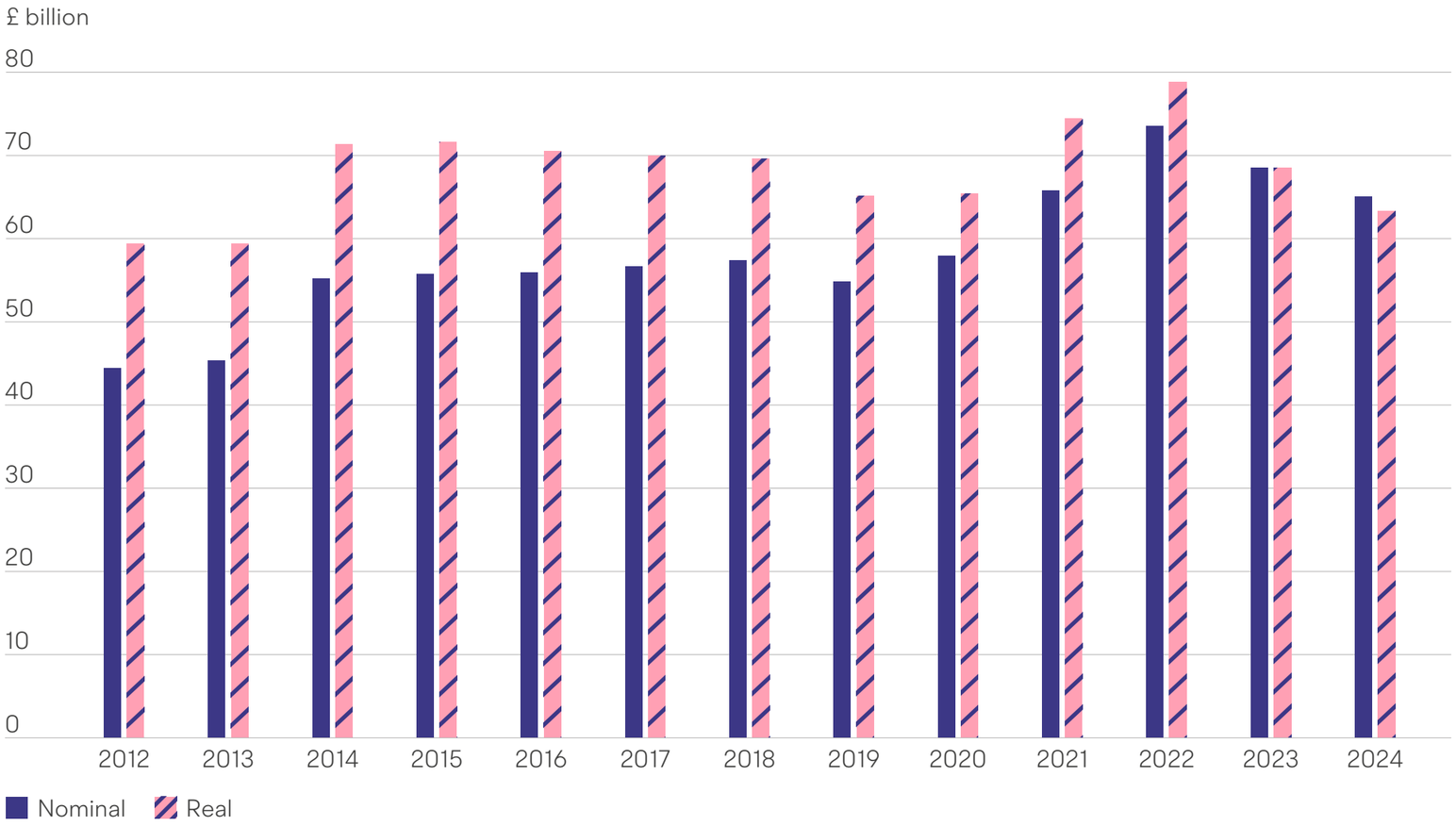
Gross repayments fell for the second consecutive year

Nominal gross repayments by SMEs in 2024 totalled £65.1bn. This was down 5% from 2023 and the second consecutive fall. In nominal terms this was still the fourth highest on record after 2022 (£73.5bn), 2023 (£68.5bn)

Figure B.88

Annual gross repayments by SMEs

Source: BoE and British Business Bank calculations



and 2021 (£65.7bn). However, in real terms, gross repayments were down 8% from 2023 and the value of gross repayments (£63.3bn) was the second lowest on record after the joint low in 2013 and 2014 (both £59.3bn) (figure B.88).

The fall in nominal gross repayments for the second consecutive year largely reflects that the one-year holiday on paying interest and repaying the principal on BBLS ended in late 2022. As a result, by the end of 2022 all those smaller businesses that had drawn down BBLS had started paying interest and repaying the principal or paid the facilities back in full. The Department for Business and Trade data as of 30 September 2024 also showed the majority (70%) of BBLS facilities drawn down from lenders including banks were either fully repaid (14%) or on schedule (56%).

The BoE measure of nominal net lending in 2024 was a negative £3bn. This was the fourth consecutive year of negative net lending but the narrowest over that period. It was also much narrower than the negative net lending in 2023 (£9.3bn), the largest on record. In real terms, net lending in 2024 was a negative £2.9bn.

The British Business Bank's programmes are set to continue to support bank lending to smaller businesses throughout the UK

The latest official forecasts suggest the economic environment facing smaller businesses in the UK is likely to remain challenging over the next few years, with subdued economic growth, high input costs and elevated interest rates.[121] Amid this backdrop, it remains crucial for smaller businesses to be able to access the finance they need from the banking sector.

The Bank's programmes are set to continue to support bank lending to smaller businesses throughout the UK. The GGS aims to help smaller businesses access the finance they need, whether it be to manage cash flow or to invest and grow. Similarly, the ENABLE Guarantee programme is designed to help lenders including banks to unlock more lending to smaller businesses. The programme's scope was recently broadened to include Community ENABLE Funding, which aims to increase the availability of finance to the social impact sector initially through Community Development Financial Institutions, some of which are banks.

2.9

Challenger and specialist banks

Gross lending by challenger and specialist banks returned to growth in 2024

Challenger and specialist banks increased their share of total gross lending again

SME real estate lending by challenger and specialist banks remained higher than that by the Big 5 banks

The impact of the Basel 3.1 reforms is now expected to be limited

Two building societies have acquired banks and four banks were granted banking licences, of which one plans to directly serve smaller businesses

This section analyses the developments in 2024 for the challenger and specialist banks that serve smaller businesses. It draws on data and market intelligence from sources including the Bank of England (BoE) and the British Business Bank (the Bank). For the purposes of this chapter, challenger and specialist banks are defined as those which have a UK banking licence but are not one of the five biggest UK banks by total lending (the Big 5).[122]

Gross lending by challenger and specialist banks returned to growth in 2024

BoE data shows nominal gross lending excluding overdrafts to small and medium-sized enterprises (SMEs) by challenger and specialist banks in 2024 was £37.3bn. This was up 8% from 2023 and followed a decrease of 2% in 2023.

Although gross lending by challenger and specialist banks in 2024 reached a record high in nominal terms, in real terms it was only the third highest on record. Real gross lending by challenger and specialist banks totalled £36.3bn, up only 5% from 2023 (figure B.91).

Government-guaranteed lending drawn down from challenger and specialist banks in 2024 totalled £0.4bn.[123,124] Of this, 59% was term loans. The £0.4bn was equivalent to 1% of total gross lending by challenger and specialist banks.

The £0.4bn government-guaranteed lending drawn down from challenger and specialist banks in 2024 was up from 2023 (£0.3bn). However, it was below that in 2020 (£6.9bn), which comprised drawdowns under the Coronavirus Business Interruption Loan Scheme and the Bounce Back Loans Scheme, and in 2021 (£3.4bn) and 2022 (£0.9bn).

Challenger and specialist banks increased their share of total gross lending again

The share of total nominal gross lending to SMEs by challenger and specialist banks in 2024 was 60%. This was up from 59% in 2023, the fourth consecutive increase. It was also the highest on record. Furthermore, challenger and specialist banks' share of total gross lending exceeded that of the big five banks for the fourth year in a row (figure B.92).

The record-high share in 2024 was driven by the previously mentioned 8% increase in gross lending by challenger and specialist banks. In contrast, gross lending by the Big 5 banks was up only 1% to £24.8bn. This was the third lowest value on record after 2012 (£23.4bn) and 2023 (£24.5bn). In real terms, gross lending by the Big 5 banks fell 2% to £24.1bn, a record low (figure B.93).

Challenger and specialist banks accounted for 62% of all government-guaranteed lending drawn down from banks in 2024. This was slightly lower than in 2022 (65%) and 2023 (64%) but still well above the figure in 2021 (39%).

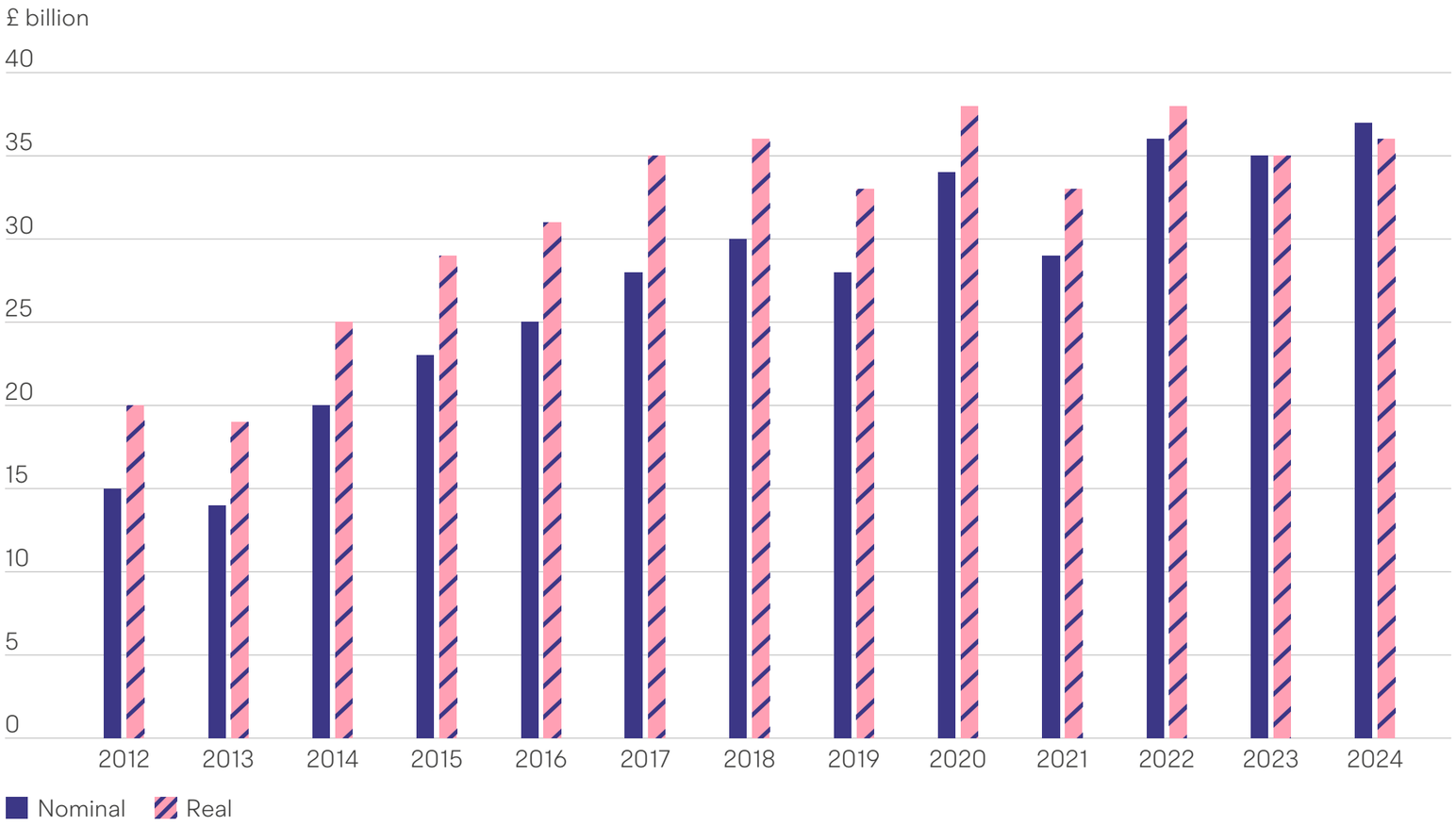
The quarterly breakdown shows nominal gross lending by challenger and specialist banks fell in Q1 2024 before increasing in the following three quarters. The pickup in Q2 (10%) was the largest in nearly two years. However, the increase in Q4 was of the same magnitude, which led challenger and specialist banks' gross lending to reach £10.3bn, the highest quarter on record.

In comparison, gross lending by the Big 5 banks increased in Q1 2024 and was broadly flat in the following two quarters before it increased again in Q4. Excluding the impact of the Covid-19 pandemic, the pick up in Q4 (16%) was the largest in just over 11 years. This led gross lending by the Big 5 banks in Q4 to total £6.9bn, the highest since Q3 2022 (£7.7bn) (figure B.94).

Figure B.91

Annual gross lending to SMEs by challenger and specialist banks

Sources: BoE and British Business Bank calculations



SME real estate lending by challenger and specialist banks remained higher than that by the Big 5 banks

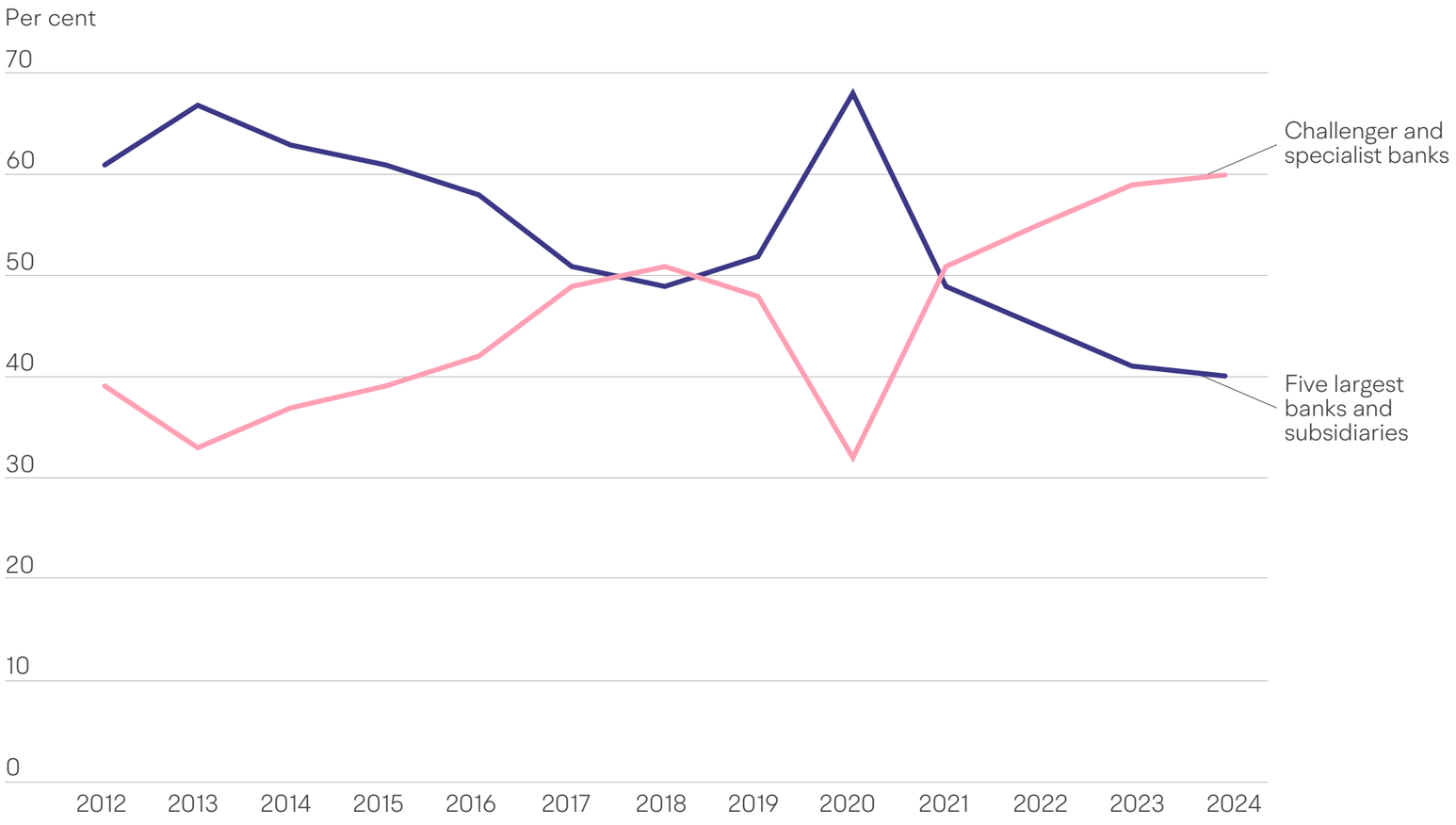
The sector breakdown shows gross lending by challenger and specialist banks to SMEs in the real estate sector (RE) in 2024 was £11.8bn. This was up 18% from 2023 and the highest since records for RE lending began in 2016. In contrast, challenger and specialist banks' gross lending to all sectors excluding RE in 2024 was £25.5bn, up only 3% from 2023 (figure B.95).

Furthermore, gross lending to the RE sector in 2024 by challenger and specialist banks was higher than that by the Big 5 for the fifth year in a row. Gross lending to the RE sector by the Big 5 banks in 2024 was £6.2bn. This was up 19% from 2023, in line with the increase in challenger and specialist banks' lending to the RE sector. Consequently, challenger and specialist banks' share of total gross bank lending to the RE sector in 2024 was unchanged from the record high in 2023 of 66% (figure B.96).

Figure B.92

Share of annual total gross bank lending to SMEs

Source: BoE and British Business Bank calculations



The impact of the Basel 3.1 reforms is now expected to be limited

In September 2024 the Prudential Regulation Authority (PRA) published the second near-final policy statement on the Basel 3.1 standards.[125,126] It also published proposals on the 'strong and simple' capital regime for smaller firms.[127,128] This followed the PRA publishing the first near-final policy statement on Basel 3.1 in 2023.[129]

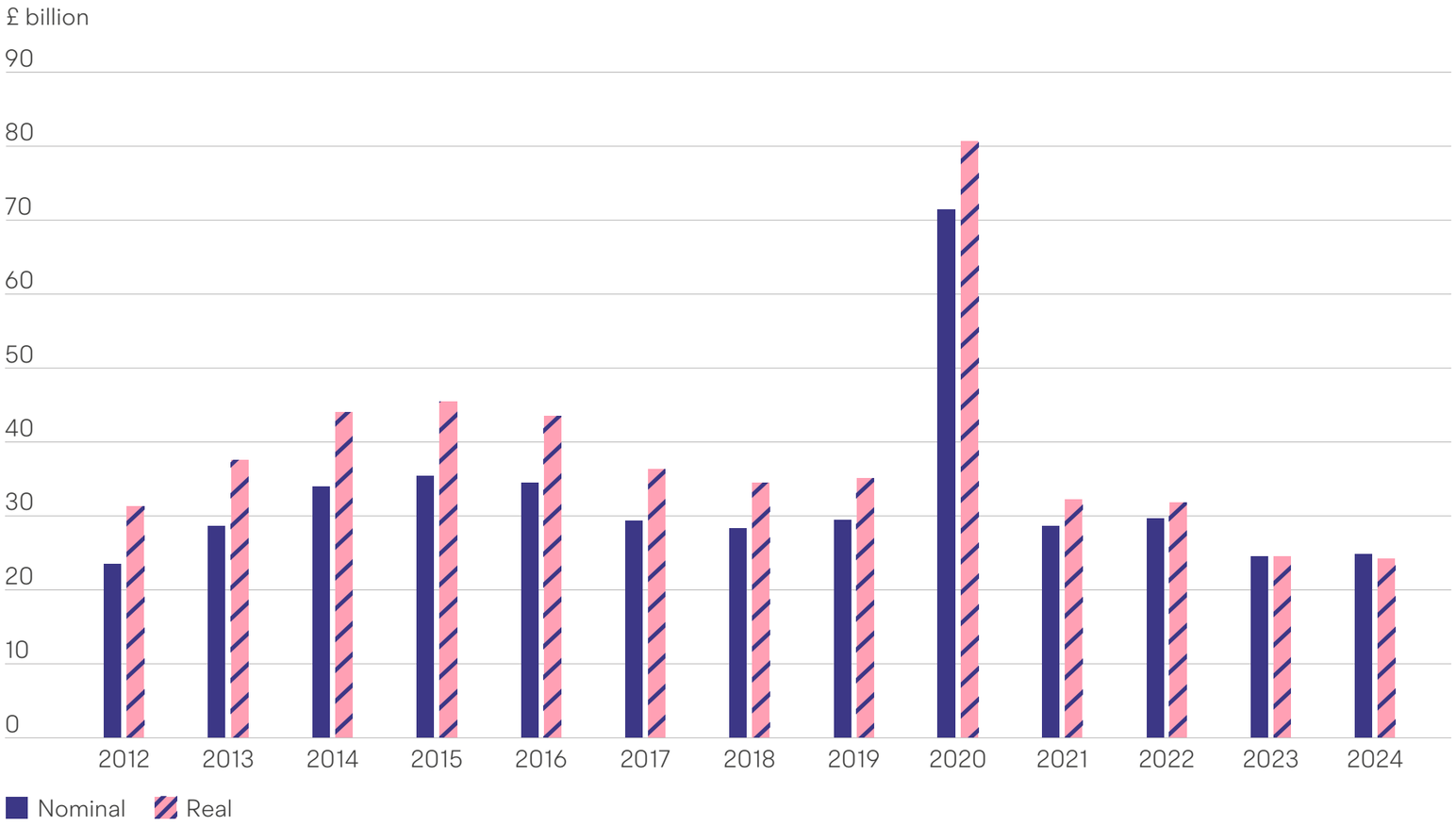
The British Business Bank's market intelligence is that, overall, the revised Basel 3.1 changes are not expected to increase the amount of capital that banks are required to hold against lending to smaller businesses. In addition, the changes are not expected to materially increase the amount of capital banks hold against other exposures. Similarly, the Bank's intelligence is the PRA's new 'strong and simple' capital regime is not expected to substantially alter the amount of capital a bank must hold against lending to smaller businesses.

However, our market contacts report some smaller banks remain concerned. The PRA still intends to remove the 'SME support factor' but now seeks to compensate for this using Pillar 2A capital.[130,131] Some have questioned how this will impact individual banks

Figure B.93

Annual gross lending to SMEs by the big five banks

Source: BoE, ONS and British Business Bank calculations



and how it will be done, particularly for smaller banks that don't have much Pillar 2A.

Previously, the PRA's first near-final policy statement proposed material increases in the capital associated with lending to smaller businesses. The PRA subsequently took on board evidence presented by the industry that banks would in response either reduce lending or increase the price charged to smaller businesses.

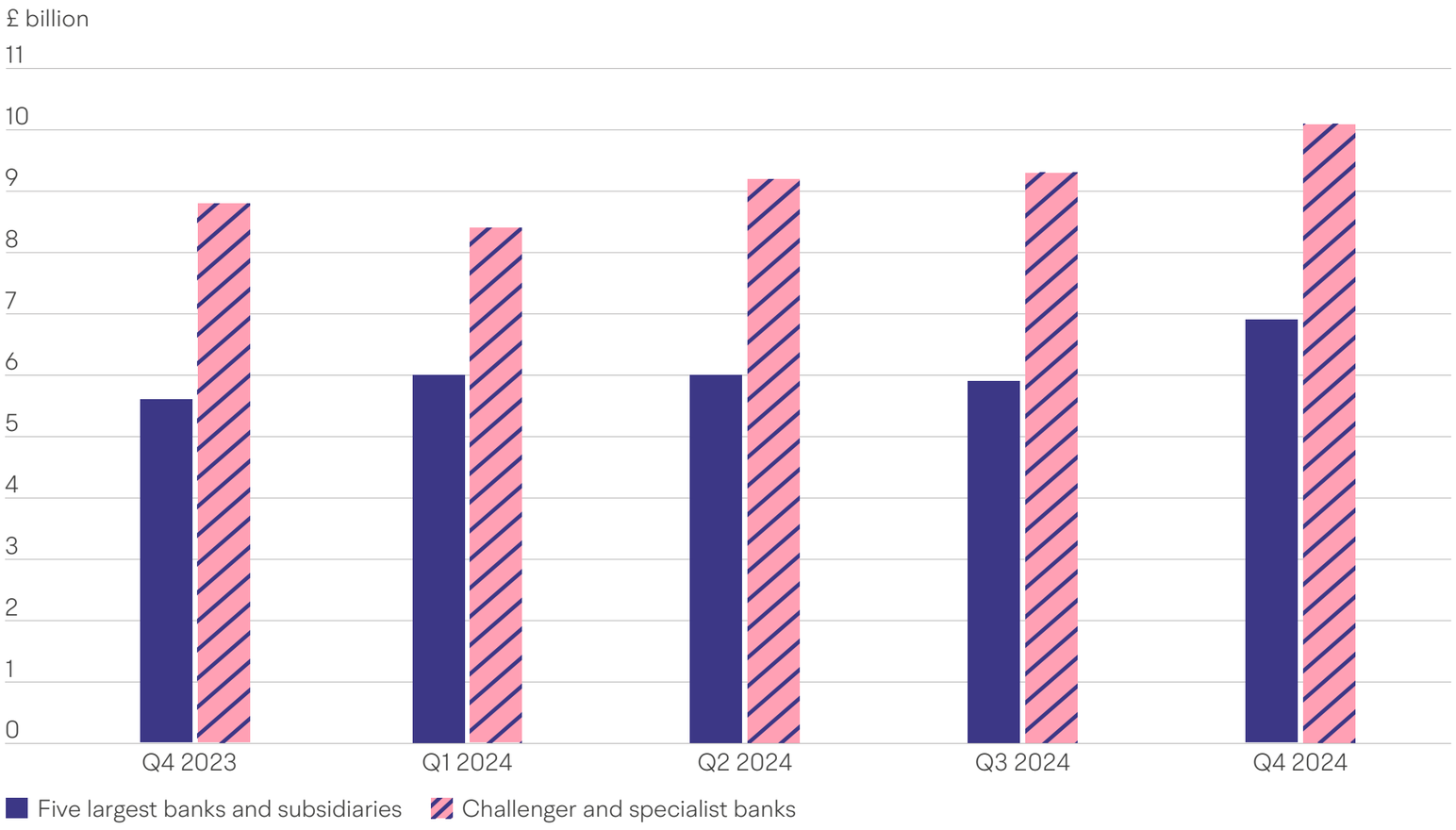
After the first near-final policy statement, market contacts reported some challenger and specialist banks had started to price in the prospective increased capital costs, which had deterred some businesses from taking on term lending. At the time of writing our contacts indicated that it's too early to know if this was still the case following the second near-final statement. However, subject to the PRA's final statement, our contacts expect it would likely unwind.

In January 2025 the start of the implementation of Basel 3.1 standards was delayed in the UK by one year to January 2027. However, the date of full implementation remains January 2030, as set out in original proposals.[132] This reduces the transitional period from four years to three. In contrast, the European Union began implementing the Basel 3.1 framework on 1 January 2025.[133]

Figure B.94

Quarterly gross lending to SMEs by the big five and challenger and specialist banks

Source: BoE and British Business Bank calculations



Two building societies have acquired banks, and four banks were granted banking licences, of which one plans to directly serve smaller businesses

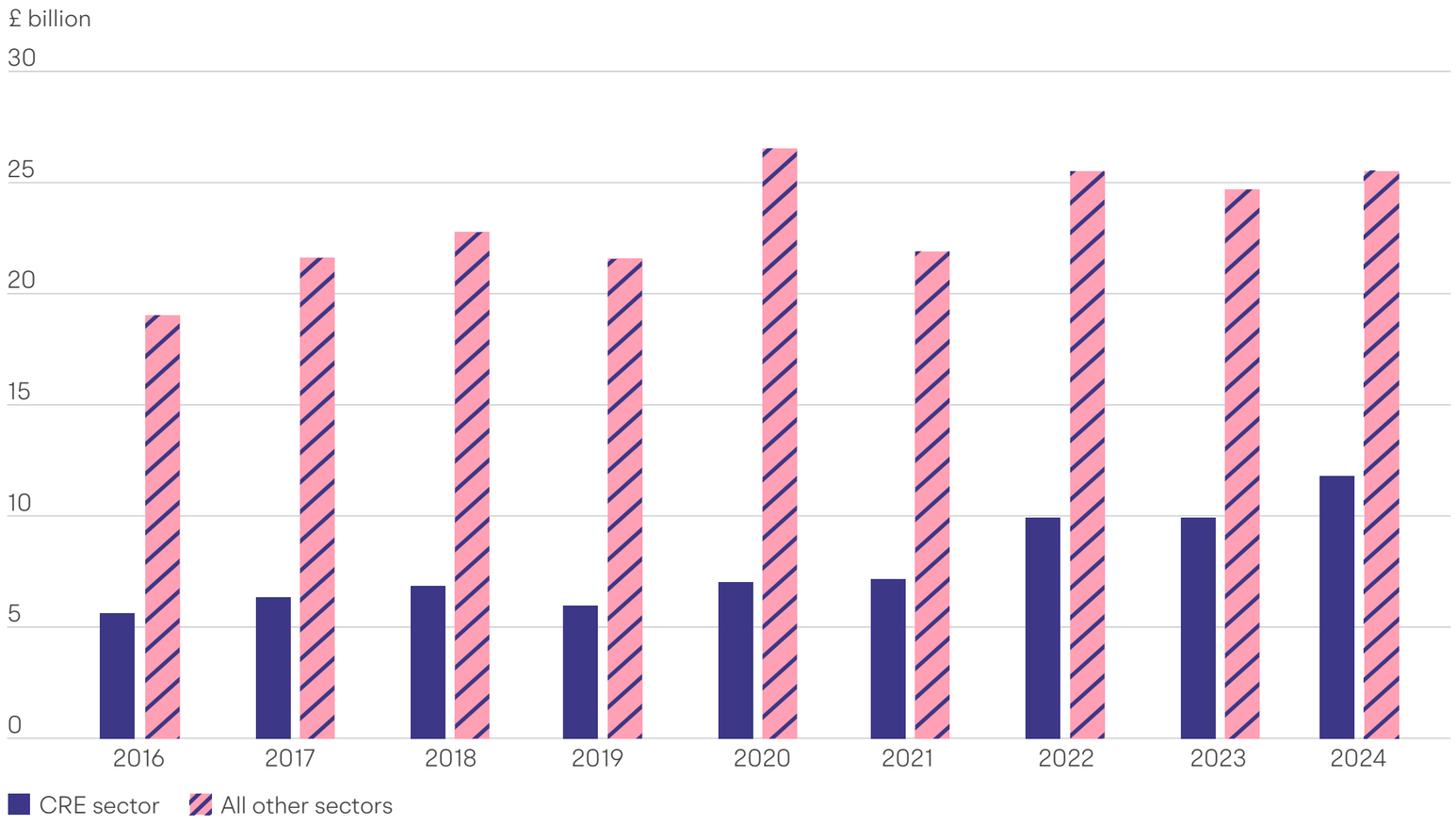
During 2024 two building societies agreed to purchase challenger banks. Nationwide Building Society, the largest building society in the UK, bought Virgin Money UK, which was the UK's sixth largest bank. Coventry Building Society, the UK's second largest building society, acquired the Co-operative Bank, the seventh largest UK bank. Nationwide's purchase was completed in October 2024.[134] Coventry's acquisition was finalised in January 2025.[135] Nationwide and Coventry will continue to operate as building societies with the management of both saying they expect the integration with the challenger banks to be gradual.

Both Nationwide and Coventry traditionally focus on providing residential mortgage lending and personal loans. Virgin Money and the Co-op are full-service banks i.e., mid-sized and offering a broad range of products to both personal and business customers including smaller firms.[136] However, the smaller business lending loan

Figure B.95

Annual gross lending to SMEs by challenger and specialist banks to the real estate sector and all other sectors

Source: BoE and British Business Bank calculations



books of Virgin and the Co-op are currently much smaller than that for residential mortgages.

According to Nationwide, its acquisition of Virgin Money means that for the first time in the UK, a full-service business bank will be part of a large mutual. Nationwide previously attempted to enter the business banking market. In 2019 it was awarded a £50m grant from the Banking Competition Remedies (BCR) Capability and Innovation Fund to launch business banking.[137] However, Nationwide returned the grant the following year due to not being able to proceed with the plans originally submitted.[138]

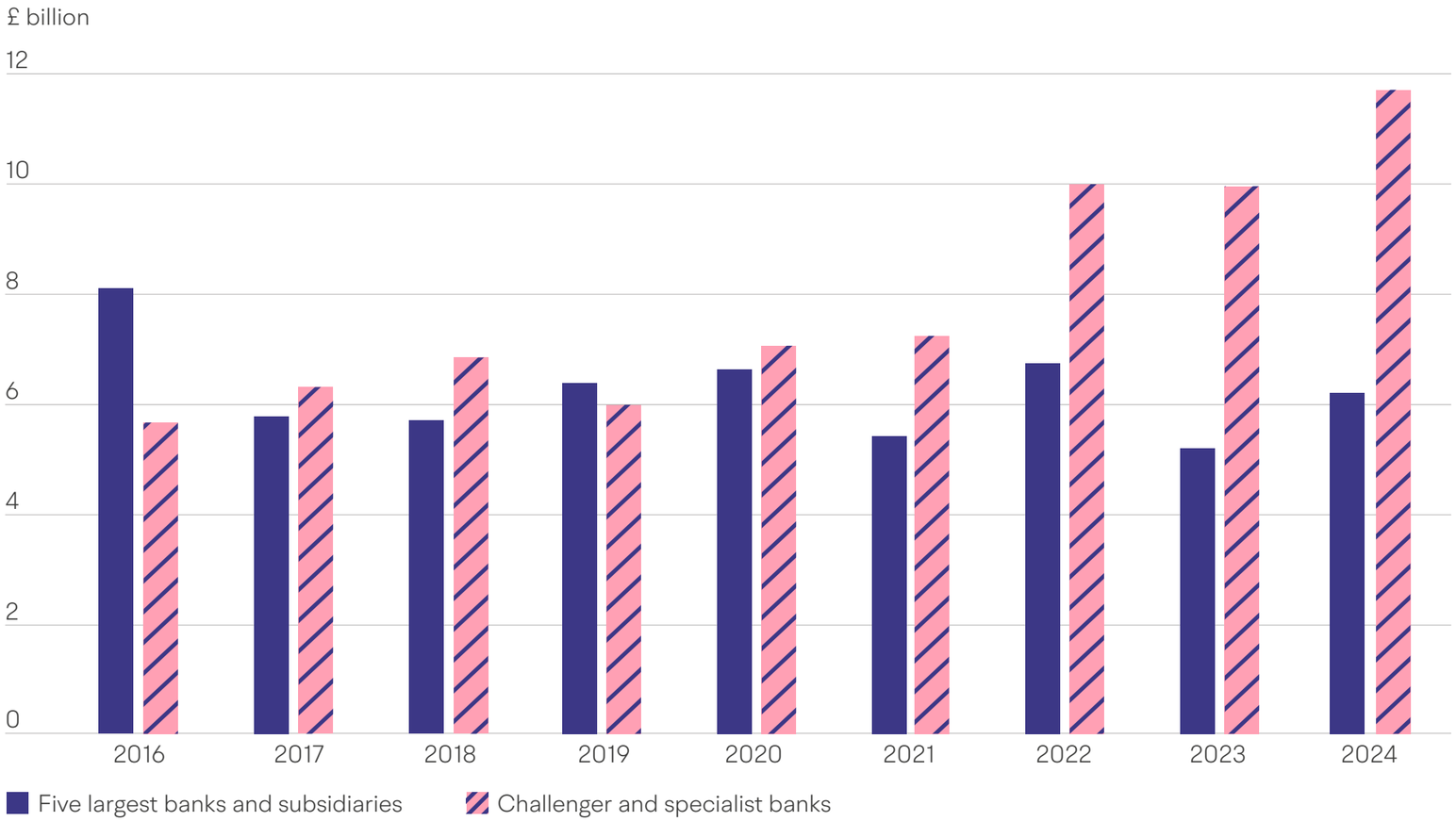
Virgin Money and the Co-op were also awarded grants from the BCR fund. In 2020 Virgin Money received £35m to expand its business banking proposition.[139] This followed the Co-op in 2019 being granted £15m to enable the bank to accelerate plans to improve and expand its proposition for UK smaller businesses.[140] Both Virgin Money and the Co-op retained their grants.

The implications of Nationwide's and Coventry's acquisitions on the UK smaller business lending market are not yet clear. Longer term, once the challenger banks are fully integrated, the resulting greater scale of the building societies could potentially help them compete

Figure B.96

Annual gross bank lending to SMEs in the real estate sector

Source: BoE and British Business Bank calculations



against the incumbents in terms of the products and services they offer to smaller businesses.

In addition, the PRA granted four new banks banking licences in 2024. This, with 2023, was jointly the lowest since 2013, when the PRA and FCA introduced reforms that lowered the barriers to entry (figure B.97).

The four banks were SilverRock,[141] Revolut,[142] Afin and Vida. At the time of writing, Vida had launched while the others were still at the mobilisation stage.[143]

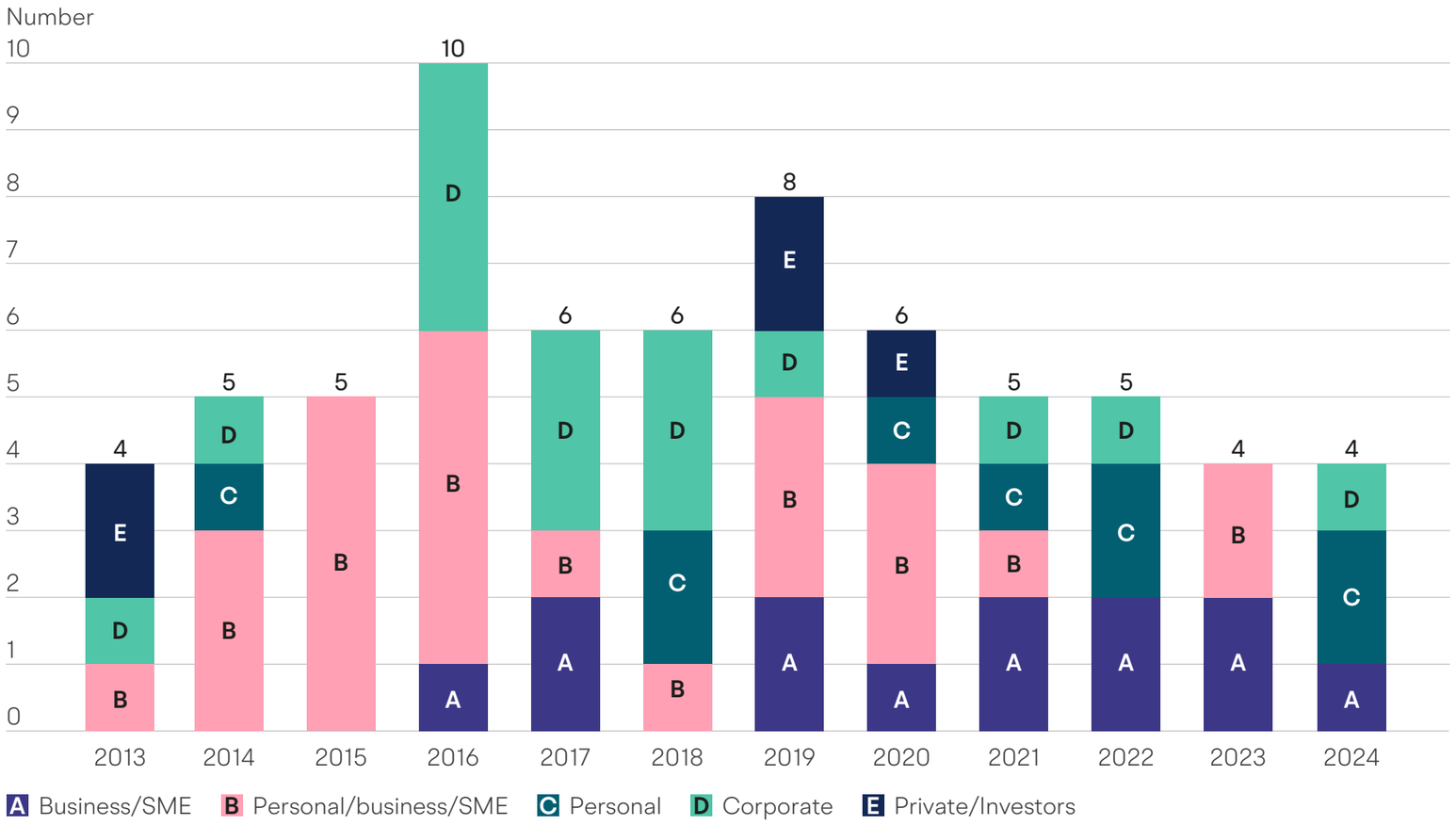
Of the four banks, only Revolut plans to directly offer products and services to smaller businesses. Prior to gaining the banking licence, Revolut already operated in the UK under a European banking licence. It provides personal and business accounts and payment services, but no credit or overdraft facilities, primarily through a digital app.[144] At the time of writing, Revolut has not said if it plans to lend to UK smaller businesses.

SilverRock has the potential to indirectly support lending to smaller businesses. While the bank will not directly lend to consumers and businesses, its focus is on "ensuring the borrowing needs of SMEs and consumers in non-standard credit markets can be met".[145] It plans to

Figure B.97

Number of new UK banking licences

Source: BoE and British Business Bank calculations



do this by providing forward flow financing to non-bank and specialist lenders and building societies that provide loans to customers.

Publicly available information indicates there are a handful of applications for UK bank licences pending. One of the most well-known is Burnley Savings and Loans (BSAL), unofficially known as "The Bank of Dave". BSAL opened in 2011, with a business model that returned to "the basic model of local banking". Products and services offered include business loans for equipment, machinery and stock or to improve premises and increase sales. If the application is successful, it plans to be "a bank for the community, run by the community, offering an expanded range of products to an expanded audience".[146]

There are likely to be fewer start-ups applying for bank licences in the next year or two than was the case in the mid-late 2010s. This largely reflects that tougher market conditions have made raising capital more challenging as well as launching a start-up bank in the UK being expensive in terms of time and capital.

The British Business Bank continues to support challenger and specialist banks that help improve smaller businesses' access to finance through programmes including the Growth Guarantee Scheme, ENABLE Guarantees and British Business Investments. This is in line with the Bank's mission to drive sustainable growth and prosperity across the UK, and to enable the transition to a net zero economy, by improving access to finance for smaller businesses.

Alternative lending and debt products

– 2.10 Asset finance

– 2.11 Invoice finance & asset-based lending

– 2.12 Alternative finance

2.10

Asset finance

Asset finance new business to SMEs steadied in 2024

Successes and challenges were largely driven by vehicles

The cost of funding has made conditions challenging for many non-bank lenders

Taxonomy and regulatory uncertainties continue to weigh on the industry

This section provides an update on developments in the asset finance (primarily leasing and hire purchase) market in 2024, highlighting the contrast in growth between different asset classes against a weak economic backdrop and political uncertainty. Asset finance continues to be the alternative finance instrument used by the largest proportion of smaller businesses and the Finance & Leasing Association calculates that as much as 40% of business investment has been funded by asset finance.

The asset finance market, through the provision of various forms of leasing and hire purchase, helps businesses invest in vehicles, equipment and plant and machinery. Leasing allows businesses to obtain new equipment by renting it for a contracted period without owning it. This can also mitigate against obsolescence, with the flexibility to upgrade assets and technology when required, which can enhance efficiency and productivity.

If a business wants to own the equipment at the end of the contract period, then hire purchase is traditionally the most common finance option. In both cases, businesses avoid paying the full cost of the equipment upfront, easing pressures on cash flow.

For businesses looking to scale up, asset finance is potentially the answer. It offers access to funds for business-critical investments, like machinery, equipment and vehicles, without the need for large up-front payments. Furthermore, by preserving working capital it also allows them to keep funds to invest to grow via activities such as R&D, staff and marketing.

Asset finance new business to SMEs steadied in 2024

The SME asset finance market reported an increase in new business of 1% in 2024 to £23.5 billion following an increase of 7% in 2023 to £23.3 billion (figure B.101). It is the fourth year in a row the series has grown after falling in 2020 as a result of the Covid pandemic.

Growth in new business has been uneven across the year. Q1 saw new business 5% lower than in Q1 2023. This was in part due to a record March in 2023 as businesses invested ahead of the end of the super-deduction allowance.

Q2 was initially more positive on the back of improved economic data. The Finance & Leasing Association's (FLA) Q2 2024 Industry Outlook Survey showed almost two-thirds of asset finance respondents expected some increase in business investment over the following 12 months and this appeared to be born out by an upturn in new business which grew by 6% in Q2 as a whole. However, June saw a decrease, with the FLA putting this down in part to businesses "delaying investment plans until after the General Election and in anticipation of a cut in Bank Rate."

Growth in Q3 moderated again, up by 2% on Q3 2023, but this masked an up and down few months. Businesses appeared to have been reacting to first the Labour victory and the hope of reduced uncertainty and then likelihood of tax increases. Furthermore, fluctuating expectations around interest rates may also have played a part and Q4 showed growth of only 1% compared with Q4 2023.

The FLA's latest (Q4 2024) industry outlook survey suggests that "despite the lower inflation and interest rate environment, uncertainty about demand and

pressure on net margins have hit business confidence and investment intentions. Nevertheless, almost two-thirds of asset finance respondents expected some increase in new business over the next year."

Successes and challenges were largely driven by vehicles

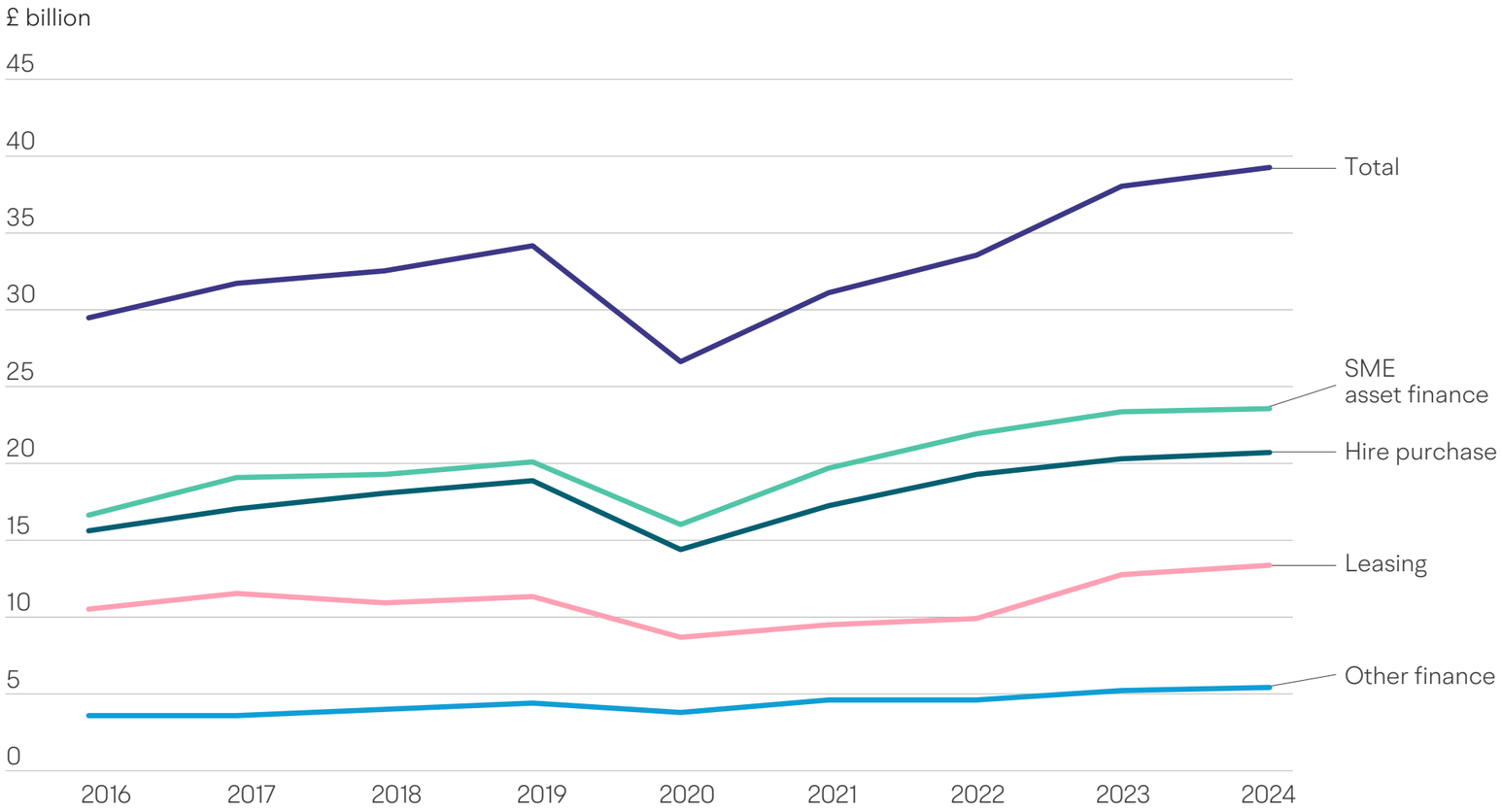
The business car finance and commercial vehicle finance sectors reported new business up 1% and 10% respectively for 2024, compared to 2023. By contrast, the plant and machinery finance and business equipment finance sectors reported falls in new business of 2% and 10% respectively, while a strong Q2 and Q4 meant new business for IT equipment increased by 6% in 2024 as a whole.

The motor vehicle sectors have not been without their challenges in 2024. One example is that the year again saw steep declines in the used prices achieved by electric vehicles (EVs). Although this could increase demand for the second-hand vehicles, it has somewhat undermined confidence in their future values among residual value setters. While new EVs often cost significantly more than the equivalent internal

Figure B.101

Size of UK asset finance market for businesses 2016-2024 – new business in £ billions[a]

Source: Finance & Leasing Association (FLA)



a Asset finance new business for deals of up to £20 million.

combustion engine (ICE) model, used EVs are now close to price parity with their ICE equivalents.

Furthermore, there were suggestions that the Zero Emission Vehicle mandate, which required 22% of a manufacturer's new car sales to be electric in 2024, ratcheting up to 80% by 2030, may be distorting the market by forcing supply ahead of demand. This risks used EV supply outstripping demand, with further negative consequences for future used prices. In addition, some have suggested that the mandate could already be resulting in an artificial supply shortage of ICE vehicles with suppliers limiting their sales to avoid fines for not reaching the EV quota.

Perhaps as a result of these concerns, the government opened a consultation in December seeking views on proposals to support the UK's transition to zero emission vehicles (ZEVs). The consultation is split into two parts, with Part 1 about phasing out sales of new petrol and diesel cars from 2030 and supporting zero emission transition. Part 2 of this consultation is about the ZEV Mandate, delivered through the vehicle emissions trading schemes. Evidence from the consultation will inform potential future amendments to the ZEV Mandate and CO_2 emissions regulation.

A further vehicle related headwind the industry may be facing is because of the investigation into commission arrangements in motor finance. While this is not related to smaller business asset finance transactions, it could have consequences for the industry. These could be via finance providers simply having less capital available to lend to smaller businesses, or via the investigation being widened to include smaller business asset finance too.

Away from vehicle asset finance, the lack of investment in other assets reflects a range of challenges businesses have faced over the last few years which have resulted in low business investment. While the start of 2024 saw the economy return to growth following a recession in 2023, businesses have still had to deal with low demand and a slowing economy as the year progressed, relatively high input prices and the considerable uncertainty present throughout most of the year.

The cost of funding has made conditions challenging for many non-bank lenders

The share of asset finance provided by non-bank lenders stood at 37% in 2024, unchanged on 2023. While interest rates have decreased slightly as inflation returned to near target, funding costs for non-bank lenders have remained above historical averages. This resulted in many non-bank lenders having to choose between losing business or reducing their margins.

This decision could have been further complicated as asset quality was expected to weaken in 2024 due to high interest rates, persistent low growth and the increases seen in insolvencies, but contacts report this wasn't the case. Indeed, it so far appears arrears and defaults decreased from the higher levels seen in 2023.

Taxonomy and regulatory uncertainties continue to weigh on the industry

Green assets have been highlighted as a key growth sector for asset finance for some time as companies invest in technologies and practices designed to move them toward net zero targets and to mitigate exposure to energy price spikes. However, on top of the concerns over the residual values of assets discussed earlier in the chapter, lenders are facing taxonomy and regulatory uncertainties which contacts suggest have somewhat slowed the pace of change.

The UK government has been looking at implementing a green taxonomy for some time with the then Chancellor saying in 2020 that the UK Green Technical Advisory Group would look to review the scientific metrics in the EU taxonomy to make sure they were right for the UK market. The launch of the taxonomy has since been delayed but HMT have now launched a consultation on whether a UK green taxonomy is required.

As HMT note in their consultation, which was launched in November 2024, the purpose of implementing a green taxonomy is to support investment into activities aligned with sustainability goals, and to mitigate greenwashing but that taxonomies can be complex in practice, and feedback on their value is mixed. The hope within government and industry is that the outcomes of the consultation will give the clarity investors and lenders require to move forward with green finance products and investments.

A second regulatory uncertainty had been around full expensing. At the October Budget, the government confirmed a continuation of the existing full expensing measures which provide a 100% first-year allowance for expenditure on qualifying plant and machinery and a 50% allowance for qualifying special rate assets, for the duration of the current parliament.

Industry has also suggested that full expensing and special rate first year capital allowances for expenditure on new plant or machinery acquired for leasing could have a significant impact. While the hope this would become policy has not yet materialised, the Budget did see a commitment to explore its possible implementation.

Asset finance plays a significant role in helping smaller businesses invest and grow. Business investment is yet to recover to pre-pandemic levels and the availability of asset finance will be crucial over the coming years for both the recovery of UK business investment and achieving net zero targets. As such the British Business Bank will continue to support asset finance providers via products such as the Growth Guarantee Scheme, ENABLE Funding and the Investment Programme.

2.11

Invoice finance & asset-based lending

The value of advances to smaller businesses increased in 2024

Average advances increased again

Client numbers have continued to fall

IF/ABL providers expect to see advances grow in 2025

Invoice finance & asset-based lending (IF/ABL) is a term used to describe funding against a range of business assets including accounts receivables (the debts owed to a business by its business customers, often represented by its invoices), stock and inventory, plant and machinery, real estate and even (sometimes) intellectual property and brands. In various forms, the principles underpinning invoice finance and asset-based lending have enabled funding to British businesses for centuries.

The value of advances to smaller businesses increased in 2024

Smaller business advances recovered in the first three quarters of 2024 after a weak Q4 2023. The Q1-Q3 quarterly average for 2024 was £8.2bn, an increase of 2.4% compared to the same period in 2023, and it seems likely the full year average will be above £8bn for the first time since 2019. In nominal terms, the three quarterly outcomes reported so far in 2024 are the second, third and fourth highest since the last pre-covid quarter at the start of 2020 with only Q3 2022 higher (figure B.111).

Despite early indications that sales in Q4 were around 3% higher than in Q4 2023, UK Finance estimates that Q4 2024 will likely see a slight reduction in advances being reported compared to Q3, to around £8bn. However, this is still likely to be around 5% higher than at the end of 2023, partly driven by businesses utilising more of their available funds, reflecting reports of increased pressure on businesses.

Average advances increased again

Average advances per client business continued to grow in nominal terms in 2024. The quarterly average for Q1-Q3 2024 was £263,416, up 3.8% compared to the same period in 2023 £253,768 (figure B.112). All three quarters recorded average advances above £260,000, the three highest totals for the series.

All four cohorts recorded positive changes in 2024 Q1-Q3, ranging from 1.4% for the smallest compared to the same period in 2023 to 13.4% for the second largest cohort. While all cohorts grew and the smallest achieved a series high, the other three cohorts remain well below their series highs ranging from 9% to 23% down in nominal terms in Q3 2024.

Client numbers have continued to fall

The number of SMEs using IF/ABL was broadly flat (-1.4%) in Q1-Q3 2024 compared to the same period in 2023 (figure B.113). Without a surprise recovery in numbers in Q4 this would mark the eighth year out of nine where client numbers have fallen with only 2018 showing a small increase (0.4%).

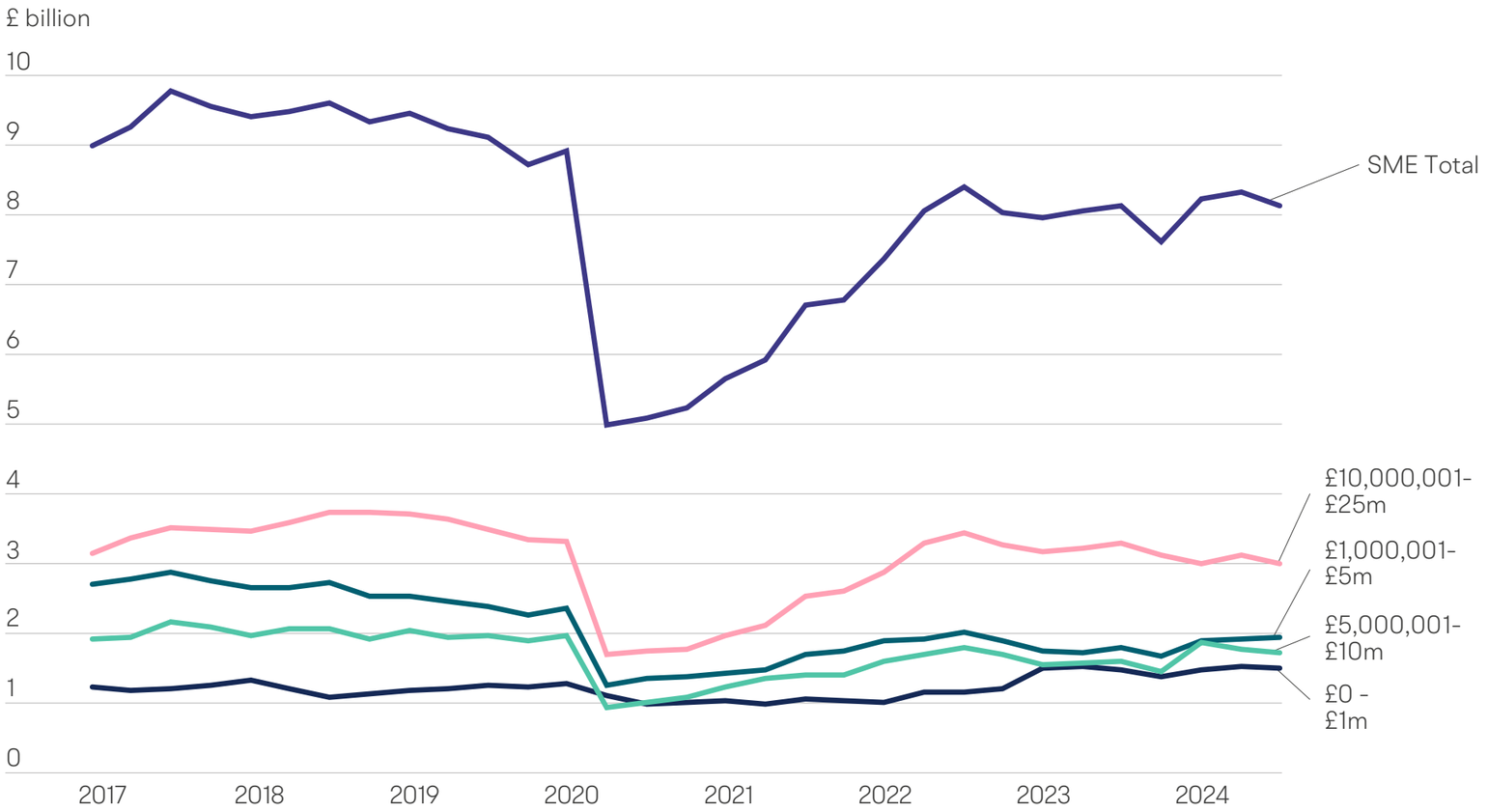
All four size cohorts were down in Q3 compared to the end of 2023, ranging from 0.04% for the second smallest cohort to 7.8% for the largest. If these decreases are maintained in Q4 2024 it will be the second successive year all four cohorts have finished the year below the previous year.

The mixed story of increasing overall sales volumes and advances against a backdrop of declining client numbers indicates that larger SMEs are now using IF/ABL products. This is certainly supported by the data for the larger client businesses outside the consideration of this report; Q3 saw the largest recorded number of £100m+ businesses using IF/ABL products.

Figure B.111

Quarterly advances of invoice and asset-based lending, by size cohort

Source: British Business Bank analysis of UK Finance data



Note: 2024 is up to Q3

IF/ABL providers expect to see advances grow

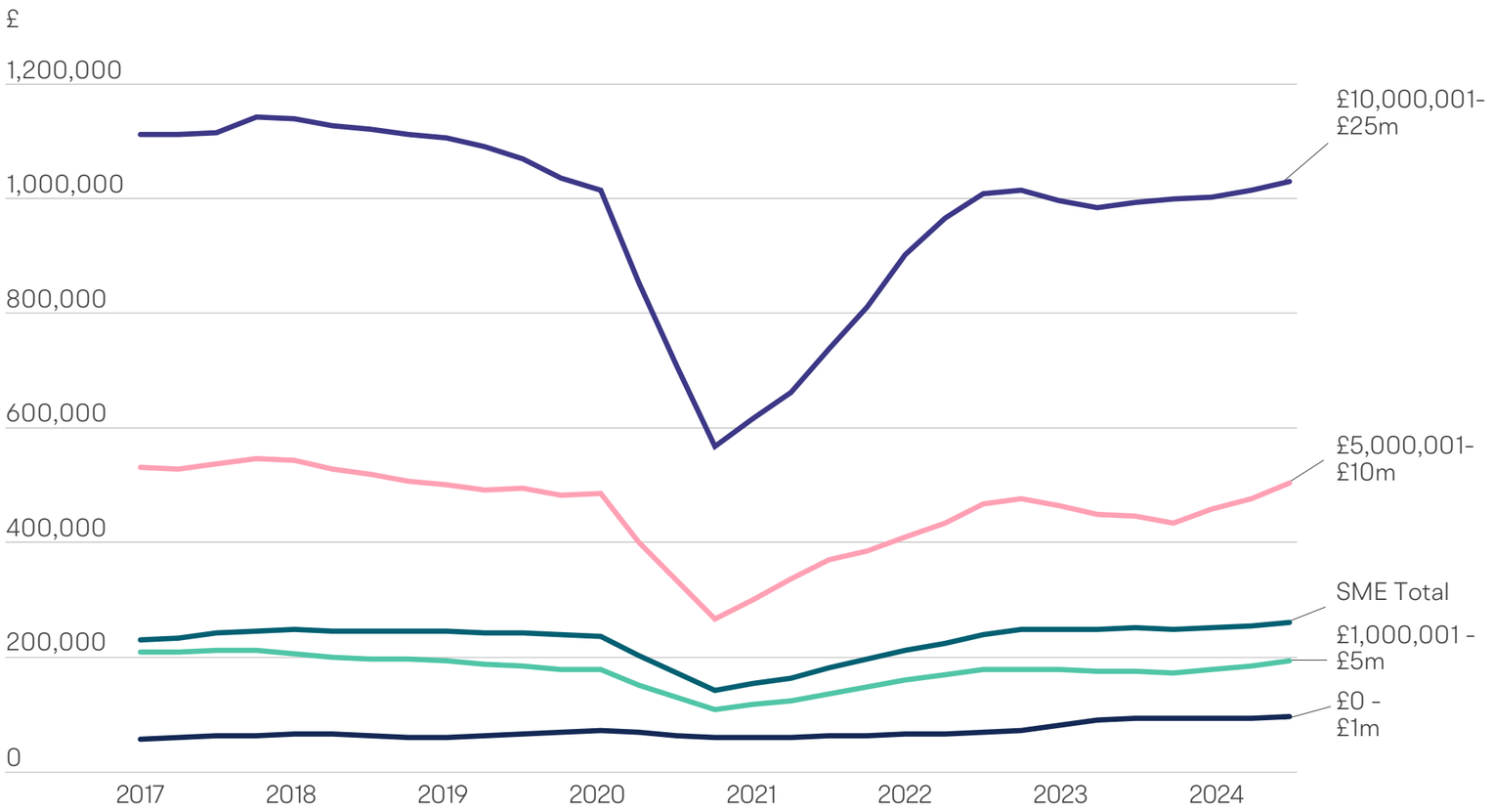
Tough economic conditions are likely to remain into the first half of 2025. However, IF/ABL providers are anticipating due to the way in which the products work and support businesses, whether it is flexible finance through high growth times, or speedy cashflow solutions through tougher times, as well as a renewed focus on the full-range of finance options to support the UK's recovery, will mean the advances are likely to continue to grow.

Those operating in Scotland have further reason to be optimistic in 2025. April will see the launch of two new statutory registers for security over business and other assets. The first, the Register of Assignations, enables the registration of claims to future payments, including invoices and other receivables such as rents. It is expected to significantly facilitate the provision of invoice finance and other types of finance secured against future receivables, for which Scots law, with its civil law origins, has always presented conceptual challenges and required complex workarounds. The second register enables the introduction of a new type

Figure B.112

Quarterly average advances of invoice and asset-based lending, by size cohort

Source: British Business Bank analysis of UK Finance data



Note: (a) Average of three quarters

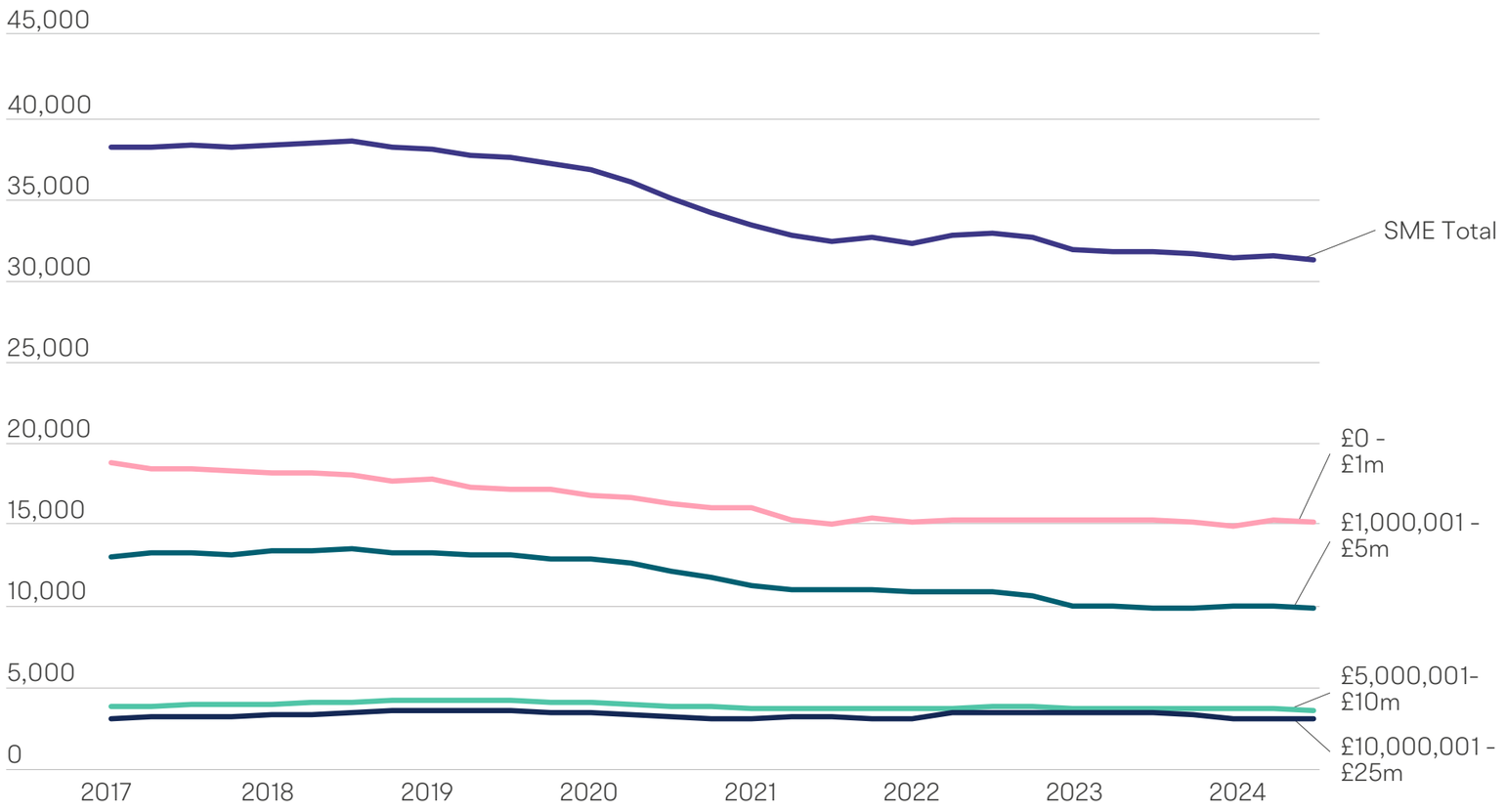
of fixed security, the Statutory Pledge, which can be taken over physical or non-physical assets from plant, machinery and stock, to intellectual property, Scottish shares and other financial instruments.

The British Business Bank continues to support IF/ABL lenders via both the Growth Guarantee Scheme and British Business Investment programmes. The British Business Bank also has a key role in providing accessible and relevant information about the full range of finance options that are appropriate for SMEs.

Figure B.113

Quarterly number of businesses using invoice and asset-based lending, by size cohort

Source: British Business Bank analysis of UK Finance data



2.12

Alternative finance

Larger alternative lenders appear to have had a mostly positive year

Non-bank and fintech lenders continue to face challenging funding conditions

Awareness of several forms of alternative finance increased

This section covers the role alternative finance providers play in UK smaller business finance markets. Most alternative finance providers, with a few notable exceptions, do not compete with the traditional banks but complement their offerings. As such they have not only increased the options available to SMEs but have also increased the accessibility and appropriateness of finance available. Last year we also covered commercial finance brokers but unfortunately the NACFB survey is not available at the time of writing, but we hope to include it again next year.

The SME lending landscape has changed substantially since the Global Financial Crisis (GFC), significantly reducing the biggest four lenders' share of SME lending which had stood at around 90% at the end of the crisis. Post-GFC, alternative finance providers, defined here as non-bank providers of products such as asset finance, invoice finance, term loans, cashflow loans, venture debt and private debt greatly increased their share of SME finance markets. This has been achieved not only by attracting businesses traditionally served by high street banks but also by being able to offer services to viable SMEs that were previously unable to access funding at all.

Larger alternative lenders appear to have had a mostly positive year

At the time of writing only a limited number of the lenders we track had published or provided comparable 2024 lending volumes. As such it has not been possible to compile our usual aggregate series ahead of this publication. However, of those lenders that have reported at least partial lending, numbers from the larger lenders appear to be mostly positive while others have had mixed results.

iwoca reported that, up to the end of October they had lent £730 million across 35,000 business loans, both records for the business, up year-on-year of 76% and 82% respectively. Funding Circle also reported growth in term loan origination of 17%, half-on-half, and 47% year-on-year. When combined with its FlexiPay product, this becomes growth of 25% half-on-half and over 60% year-on-year.

Folk2Folk, the UK's largest business P2P lender, also reported increased origination for the year while ThinCats reported a decrease in origination (15%) but still recorded their second highest year to date after growing origination 31% in 2023. Other lenders who have reported partial or full year origination, and particularly those lending to commercial real estate, have recorded more mixed fortunes with several showing decreases in origination for the year.

As noted in previous Small Business Finance Markets reports, much of the non-bank lender space appears to have entered a stage of consolidation as many lending models continue to mature. This continued in 2024 with several larger lenders posting profits. This profitability has been achieved through a range of measures including consolidating core business models.

One example is Funding Circle which, alongside its increased origination in H1, sold its loss-making US arm for £33 million as part of an attempt to simplify the company and reduce losses.[147] It also said it will cut over 100 jobs as part of a cost-cutting drive. Funding Circle reported pre-tax profits of £0.5m for the first six months of 2024 and they said they expect to be profitable for the whole of 2024. This followed several lenders reporting a profit for 2023 including iwoca and Folk2Folk and has been achieved against a backdrop of high wholesale market costs for alternative finance providers and reduced use of external finance by smaller businesses in 2024 compared to 2023 (see chapter 2.2).

Figure B.121

2 year SONIA swaps

Source: Bloomberg

Non-bank and fintech lenders continue to face challenging funding conditions

Interest rates have remained relatively high in 2024, which has impacted non-bank and fintech lenders more than banks. Banks typically have access to deposits, the cost of which is usually lower than wholesale funding. The 2-year SONIA rate has fallen from the 2023 peaks and remained more stable in 2024, but it remains high relative to historical levels. In 2024, it peaked at 4.8% in May before falling to 4.27% at the end of the year (figure B.121). Despite the challenging funding conditions, several non-bank lenders have made funding line announcements in 2024, often building on existing institutional investor relationships.

UK fintech businesses also raised £3.8bn of venture capital (VC) investment in 2024, based on analysis of PitchBook data. This total was 9% lower than in 2023 (£4.1bn). The value of deals was the lowest since 2020 and followed 2023 also being lower than 2022. Despite the value of deals falling in the UK, it has fallen less than in Europe and the US, where investment was down by 17% and 16% respectively.

Deal numbers in the UK also fell in 2024. In the UK, there was 353 deals completed in 2024, down 15% on last year (413) and the lowest since 2018 (346). In Europe, there was 888 deals completed in 2024, 20% lower than in 2023 (1,106). Meanwhile, in the US, there were 1,571 deals completed in 2024, which is only 5% lower than in 2023 (1,655).

Despite the challenging funding conditions, non-bank and fintech lenders are clearly still seeking finance and exploring options for expansion. This is encouraging, given the benefits to smaller business of having a wide array of finance options available.

Awareness of several forms of alternative finance increased

Awareness of several main forms of alternative external finance increased in 2024, as shown in figure B.122. This supports the view that alternative lenders are becoming more mainstream and influential within lending markets. Alternative lenders are now an important and fundamental aspect of the SME lending landscape.

44% of SMEs surveyed were aware of marketplace lending, up from 41% in 2023. Additionally, awareness of “leasing/hire purchasing” has increased from 78% in 2023 to 83% in 2024 and awareness of “invoice finance” has increased from 54% in 2023 to 57% in 2024.

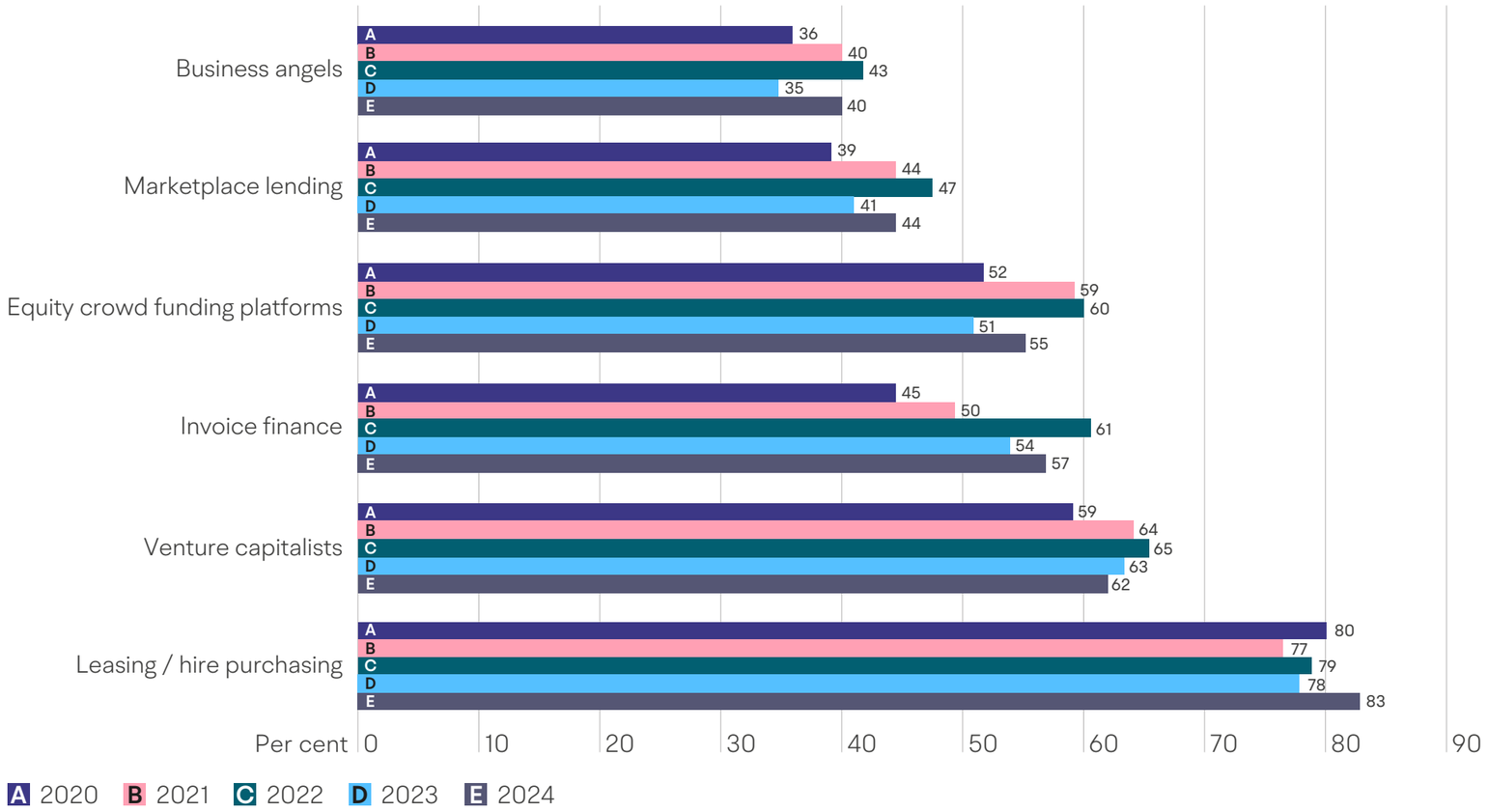
Despite the awareness of most main forms of alternative finance increasing in 2024, compared to 2023, many of them still fall short of the levels witnessed in 2022. The main exception is “leasing/hire purchasing”, which experienced higher awareness in 2024 than any of the other years observed in figure B.122. However, it is likely that the high levels of awareness in 2022 were likely driven by awareness of the lenders that were participating in covid loan schemes.

As the alternative lending sector adapts to the challenges it currently faces and continues to evolve smaller business lending markets, the British Business Bank will be there to support alternative finance providers to further enrich the options available to UK smaller businesses. This support is predominately provided via products such as ENABLE Funding, the Growth Guarantee Scheme and the Investment Programme but also by using its role as a convenor within the market.

Figure B.122

Awareness of main forms of alternative external finance

Source: British Business Bank analysis of the 2024 Business Finance Survey. Base = all businesses (n=4,125 in 2020, n=2,804 in 2021, n=2,213 in 2022, n=1,723 in 2023, n=1,547 in 2024)



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