THINCATS

PRISM INSIGHTS

THE IMPACT OF COVID ON MID-SIZED SMES

An analysis of how the UK's mid-sized SMEs navigated the impacts of the covid pandemic and how they are positioned for the new opportunities and challenges ahead

Does SME size matter?

This report draws on multiple data sources, including ThinCats' proprietary credit model, PRISM, to assess how the UK's mid-sized businesses performed during the covid pandemic. It also investigates their resilience to face a post-pandemic environment in which historically low insolvency rates – the result of unprecedented levels of government support – are certain to rise.

Small and mid-size enterprises (SMEs) are often viewed as a homogeneous group, accounting for around 2/3 of private sector employment and a similar proportion of GDP. In reality, the "S" and "M" of SME are two very distinct populations each representing around 1/3 of the workforce and total UK output. With only 1/10 the number of companies compared to smaller businesses, the financial health of the mid-sized sector is key to driving the UK's economic growth.

By analysing the amount of borrowing, its impact on net cash levels and the current levels of insolvencies compared to recent years, the report assesses the relative resilience of mid-sized SMEs compared to smaller businesses and their prospects for navigating a UK and global economy in transition. We also dig deeper into the financial performance of different sectors within the mid-sized universe to identify those showing the most resilience.

The universe of UK SMEs

Small businesses – approximately 4.5m companies employing 1-10 people with annual turnover under £1m

Mid-sized businesses – approximately 440,000 companies employing 10-250 people with annual turnover ranging from £1m - £25m

Borrowing critical for liquidity once covid restrictions imposed

An immediate priority for SMEs when the pandemic hit was to ensure there was sufficient liquidity in the business to meet their ongoing commitments. Whilst government support schemes such as furlough schemes and tax deferrals helped reduce costs, many SMEs needed new borrowings either to make up for reduced income or to put aside should the cash be needed at a later date.

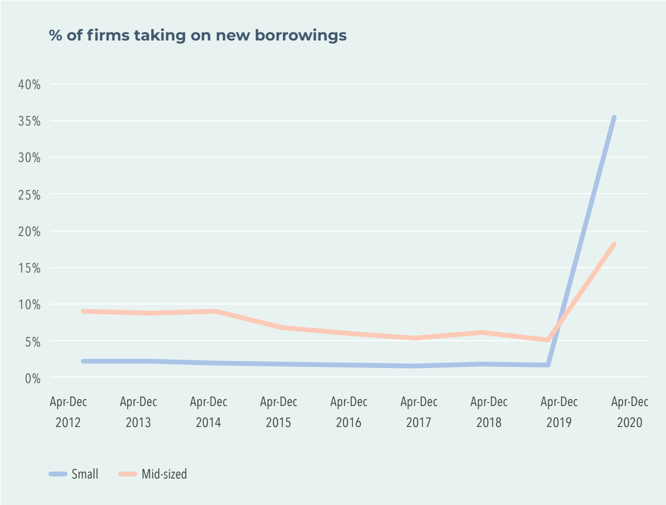
Within the mid-market, a lot of the lending provided through the Coronavirus Business Interruption Loan Scheme (CBILS) simply replaced normal business loans: 18% of this population took out loans between April and December 2020, totalling £20bn of borrowing. This compares to between 5 and 10% of firms borrowing between £10bn and £15bn in the same months of 2012 to 2019.

However, it is a very different story for small businesses, for whom the Bounce Back Loan Scheme (BBLS) was the predominant source of new funding. Only 2% of these smaller firms take out loans totalling £5bn to £9bn in April - December of a "normal" year, yet in 2020, this rose to 35% of the population borrowing £45bn.

The charts below show the sharp rise in the proportion of businesses with loans approved during the first 9 months of the covid pandemic (April-Dec 2020) compared to previous years. Given the huge increase in the number of small businesses taking out loans during this period, it is safe to assume that a significant proportion of these businesses were first-time borrowers.

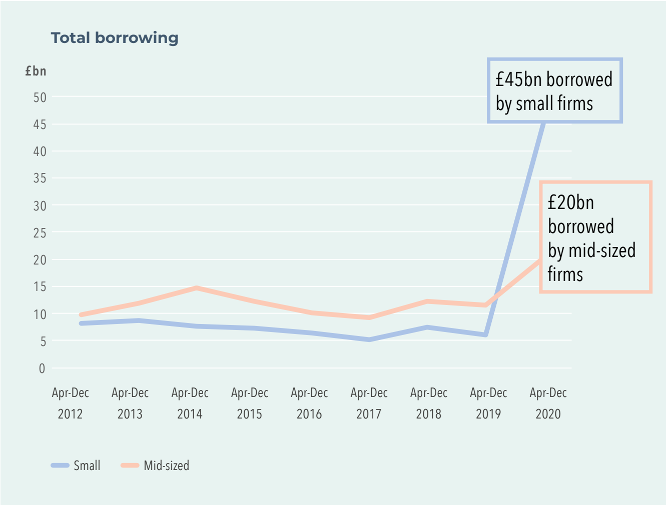
We should note however, that the average size of loan taken out in 2020 was around 1/3 as much as in previous years for small firms and around 2/3 as much for mid-sized firms.

More businesses borrowing (many for the first time) ...



Source: ThinCats analysis of UK Finance data

... saw 2x the total " normal " amount borrowed by mid-sized SMEs against 6x for small companies

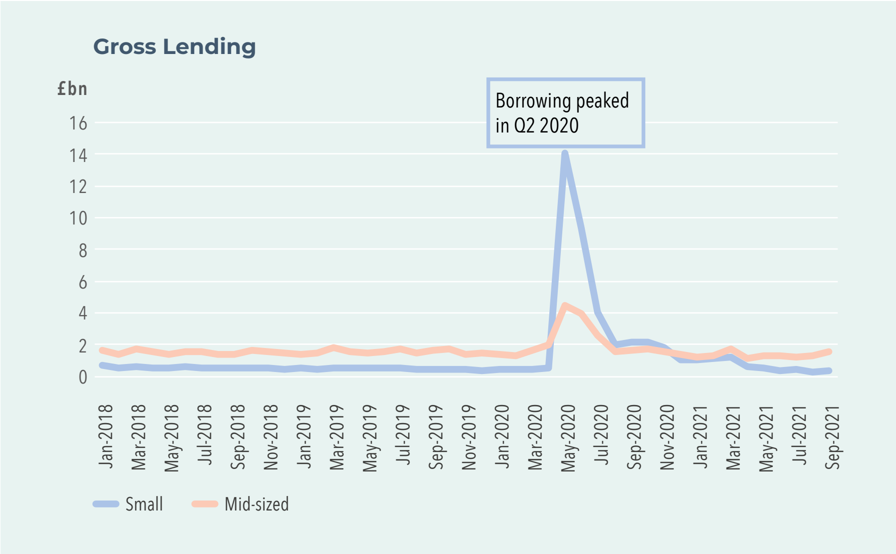


Source: ThinCats analysis of UK Finance data

After a frenzy of borrowing, levels quickly returned to normal

Moreover, most of the excess borrowing in 2020 happened during the first 6 months of the pandemic: by the end of 2020 both mid-sized and small businesses had returned to more normal borrowing levels

MOST OF THE EXCESS BORROWING IN 2020 HAPPENED DURING THE FIRST 6 MONTHS OF THE PANDEMIC



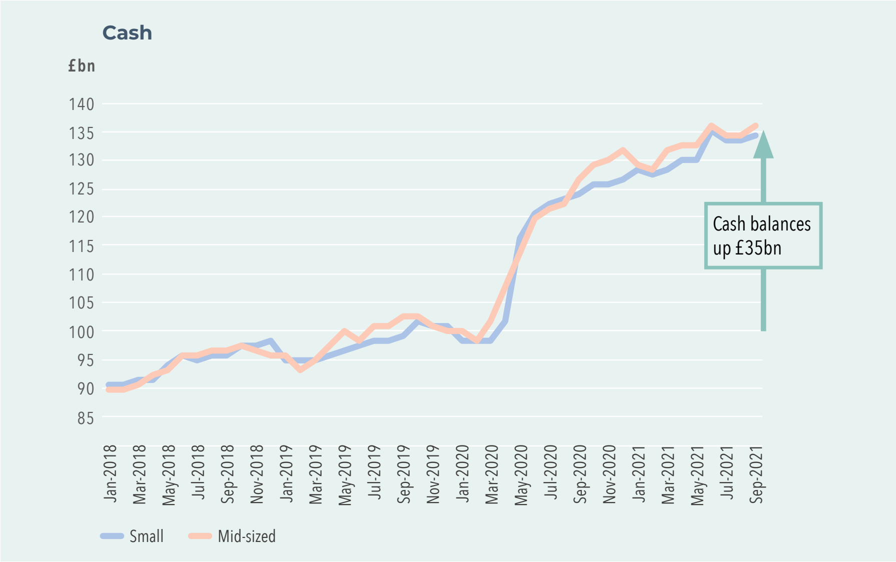
Source: ThinCats analysis of UK Finance data

Cash is King

Both small and mid-sized firms built up their cash reserves thanks to a combination of borrowing and reduced outgoings as a result of furlough and other measures. Although the trend in cash held by mid-sized and small businesses is remarkably similar – both rising rapidly as all SMEs sought to bolster their cash positions – as we showed above, the contribution of borrowing to this rise is by no means equal: small firms had to increase borrowings much more substantially than mid-sized firms.

THE PATTERN OF CASH HELD BY MID-SIZED AND SMALL BUSINESSES WAS REMARKABLY SIMILAR AS ALL SMES SOUGHT TO BOLSTER THEIR CASH POSITIONS.

Similar rise in cash levels for both mid-sized and small businesses ...

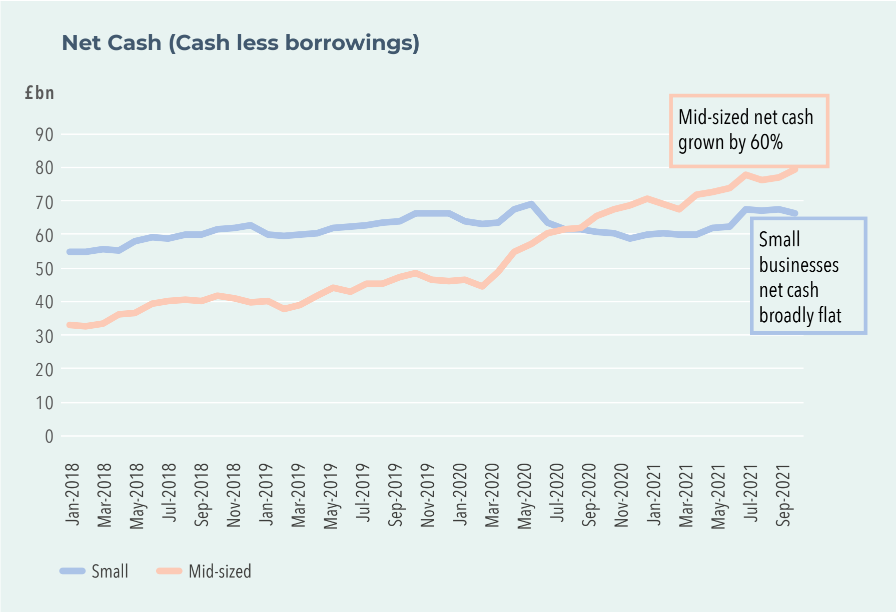


Source: ThinCats analysis of UK Finance data, current and deposit accounts

... but mid-sized businesses improved and sustained net cash positions much better than small businesses

Because of these different relative increases in cash and borrowing, mid-sized businesses have emerged from the pandemic with a significantly improved net cash position, whereas small firms are in approximately the same position as they were before the pandemic – but with twice as much debt to repay.

MID-SIZED BUSINESSES HAVE EMERGED FROM THE PANDEMIC WITH A SIGNIFICANTLY IMPROVED NET DEBT POSITION



Source: ThinCats analysis of UK Finance data, cash plus deposits less borrowing

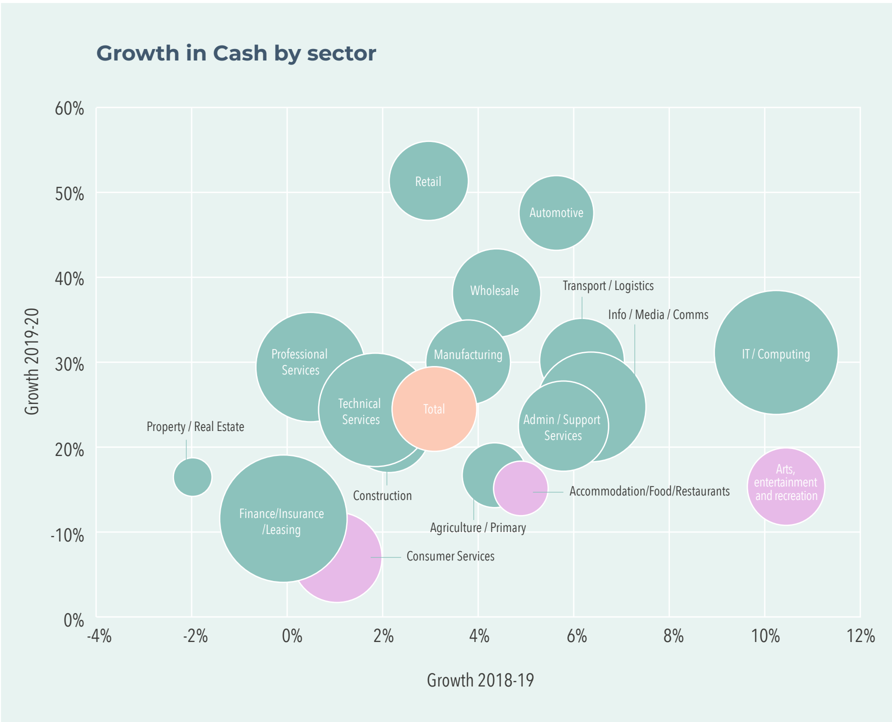
A deeper dive into the financial health of the mid-sized

Using our purpose built model PRISM to analyse the financial health of the mid-sized universe during the pandemic, we looked at three important metrics; Cash, Turnover and Profit Margin to assess how different sectors had fared during the pandemic.

Cash levels up

Reinforcing the strengthening of cash positions across the mid-sized sector mentioned earlier, we see that cash levels rose across all sectors. For the three sectors most reliant on footfall (Arts & entertainment, Accommodation & restaurants, Consumer services) the growth in cash levels was much less pronounced highlighting the disproportionate impact of the pandemic restrictions.

Cash positions strengthened although less so for footfall dependent sectors



Source: Companies House filed accounts 2018-2021, ThinCats analysis

Each bubble represents an industry sector with the size of the bubble determined by the average cash levels per business.

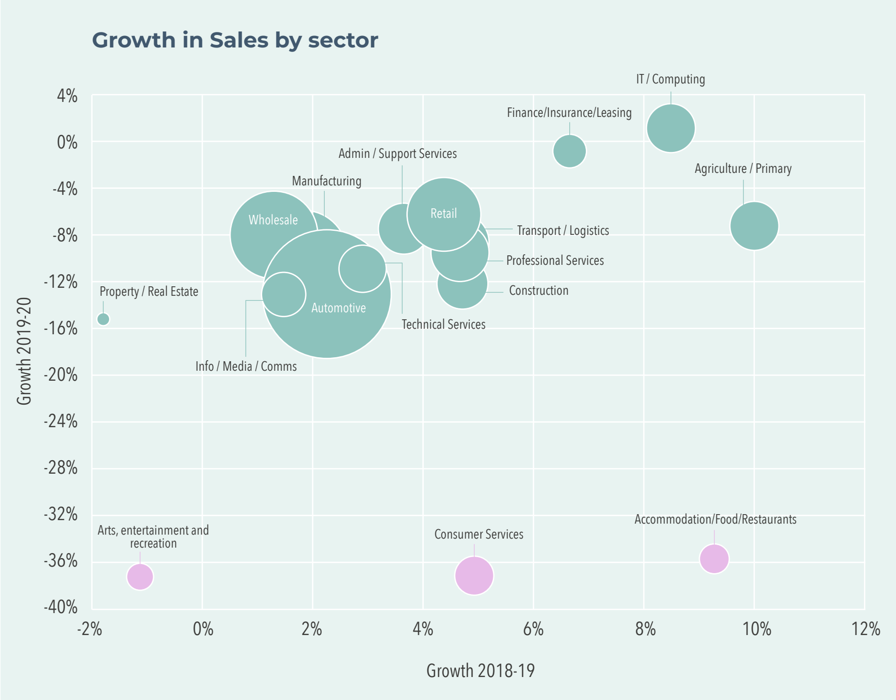
The position on the horizontal axis shows the aggregate growth in cash from Dec 2018 to Dec 2019 accounts.

The position on the vertical axis shows the aggregate growth in cash from Dec 2019 to Dec 2020 accounts.

Turnover down

Once again, the three footfall sectors were the ones most impacted by covid restrictions with turnover significantly down by more than 35% compared to a drop of 5-15% for most other sectors

5-15% drop in turnover for most, but 35%+ for footfall sectors



Source: Companies House filed accounts 2018-21, ThinCats analysis

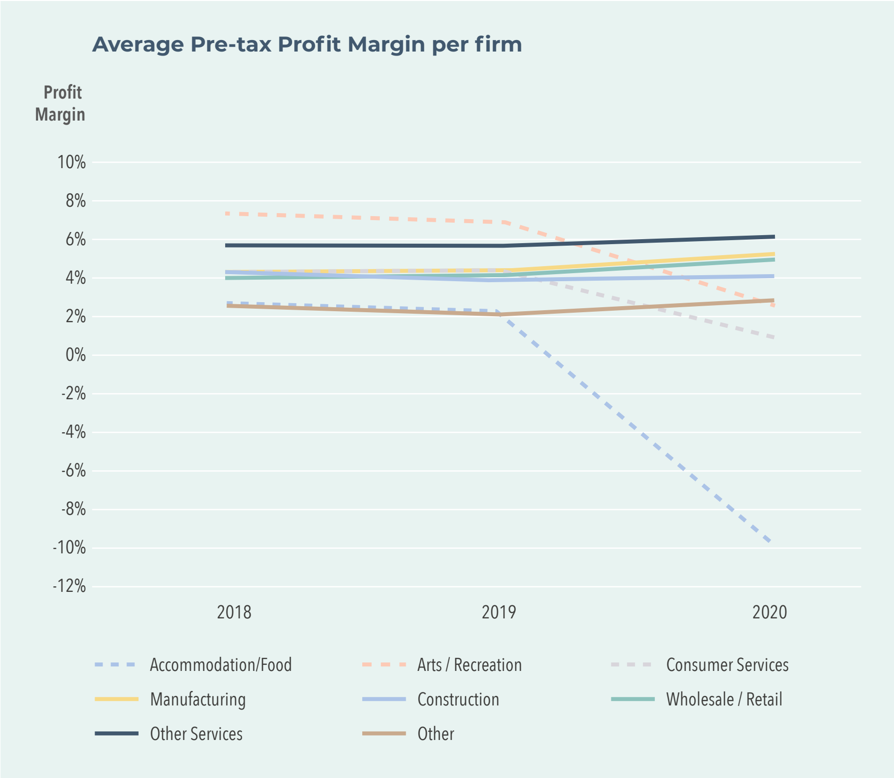
Each bubble represents an industry sector with the size of the bubble determined by the average sales per business.

The position on the horizontal axis shows the aggregate growth in turnover from Dec 2018 to Dec 2019 accounts.

The position on the vertical axis shows the aggregate growth in turnover from Dec 2018 to Dec 2020 accounts.

… but net profit margins sustained

However, measures such as furlough enabled most businesses to keep costs under control, resulting in stable, rather than declining profit margins – with the footfall sectors again being the most squeezed on this measure.



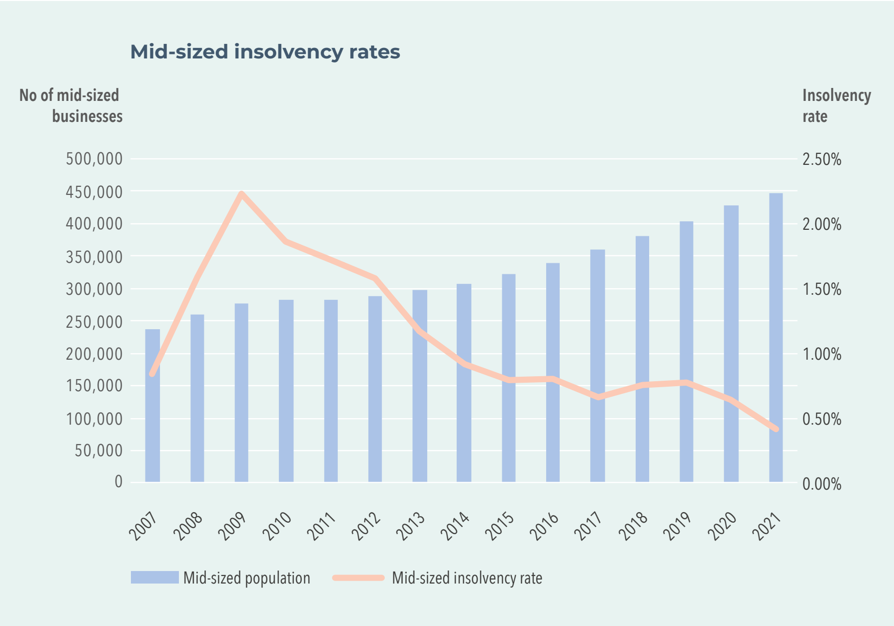
Source: Companies House filed accounts 2018-21, ThinCats analysis

Business failures

In terms of net cash and net profits margins, most mid-sized sectors have shown good resilience during the pandemic and this is reflected in the very low rates of business failures. A look at recent insolvency rates confirms that government support programmes have been effective in suppressing business failures so far. Insolvency rates as shown in the chart below are at historically low levels. In fact, 2021 insolvency levels were even lower than for 2020.

A LOOK AT RECENT INSOLVENCY RATES CONFIRMS THAT GOVERNMENT SUPPORT PROGRAMMES HAVE BEEN EFFECTIVE IN SUPPRESSING BUSINESS FAILURES SO FAR

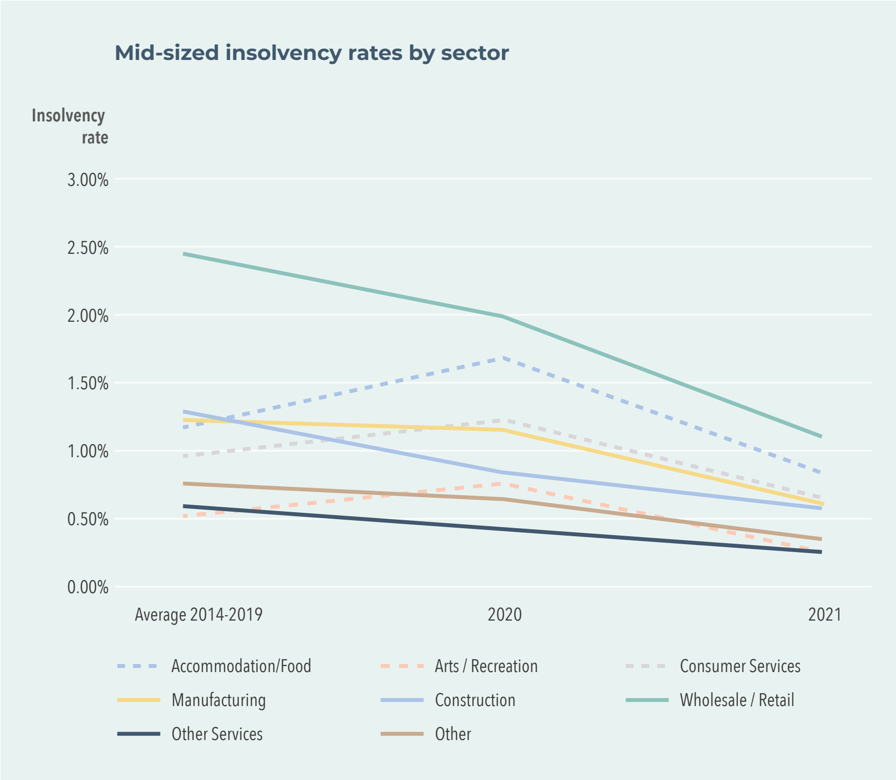
Mid-sized SME insolvencies at record low levels



Source: Companies House filed accounts 2007-2021

Even the hardest hit sectors have survived better than in more normal times

If you drill down to look at different sectors, all sectors recorded a further fall in 2021 compared to 2020, even for those hardest hit by pandemic restrictions.



Source: Companies House filed accounts 2014-2021

Where next? A comparison with the 2009 global financial crisis

When assessing the impact of the covid pandemic on the mid-sized and small business populations, it's useful to draw comparisons to the global financial crisis (GFC), the most recent period of significant economic decline. A key difference is that the GFC was driven by a lack of liquidity whilst the covid pandemic has seen plentiful liquidity as government programmes have reduced costs for businesses and encouraged lending from banks and other institutions.

The GFC saw medium-sized businesses hit hard: accustomed to borrowing, but unable to borrow as normal due to the liquidity crisis faced by banks, official insolvency rates within this population increased from 1% to nearly 2.5%.

Small businesses in, comparison, registered only a tiny uptick in official insolvency rates during this period. During 2009 over 500,000 businesses ceased trading, the vast majority of them small SMEs, not reflected in the official insolvency stats. This represented around 20% of the total business population at the time and the wave of closures lagged the huge dip in GDP by around one quarter.

Within these "benign" business closures were a significant minority that were probably technically insolvent (liabilities greater than assets), but the level of debt was too low to justify creditors invoking insolvency proceedings to recover what they were owed.

In 2022, the picture is very different. Mid-sized businesses, whilst naturally impacted by the pandemic, have been able to not only maintain, but significantly improve liquidity. The range of support measures put in place by government have ensured that the 2020 GDP fall didn't result in a corresponding tsunami of business closures as in 2009. However, this time, rather than the normal 2%, over 35% of small businesses have taken out bank loans – most of them BBLS loans.

The flexibility around BBLS loan repayments announced by the Chancellor last year – including "Pay as you Grow" means that it is unlikely that we will see as steep a rise in closures as we did in 2009. Nonetheless, the post-covid world of hybrid working will undoubtedly hit sectors that rely on the footfall of office-based staff; many of these businesses will be first time borrowers, trying to repay BBLS loans with income hit by the reduced footfall.

Whether these will result in official insolvencies will depend largely on how aggressively the banks pursue recoveries on BBLS loans, especially if the government is willing to meet the guarantee in most instances of default. It seems likely there will be a turbulent few years for small businesses, whilst mid-sized firms look well-positioned for a strong recovery.

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